

Owens Realty Mortgage, Inc.
Form 10-Q
May 09, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the Quarterly Period Ended March 31, 2018

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the transition period from _____ to _____

Commission file number 000-54957

OWENS REALTY MORTGAGE, INC.
(Exact Name of Registrant as Specified in Its Charter)

Maryland	46-0778087
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

2221 Olympic Boulevard	
Walnut Creek, California	94595
(Address of Principal Executive Offices)	(Zip Code)

(925) 935-3840
Registrant's Telephone Number, Including Area Code

NOT APPLICABLE

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

Emerging growth company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class Outstanding as of May 4, 2018

Common Stock, \$.01 par value 8,955,308 shares

2

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

	<u>Page</u>
<u>Item 1. Financial Statements</u>	
<u>Consolidated Financial Statements (Unaudited):</u>	
<u>Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017</u>	<u>4</u>
<u>Consolidated Statements of Income for the three months ended March 31, 2018 and 2017</u>	<u>5</u>
<u>Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2018 and 2017</u>	<u>6</u>
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2018 and 2017</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>47</u>
<u>Item 4. Controls and Procedures</u>	<u>49</u>

PART II – OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	<u>49</u>
<u>Item 1A. Risk Factors</u>	<u>49</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>50</u>
<u>Item 6. Exhibits</u>	<u>50</u>

Part I. FINANCIAL INFORMATIONItem 1. Financial Statements

OWENS REALTY MORTGAGE, INC.

Consolidated Balance Sheets

(UNAUDITED)

	March 31, 2018	December 31, 2017
<u>ASSETS</u>		
Cash, cash equivalents and restricted cash	\$5,902,365	\$5,670,816
Loans, net of allowance for losses of \$1,637,067 in 2018 and \$1,827,806 in 2017	156,344,277	144,343,844
Interest and other receivables	1,264,823	2,430,457
Other assets, net of accumulated depreciation and amortization of \$322,203 in 2017 and \$309,686 in 2017	622,214	725,341
Deferred financing costs, net of accumulated amortization of \$292,099 in 2018 and \$265,276 in 2017	—	26,823
Deferred tax assets, net	3,023,877	3,207,322
Investment in limited liability company	2,172,428	2,140,545
Real estate held for sale	41,899,602	56,110,472
Real estate held for investment, net of accumulated depreciation of \$3,521,308 in 2018 and \$3,316,753 in 2017	28,804,738	24,355,653
Total assets	\$240,034,324	\$239,011,273
<u>LIABILITIES AND EQUITY</u>		
<u>LIABILITIES:</u>		
Dividends payable	\$1,449,435	\$1,572,047
Due to Manager	312,344	277,671
Accounts payable and accrued liabilities	1,314,836	1,390,329
Deferred gains on sales of real estate	—	302,895
Forward contract liability – share repurchase	—	2,731,171
Lines of credit payable	12,085,200	1,555,000
Notes and loans payable on real estate	25,238,519	30,192,433
Total liabilities	40,400,334	38,021,546
Commitments and Contingencies (Note 14)		
<u>EQUITY:</u>		
Stockholders' equity:		
Preferred stock, \$.01 par value per share, 5,000,000 shares authorized, no shares issued and outstanding at March 31, 2018 and December 31, 2017	—	—
Common stock, \$.01 par value per share, 50,000,000 shares authorized, 11,198,119 shares issued, 9,058,971 and 9,095,454 shares outstanding at March 31, 2018 and December 31, 2017	111,981	111,981
Additional paid-in capital	182,437,522	182,437,522
Treasury stock, at cost – 2,139,148 and 2,102,665 shares at March 31, 2018 and December 31, 2017	(32,197,782)	(31,655,119)
Retained earnings	49,282,269	50,095,343
Total stockholders' equity	199,633,990	200,989,727
Total liabilities and equity	\$240,034,324	\$239,011,273

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

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Income
(UNAUDITED)

	Three Months Ended March 31,	
	2018	2017
Revenues:		
Interest income on loans	\$2,889,568	\$2,547,042
Rental and other income from real estate properties	1,070,236	946,371
Other income	32,116	43,992
Total revenues	3,991,920	3,537,405
Expenses:		
Management fees to Manager	737,361	947,514
Servicing fees to Manager	95,143	86,138
General and administrative expense	529,196	483,814
Rental and other expenses on real estate properties	1,459,172	1,203,319
Depreciation and amortization	217,072	309,960
Interest expense	535,907	286,801
(Reversal of) provision for loan losses	(80,265)	38,036
Total expenses	3,493,586	3,355,582
Operating income (loss)	498,334	181,823
Gain (loss) on sales of real estate, net	154,577	(181)
Net income before income tax expense	652,911	181,642
Income tax (expense) benefit	(183,445)	10,036
Net income attributable to common stockholders	\$469,466	\$191,678
Per common share data:		
Basic and diluted earnings per common share	\$0.05	\$0.02
Basic and diluted weighted average number of common shares outstanding	9,089,270	10,247,477
Dividends declared per share of common stock	\$0.16	\$0.08

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

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Stockholders' Equity
Three Months Ended March 31, 2018 and 2017
(UNAUDITED)

	Common Stock		Additional	Treasury Stock		Retained	Total
	Shares	Amount	Paid-in Capital	Shares	Amount	Earnings	Stockholders' Equity
Balances, December 31, 2016	11,198,119	\$ 111,981	\$ 182,437,522	(950,642)	\$(12,852,058)	\$45,830,432	\$ 215,527,877
Net income	—	—	—	—	—	191,678	191,678
Dividends declared	—	—	—	—	—	(819,798)	(819,798)
Balances, March 31, 2017	11,198,119	\$ 111,981	\$ 182,437,522	(950,642)	\$(12,852,058)	\$45,202,312	\$ 214,899,757
Balances, December 31, 2017	11,198,119	\$ 111,981	\$ 182,437,522	(2,102,665)	\$(31,655,119)	\$50,095,343	\$ 200,989,727
Net income	—	—	—	—	—	469,466	469,466
Net effect of adoption of new accounting standards	—	—	—	—	—	166,895	166,895
Dividends declared	—	—	—	—	—	(1,449,435)	(1,449,435)
Purchase of treasury stock	—	—	—	(36,483)	(542,663)	—	(542,663)
Balances, March 31, 2018	11,198,119	\$ 111,981	\$ 182,437,522	(2,139,148)	\$(32,197,782)	\$49,282,269	\$ 199,633,990

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

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Cash Flows
(UNAUDITED)

	Three Months Ended March 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$469,466	\$191,678
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
(Gain) loss on sales of real estate, net	(154,577)	181
Deferred income tax expense (benefit)	183,445	(10,036)
(Recovery of) provision for loan losses	(80,265)	38,036
Depreciation and amortization	217,072	309,960
Amortization of deferred financing costs	85,801	45,902
Accretion of discount on loans	(37,178)	—
Changes in operating assets and liabilities:		
Interest and other receivables	460,384	(1,904)
Other assets	90,610	(57,224)
Investment in limited liability company	(31,883)	(43,992)
Accounts payable and accrued liabilities	(91,862)	(2,385,879)
Due to Manager	34,673	11,905
Forward contract liability	(459,688)	—
Net cash provided by (used in) operating activities	685,998	(1,901,373)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal collected on loans	11,728,112	8,603,121
Investment in loans	(18,340,807)	(15,733,733)
Investment in real estate properties	(198,037)	(3,825,224)
Net proceeds from disposition of real estate properties	5,225,168	871,856
Purchases of vehicles and equipment	—	(10,957)
Net cash used in investing activities	(1,585,564)	(10,094,937)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances on notes payable	238,393	4,475,120
Repayments on notes payable	(5,251,285)	(96,823)
Advances on lines of credit	12,957,200	14,918,000
Repayments on lines of credit	(2,427,000)	(5,730,000)
Purchase of treasury stock	(2,814,146)	—
Dividends paid (including tax payments on behalf of shareholders)	(1,572,047)	(1,402,496)
Net cash provided by financing activities	1,131,115	12,163,801
Net increase in cash, cash equivalents and restricted cash	231,549	167,491
Cash, cash equivalents and restricted cash at beginning of period	5,670,816	6,934,243
Cash, cash equivalents and restricted cash at end of period	\$5,902,365	\$7,101,734
<u>Supplemental Disclosure of Cash Flow Information</u>		
Cash paid during the period for interest (excluding amounts capitalized)	\$411,017	\$215,585
Cash paid during the period for interest that was capitalized	—	267,580
<u>Supplemental Disclosure of Non-Cash Activity</u>		
Amortization of deferred financing costs capitalized to construction project	—	(49,945)
Increase in loans from sales of real estate	5,406,295	—
Change in capital expenditures financed through accounts payable	(16,369)	(1,197,794)

Edgar Filing: Owens Realty Mortgage, Inc. - Form 10-Q

Dividends declared but not paid	(1,449,435)	(819,798)
Reversal of deferred gain on adoption of ASU 2014-09	(302,895)	—
Loan discounts established on adoption of ASU 2014-09	136,000	—

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

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1 – ORGANIZATION

Owens Realty Mortgage, Inc. (the "Company") was incorporated on August 9, 2012, under the laws of the State of Maryland. The Company is authorized to issue 50,000,000 shares of its \$0.01 par value common stock ("Common Stock"). In addition, the Company is authorized to issue 5,000,000 shares of preferred stock at \$0.01 par value per share. The Company was created to effect the merger (the "Merger") of Owens Mortgage Investment Fund, a California Limited Partnership ("OMIF") with and into the Company as described in the Registration Statement on Form S-4, as amended, of the Company, declared effective on February 12, 2013 (File No. 333-184392). The Merger was part of a plan to reorganize the business operations of OMIF so that it could elect to qualify as a real estate investment trust for Federal income tax purposes. The Merger was approved by OMIF limited partners on April 16, 2013 and was completed on May 20, 2013.

The Company has elected to be taxed as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code"), commencing with the Company's taxable year ended December 31, 2012. As a REIT, the Company is permitted to deduct distributions made to its stockholders, allowing its operating income represented by such distributions to avoid taxation at the entity level and to be taxed generally only at the stockholder level. The Company currently intends to distribute substantially all of its REIT taxable income, excluding net capital gains. As a REIT, however, the Company is subject to separate, corporate-level tax, including potential 100% penalty taxes under various circumstances, as well as certain state and local taxes. In addition, the Company's taxable REIT subsidiaries are subject to full corporate income tax. Furthermore, the Company's ability to continue to qualify as a REIT will depend upon its continuing satisfaction of various requirements, such as those related to the diversity of its stock ownership, the nature of its assets, the sources of its income and the distributions to its stockholders, including a requirement that the Company distribute to its stockholders at least 90% of its REIT taxable income on an annual basis (determined without regard to the dividends paid deduction and by excluding net capital gain).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In the opinion of the management of the Company, the accompanying unaudited financial statements contain all adjustments, consisting of normal, recurring adjustments, necessary to present fairly the financial information included therein. Certain information and footnote disclosures presented in the annual consolidated financial statements are not included in these interim financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Form 10-K of ORM for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC") on March 13, 2018. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the operating results to be expected for the full year ending December 31, 2018. The Company evaluates subsequent events up to the date it files its Form 10-Q with the SEC.

Basis of Presentation

Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its wholly-owned taxable REIT subsidiaries ("TRSs") and its majority- and wholly-owned limited liability companies. The Company is in the business of providing mortgage lending services and manages its business as one operating segment. Due to foreclosure activity, the Company also owns and manages real estate assets.

Certain reclassifications, not affecting previously reported net income or stockholders' equity, have been made to the previously issued consolidated financial statements to conform to the current period presentation.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates are inherently imprecise and actual results could differ significantly from such estimates.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326) – Measurement of Credit Losses on Financial Instruments", or ASU 2016-13. The amendments in ASU 2016-13 eliminate the probable and incurred credit loss recognition threshold in current GAAP and, instead, reflect an entity's current estimate of all expected credit losses. The amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss. This standard is effective for interim and annual reporting beginning after December 15, 2019, with early adoption permitted for interim and annual reporting beginning after December 15, 2018. While the Company is currently evaluating the impact that ASU 2016-13 will have on its consolidated financial statements, the adoption is not expected to result in a material increase in the amount of allowance for loan losses based on the short maturity of loans in the Company's portfolio. However, if the Company makes longer term loans, the impact may be greater.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" or ASU 2016-02, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). ASU 2016-02 amends existing guidance related to leases, primarily by requiring the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under the current accounting guidance. This standard is effective for interim and annual reporting beginning after December 15, 2018, with early adoption permitted. The Company does not currently have any lease obligations. The Company expects that its operating leases where it is the lessor will be accounted for on its balance sheet similar to its current accounting with the underlying leased asset recognized as real estate. The Company expects that executory costs and certain other non-lease components will need to be accounted for separately from the lease component of the lease with the lease component continuing to be recognized on a straight-line basis over the lease term and the executory costs and certain other non-lease components being accounted for under the new revenue recognition guidance in ASU 2014-09, discussed below. The Company does not believe that adoption of ASU 2016-02 will have a material impact on its consolidated financial statements.

Recently Adopted Accounting Pronouncements

On January 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2017-01, "Business Combinations (Topic 805) – Clarifying the Definition of a Business", or ASU 2017-01. The amendments in ASU 2017-01 clarify the definition of a business by more clearly outlining the requirements for an integrated set of assets and activities to be considered a business and by establishing a practical framework to determine when the integrated set of assets and activities is a business. The adoption of ASU 2017-01 during the quarter ended March 31, 2018 did not have an impact on the Company's consolidated financial statements.

On January 1, 2018, the Company adopted ASU 2016-18, "Statement of Cash Flows (Topic 230) – Restricted Cash". The amendments in ASU 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and cash equivalents together when reconciling the beginning and end of period total amounts shown on the statement of cash flows. The adoption of ASU 2016-18 during the quarter ended March 31, 2018 resulted in the Company including its restricted cash with cash and cash equivalents when reconciling the beginning and ending amounts shown on its consolidated statement of cash flows.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

On January 1, 2018, the Company adopted ASU 2016-15, "Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments". The amendments in ASU 2016-15 reflect eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The adoption of ASU 2016-15 during the quarter ended March 31, 2018 will result in the Company reporting distributions it receives from its equity method investment in cash flows from operating activities rather than financing activities on its consolidated statement of cash flows, however there were no such distributions during the quarter.

On January 1, 2018, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revised when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as real estate held for sale. The majority of the Company's revenues come from interest income and other sources, including loans and leases, that are outside the scope of ASC 606. The Company's revenue from real estate properties is not significantly impacted by ASC 606, as rental income from leasing arrangements is specifically excluded from ASC 606, and will be evaluated with the adoption of the lease accounting standard, ASU 2016-02, discussed above.

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The Company recorded a net increase in beginning retained earnings of \$167,000 as of January 1, 2018 due to the cumulative effect of adopting ASC 606 for four past real estate sales transactions where the sale was financed by the Company. The transition adjustment resulted in the recognition of previously deferred gains on two sales in the total amount of approximately \$303,000 and the recording of net discounts against two carryback loans in the total amount of approximately \$136,000.

On January 1, 2018, the Company adopted ASU 2016-01, "Financial Instruments- Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities". ASU 2016-01 enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 contains several provisions, including but not limited to 1) requiring equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) eliminating the requirement to disclose the method(s) and significant assumptions used to estimate fair value; and 4) requiring separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. ASU 2016-01 also changes certain financial statement disclosure requirements, including requiring disclosures of the fair value of financial instruments be made on the basis of exit price. The adoption of ASU 2016-01 during the quarter ended March 31, 2018 resulted in the Company using an exit price methodology for disclosing the fair value of the Company's financial instruments (loans receivable).

Significant Accounting Policies

The significant accounting policies used in the preparation of these interim consolidated financial statements are disclosed in the Company's consolidated financial statements for the year ended December 31, 2017 included in its 2017 annual report on Form 10-K. There have been no significant changes to those significant accounting policies during the quarter ended March 31, 2018, other than those discussed under "Real Estate Held for Sale" below.

Real Estate Held for Sale

The Company records a gain or loss from the sale of real estate when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of real estate to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether the collectability of the transaction price is probable. Once these criteria are met, the real estate is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present. This adjustment is based on management's estimate of the fair value of the loan extended to the buyer to finance the sale.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans are generally stated at the principal amount outstanding, net of unamortized loan discounts which totaled approximately \$568,000 at March 31, 2018. Advances under the terms of a loan to pay property taxes, insurance, legal and other costs are generally capitalized and reported as interest and other receivables. The Company's portfolio consists primarily of real estate loans generally collateralized by first, second and third deeds of trust. Interest income on loans is accrued by the simple interest method. A loan is generally placed on nonaccrual status when the loan becomes greater than ninety days delinquent in monthly payments and/or full payment of principal and interest is not expected. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest is included in the recorded investment in the impaired loan that is measured as described below. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Cash receipts on nonaccrual loans are used to reduce any outstanding accrued interest, and then are recorded as interest income, except when such payments are specifically designated as principal reduction or when management does not believe the Company's investment in the loan is fully recoverable. The Company does not incur origination costs, and until April 1, 2018, did not earn or collect origination fees from borrowers as OFG was entitled to all such fees prior to the amendment of the Management Agreement between the Company and OFG that became effective April 1, 2018 (see Note 9).

Loans and the related accrued interest and advances are analyzed by management on a periodic basis for ultimate recovery. The allowance for loan losses is management's estimate of probable credit losses inherent in the Company's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components: specific reserves related to impaired loans that are individually evaluated for impairment and general reserves for inherent losses related to loans that are not considered impaired and are collectively evaluated for impairment.

Regardless of a loan type, a loan is considered impaired when, based on current information and events, management believes it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. All loans determined to be impaired are individually evaluated for impairment. When a loan is considered impaired, management estimates impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, management may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. These valuations are generally updated during the fourth quarter but may be updated during interim periods if deemed appropriate by management.

A restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDR's are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are not considered impaired and are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

The Company maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, residential real estate and land loans. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans that are individually evaluated for impairment and loans that are not considered impaired and are collectively evaluated for impairment, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet. The reserve for loans that are not considered impaired consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses, and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

Land Loans – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete the projects within the specified costs and time lines. Trends in the construction industry significantly impact the credit quality of these loans as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values generally determine the economic viability of construction projects.

Commercial and Residential Real Estate Loans –Adverse economic developments or an overbuilt market impact commercial and residential real estate projects and may result in troubled loans. Trends in vacancy rates of properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Management monitors the credit quality of the Company's loan portfolio on an ongoing basis using certain credit quality indicators including a loan's delinquency status and internal asset classification. A loan is considered classified when it meets the definition of impaired as described above.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

The following tables show the changes in the allowance for loan losses by portfolio segment for the three months ended March 31, 2018 and 2017 and the allocation of the allowance for loan losses and loans as of March 31, 2018 and December 31, 2017 by portfolio segment and by impairment methodology:

<u>2018</u>	Commercial	Residential	Land	Total
Allowance for loan losses:				
	Three Months Ended March 31, 2018			
Beginning balance	\$ 1,069,458	\$ 451,537	\$ 306,811	\$ 1,827,806
Charge-offs	—	(186,708)	—	(186,708)
Recoveries	—	76,234	—	76,234
Provision (Reversal)	39,903	(113,878)	(6,290)	(80,265)
Ending balance	\$ 1,109,361	\$ 227,185	\$ 300,521	\$ 1,637,067
	March 31, 2018			
Ending balance: individually evaluated for impairment	\$—	\$—	\$—	\$—
Ending balance: collectively evaluated for impairment	1,109,361	227,185	300,521	1,637,067
Ending balance	\$ 1,109,361	\$ 227,185	\$ 300,521	\$ 1,637,067
Loans:				
Ending balance: individually evaluated for impairment	\$ 1,242,956	\$ 6,522,732	\$—	\$ 7,765,688
Ending balance: collectively evaluated for impairment	140,266,507	4,926,689	5,022,460	150,215,656
Ending balance	\$ 141,509,463	\$ 11,449,421	\$ 5,022,460	\$ 157,981,344

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

<u>2017</u>	Commercial	Residential	Land	Total
Allowance for loan losses:				
	<u>Three Months Ended March 31, 2017</u>			
Beginning balance	\$ 864,971	\$ 1,331,318	\$ 510,533	\$ 2,706,822
Charge-offs	—	(107,999)	—	(107,999)
Provision (Reversal)	69,577	(13,964)	(17,577)	38,036
Ending balance	\$ 934,548	\$ 1,209,355	\$ 492,956	\$ 2,636,859
	<u>December 31, 2017</u>			
Ending balance: individually evaluated for impairment	\$—	\$ 186,708	\$—	\$ 186,708
Ending balance: collectively evaluated for impairment	1,069,458	264,829	306,811	1,641,098
Ending balance	\$ 1,069,458	\$ 451,537	\$ 306,811	\$ 1,827,806
Loans:				
Ending balance: individually evaluated for impairment	\$ 1,212,851	\$ 7,321,359	\$—	\$ 8,534,210
Ending balance: collectively evaluated for impairment	126,660,430	5,849,436	5,127,574	137,637,440
Ending balance	\$ 127,873,281	\$ 13,170,795	\$ 5,127,574	\$ 146,171,650

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

The following tables show an aging analysis of the loan portfolio by the time monthly payments are past due as of March 31, 2018 and December 31, 2017. All of the loans that were 90 or more days past due as listed below were on non-accrual status as of March 31, 2018 and December 31, 2018.

	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans
March 31, 2018						
Commercial	\$ 1,242,956	\$ —	\$ —	\$ 1,242,956	\$ 140,266,507	\$ 141,509,463
Residential	—	1,937,475	4,585,257	6,522,732	4,926,689	11,449,421
Land	—	—	—	—	5,022,460	5,022,460
	\$ 1,242,956	\$ 1,937,475	\$ —			