

Consolidated Financial Statements and  
Independent Auditor's Report

**ECC Capital Corporation and Subsidiaries**

Year Ended December 31, 2020

# **ECC Capital Corporation and Subsidiaries**

## **Table of Contents**

<b><u>Title</u></b>	<b><u>Page</u></b>
<b>Independent Auditor's Report</b>	<b>2</b>
<b>Consolidated Balance Sheet</b>	<b>4</b>
<b>Consolidated Statement of Operations</b>	<b>5</b>
<b>Consolidated Statement of Stockholders' Equity</b>	<b>6</b>
<b>Consolidated Statement of Cash Flows</b>	<b>7</b>
<b>Notes to the Consolidated Financial Statements</b>	<b>8-20</b>



## **Independent Auditor's Report**

To Board of Directors  
ECC Capital Corporation and Subsidiaries  
Corona Del Mar, California

We have audited the accompanying consolidated financial statements of ECC Capital Corporation and subsidiaries (the "Company") (a Maryland corporation), which comprise the consolidated balance sheet as of December 31, 2020, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

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

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



**Independent Auditor's Report (Continued)**

**Opinion**

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ECC Capital Corporation and subsidiaries as of December 31, 2020, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Rogers & Associates, LLC*

Rockville, MD  
May 12, 2021

ECC CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
December 31, 2020  
(in thousands, except share data)

ASSETS

Cash and cash equivalents	\$	9,864
Restricted cash		154
Mortgage loans held for investment, net		178,936
Accrued mortgage loan interest		1,090
Mortgage servicing rights		1,246
Real estate owned		84
Real estate and other investments		500
Prepaid expenses and other assets		1,338
Total assets	\$	<u>193,212</u>

LIABILITIES AND STOCKHOLDERS' DEFICIT

Liabilities:		
Long-term debt	\$	466,986
Accounts payable and accrued expenses		485
Total liabilities		<u>467,471</u>
Commitments and contingencies		
Stockholders' deficit:		
Common stock authorized, 200,000,000 shares of \$0.001 par value, 106,523,300 shares issued and outstanding		107
Additional paid-in capital		375,335
Minority interest		-
Accumulated deficit		<u>(649,701)</u>
Total stockholders' deficit		<u>(274,259)</u>
Total liabilities and stockholders' deficit	\$	<u>193,212</u>

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF OPERATIONS  
For the year ended December 31, 2020  
(in thousands)

Revenue

Interest income	\$	11,800
Interest expense		(4,391)
Net interest income		<u>7,409</u>
Provision for loan losses		<u>3,116</u>
Net loss, after provision for loan losses		<u>4,293</u>
Lower of cost or market adjustment-loans held for investment		(344)
Gain on sale of residual interests		1,437
Change in value of mortgage servicing rights		(247)
Net revenues		<u>5,139</u>
Expenses		
Operating expenses		4,330
Servicing fees, net		739
Total expenses		<u>5,069</u>
Other income		<u>1,098</u>
Income before tax provision		1,168
Tax provision		<u>83</u>
Net income	\$	<u><u>1,085</u></u>

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT  
For the year ended December 31, 2020  
(in thousands)

	Number of Common Shares Outstanding	Common Stock	Additional Paid In Capital	Minority Interest	Accumulated Deficit	Total
Balance December 31, 2019	106,523	\$107	\$373,998	\$(459)	\$(648,148)	\$(274,502)
Net income					1,085	1,085
Dividends					(8)	(8)
Adjustments for Intus Redemption			1,337		(2,171)	(834)
Minority interest				459	(459)	-
Balance December 31, 2020	106,523	\$107	\$375,335	\$0	\$(649,701)	\$(274,259)

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CASH FLOWS  
For the year ended December 31, 2020  
(in thousands)

Cash Flows from Operating Activities:	
Net income	\$ 1,085
Adjustments to Net income to Net Cash provided by Operating Activities:	
Changes in operating assets and liabilities	
Provision for loan losses	3,116
Depreciation and amortization	360
Gain on sale of residual interests in securitizations	(1,437)
Gain on sale of real estate investments	(120)
Change in value of mortgage servicing rights	247
Intus Capital Redemption	91
Accrued interest	10
Accrued expenses	96
Prepays and other assets	218
<hr/>	
Net cash provided by operating activities	3,666
Cash Flows from Investing Activities:	
Cash received from residual interests in securitizations	3,700
Cash received from sale of real estate investments	879
Origination of mortgage loans held for investment	(450)
Amortization and payoff of mortgage loans held for investment	30,132
Net proceeds from sale of REO	760
<hr/>	
Net cash provided by investing activities	35,021
Cash Flows from Financing Activities:	
Dividends paid	(8)
Payments on long-term debt	(33,430)
<hr/>	
Net cash used in financing activities	(33,438)
Net increase in cash and equivalents	5,249
Cash and equivalents-Beginning of Year	4,769
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Cash and equivalents-End of Period	\$ 10,018
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Supplemental disclosure of cash flow information:	
Cash used to pay interest	\$ 4,362
	<hr/>
Cash used to pay income taxes	\$ 83
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Supplemental disclosure of non-cash investing and financing activities:	
Loans transferred to real estate owned due to foreclosure	\$ 520
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See notes to the consolidated financial statements



**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization and Operating Plans

The Company is a C-Corporation that invested in nonconforming residential mortgage loans. The Company elected to convert from REIT status to a C-Corporation on January 1, 2020. The Company owns and manages interests in securitization trusts which issued securities collateralized by residential real estate mortgages. Its principal sources of revenue are net interest income on its portfolio of loans held for investment and interest accretion on its investments in residual interests in its securitizations. As part of managing the *Company's* portfolio of loans held for investment, it may also originate mortgage loans to generate additional revenue.

The Company's four securitization trust subsidiaries are specifically engaged in the securitization of loans and their related financial assets, whether permanent or temporary in purpose. These entities hold beneficial interest in eligible loans that are subject to creditors with specific interests. The transfers of mortgage loans and their related financial assets to the eligible lender trusts that comprise the securitization trusts do not qualify as sales under the provisions of FASB ASC 860 (formerly SFAS 140), *Transfers and Servicing*, as: (i) the Company retains certain discretionary rights as servicer of the mortgage loans transferred to the trust, (ii) the Company holds a right to repurchase any of the loans in the trust aggregating up to 1% of the initial principal balance of the transferred loans, and (iii) the trust may, with the approval of the beneficial interest holders, acquire derivative financial instruments.

However, the liabilities of the securitization trusts are not the obligations of the Company or any of its other subsidiaries, and cannot be consolidated in the event of bankruptcy, default or liquidation. The Corporation is merely a beneficiary of the eligible lender trusts' residual equity, if any. The following schedule shows the negative equity of the securitization trusts that are consolidated into the financial statements, but have no recourse on the Corporation as of December 31, 2020:

	Securitization trusts	Non-trust entities	Company total
Assets:			
Cash and cash equivalents	\$ -	\$ 9,864	\$ 9,864
Restricted cash	2	152	154
Mortgage loans held for investment, net	178,083	853	178,936
Accrued mortgage loan interest	1,059	31	1,090
Mortgage servicing rights	-	1,246	1,246
Real estate owned	84	-	84
Real estate and other investments	-	500	500
Prepaid expenses and other assets	51	1,287	1,338
Total assets	179,279	13,933	193,212
Liabilities and equity:			
Long-term debt	466,986	-	466,986
Accounts payable and accrued expenses	-	485	485
Total liabilities	466,986	485	467,471
Net stockholders' equity (deficit)	<u>\$ (287,707)</u>	<u>\$ 13,448</u>	<u>\$ (274,259)</u>

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Principles of Consolidation

The consolidated financial statements of the Company include the financial position and results of operations of ECC Capital Corporation and its wholly-owned subsidiaries, ECR Mortgage Corp., ECR Investment Corp., and majority-owned subsidiaries, Performance Real Estate, Inc., and Intus Capital Corporation. Intus Capital Corporation owned 100% of Performance Credit, LLC, PerformanceOne Financial, Inc., and ECC Rancho Plaza, Inc.

On December 17, 2020, the Company entered into stock redemption agreement to fully redeem its shares of common stock of Intus Capital Corporation. After the stock redemption, the consolidated financial statements of the Company include the financial position and results of operations of ECC Capital Corporation and its wholly-owned subsidiaries, ECR Mortgage Corp., ECR Investment Corp., Performance Credit, LLC, ECC Rancho Plaza, Inc., and majority-owned subsidiary, Performance Real Estate, Inc. All material intercompany balances and transactions are eliminated in consolidation.

The Company securitized its loans held for investment by transferring loans to trusts that issued long-term debt. The Company retained certain servicing rights and the excess interest spread between the rate paid by the borrowers and the rate paid to the noteholders. The structure of the trusts limits its activities to holding the transferred assets and transferring cash collected to the trusts' beneficial interest holders. The securitization trusts utilized by the Company do not meet the definition of a qualified special purpose entity, therefore such trusts are considered variable interest entities ("VIEs"). The Company is considered the primary beneficiary of the trusts because, as the recipient of the excess cash flows from the trusts, the Company's interests in the trusts are exposed to the majority of the variability in the trust's cash flows. As the primary beneficiary of the trusts, the Company has consolidated the assets and liabilities of the trusts in the accompanying consolidated financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities and contingencies at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant balance sheet items which could be materially affected by such estimates include mortgage servicing rights, deferred fees, deferred bond issuance costs and allowance for loan losses on loans held for investment and real estate owned.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Cash equivalents include Company operating checking accounts and funds invested in interest bearing accounts such as money market funds and similar accounts.

Restricted Cash

Cash and cash equivalents as of December 31, 2020 consist of the following:

Cash and cash equivalents	\$	9,864
Restricted cash		154
		10,018
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	\$	10,018

At December 31, 2020, restricted cash primarily consisted of funds collected from tenants for the benefit of landlords associated with a subsidiary property management business and deposited in separate trust accounts with financial institutions. The liability associated with the funds due the landlords is included in accounts payable and accrued expenses on the Consolidated Balance Sheet.

Mortgage Loans Held for Investment and Loan Origination Fees and Costs

Mortgage loans held for investment are stated at amortized cost, including the outstanding principal balance, less the allowance for loan losses and servicer advances of principal and interest. Deferred origination fees and costs, net of discounts, are amortized as an adjustment of yield over the life of the portfolio using the effective yield method in a manner that anticipates prepayments.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Interest Income Recognition

Interest income is accrued as earned. Loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due, based on contractual terms of the loan, or earlier when any concern exists as to the ultimate collectability of principal or interest. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectable.

Allowance for Loan Losses on Mortgage Loans Held for Investment

In connection with its mortgage loans held for investment, the Company establishes an allowance for loan losses based on its estimate of losses inherent and probable for the next 12 to 18 months as of the balance sheet date. The Company charges off uncollectible loans at the time of liquidation. The Company evaluates the adequacy of the allowance each reporting period, giving consideration to factors such as the current performance of the loans, characteristics of the portfolio, the value of the underlying collateral and the general economic environment. The Company believes the allowance for loan losses is adequate for known and inherent losses in its portfolio of mortgage loans held for investment. Provision for losses is charged to the Company's Consolidated Statement of Operations and losses incurred are charged against the allowance.

Troubled Debt Restructuring

Loans in the Company's held for investment portfolio for which the contractual terms have been restructured for economic or other reasons related to the borrower's financial difficulty, under which concessions are provided to the borrower are classified as troubled debt restructurings. Troubled debt restructurings may include, among other things, reduction in the stated interest rate, conversion of a variable rate to a fixed rate, extension of the maturity date, capitalization of interest or reduction of principal and/or interest due. Pursuant to the impairment accounting guidance FASB ASC 310-10-35 (formerly SFAS 114), when a troubled debt restructuring occurs, the Company establishes a valuation allowance to recognize impairment of a loan. A loan is considered impaired when, based on current events and information, it is probable the Company will be unable to collect amounts due according to the contractual terms of the loan agreement. For all modified loans, impairment is measured as the difference in the present value of the cash flows of the loans on a pool basis, as the Company deems these loans to have similar risk characteristics, prior to and subsequent to the restructuring. During the year ended December 31, 2020, modifications were done on loans with an aggregate unpaid principal balance of approximately \$21.7 million. As of December 31, 2020, the aggregate unpaid principal balance of modified loans was \$199.6 million with an accompanying troubled debt restructuring reserve of approximately \$104 million. The Company recorded \$438,000 of interest capitalized during the loan modification process for the year ended December 31, 2020, however, such amount was fully reserved at December 31, 2020 and is reported as a reduction of the outstanding principal balance of modified loans. Interest income is recognized from the reserve as payments are received on the related impaired loans, up to the amount originally capitalized. Apart from the reserved capitalized interest, interest income is recognized on all such loans unless the loan is over 90 days past due, or otherwise identified as non-performing in accordance with the Company's interest income recognition policy. For the year ended December 31, 2020, the average balance of modified loans and the interest income recognized on such loans were approximately \$212.4 million and \$8.6 million, respectively. The provision for losses is charged to the Company's Consolidated Statement of Operations and actual losses incurred are charged against the valuation allowance.

Real Estate Owned

Real estate owned ("REO") results from the Company foreclosing on delinquent borrowers. These properties are initially recorded at fair value at the date of foreclosure less estimated selling cost, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in losses associated with real estate owned in the accompanying consolidated statement of operations. At December 31, 2020, the Company held REO properties in its four on balance sheet securitizations valued at \$84,000 resulting from foreclosing on loans held for investment.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 1—ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Residual Interests in Securitizations

Residual interests in securitizations represent interests retained from the sale of loans through securitizations that the Company structures as sales rather than financings, referred to as “off-balance sheet securitizations.” The Company may also sell residual interests in securitizations through, what are sometimes referred to as, net interest margin securities, or NIMS.

In an off-balance sheet securitization, the Company transfers mortgage loans to a Real Estate Mortgage Investment Conduit (the “REMIC” or “Trust”), which is a Qualified Special Purpose Entity (“QSPE”), and accounts for the transfer as a sale of loans. The Trust, in turn, issues interest-bearing asset-backed securities (the “Certificates”). The Certificates are sold without recourse except that the Company provides representations and warranties customary to the mortgage banking industry with respect to loans transferred to the Trust. The Trust uses the cash proceeds from the sale of the Certificates to pay the Company the purchase price for the mortgage loans. The Trust also issues certificates representing interests in the excess interest spread and other residuals. The excess interest spread represents the present value of estimated cash flows that the holder of such Certificates will receive as a result of the interest collected from borrowers exceeding the interest paid to security holders by the Trust. The Company retained the Certificates from securitizations in 2004, representing the excess interest spread and other residuals, collectively referred to as residual interests. Changes to the fair value of trading residual interests are recorded through earnings as a change in value of residual interests. Accretion, or payment made to the Company by the trust from the residual interests is booked against the outstanding residual asset value as received. During March 2020, the Company sold and settled its residual interests in the 2004 securitizations so the Company no longer carries this residual on the Consolidated Balance Sheet.

Income Taxes

The Company elected to convert from REIT status to a C-Corporation on January 1, 2020. The Company is subject to federal and state taxes on its income. Accordingly, the Company reports a provision for taxes based upon the earnings using the asset and liability method of accounting for income taxes.

Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates for the periods in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date.

The Company records a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax asset will not be realized. In determining the possible realization of deferred tax assets, the Company considers future taxable income from the following sources: (i) the reversal of taxable temporary differences, (ii) taxable income from future operations and (iii) tax planning strategies that, if necessary, would be implemented to accelerate taxable income into periods in which net operating losses might otherwise expire.

Uncertain tax positions that meet the more likely than not recognition threshold are measured to determine the amount of benefit to recognize. An uncertain tax position is measured at the largest amount of benefit that management believes has a greater than 50% likelihood of realization upon settlement. If recognized, the tax portion of the adjustment would affect the effective tax rate. There were no new uncertain tax positions taken during 2020. Open tax return years are subject to future examination by tax authorities. Federal and state tax returns are open for years 2017 and after.

Concentrations of Credit Risk

The Company maintains cash accounts in financial institutions that are guaranteed by the Federal Deposit Insurance Corporation (“FDIC”) up to \$250,000 on interest bearing accounts. At times, cash balances may be in excess of the amounts insured by the FDIC. The Company has not experienced any losses in such accounts and believes it should not be exposed to any significant credit risk on cash and cash equivalents.

Loans originated in the state of California comprise approximately 32% of the Company’s total loans held for investment portfolio.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 2—LOANS HELD FOR INVESTMENT**

The components of mortgage loans held for investment at December 31, 2020 were as follows (in thousands):

Unpaid principal balance of mortgage loans	\$	316,247
Servicing advances		1,475
Net deferred origination costs and discounts		571
Allowance for loan losses		(139,357)
	<u>\$</u>	<u>178,936</u>

The following table presents a summary of the activity in the allowance for losses on mortgage loans held for investment for the year ended December 31, 2020 (in thousands):

Beginning balance	\$	137,786
Additions		2,659
Charge-offs, net		(1,087)
Ending balance	<u>\$</u>	<u>139,357</u>

At December 31, 2020, the Company had loans held for investment in its four on balance sheet securitizations valued at \$178,082,000. Additionally, as of December 31, 2020, the Company directly held unencumbered loans held for investment valued at \$854,000. The aggregate weighted average coupon for loans held for investment at December 31, 2020 was 4.49%.

December 31, 2020, there were loans with an aggregate unpaid principal balance of \$33,556,000 on non-accrual status and there were no loans past due ninety days or more and still accruing interest. All non-accrual loans were associated with the four on balance sheet securitization trusts.

**NOTE 3—RESIDUAL INTERESTS IN SECURITIZATIONS**

The Company sold and settled its residual interests in the CWABS 2004-1 and 2 securitizations with a trade date of March 6, 2020 and a settlement date of March 10, 2020 for \$1,762,000 and \$1,829,000, respectively. The sale resulted in a gain of approximately \$1.4 million and was reported as a gain on sale of residual interests on the Company's statement of operations for the year ended December 31, 2020.

The following table summarizes activity in residual interests for the year ended December 31, 2020 (in thousands):

		<u>Residual Interests in</u> <u>Securitizations</u>
Beginning balance	\$	2,263
Purchases		-
Sales		(3,590)
Total gains or losses for the period		
Included in earnings		1,437
Included in other comprehensive income		-
Accretion of residual interests		-
Cash received from residual interests		(110)
Transfers into (out of) level 3		-
Ending balance	<u>\$</u>	<u>-</u>

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 3—RESIDUAL INTERESTS IN SECURITIZATIONS (CONTINUED)**

The Company used certain assumptions and estimates to determine the fair value allocated to the residual interests at the time of initial sale and each subsequent reporting date. These assumptions and estimates included projections concerning the various rate indices applicable to the Company's loans and the pass-through rate paid to bondholders, credit loss experience, prepayments rates and a discount rate commensurate with the risks involved. These assumptions were reviewed periodically by management. If these assumptions changed, the related asset and income would be affected.

**NOTE 4—MORTGAGE SERVICING RIGHTS**

Mortgage servicing rights ("MSRs") represent the rights associated with servicing pools of residential mortgage loans under four securitization trust subsidiaries. The Company entered into subservicing agreements with a duly licensed servicer who performs all servicing functions for the loans underlying the MSRs. The Company splits the servicing fee with servicer. The Company elected to account for all of its investments in MSRs at fair value. As such, they are recognized at fair value on the accompanying Consolidated Balance Sheet with changes in the estimated fair value presented in the Consolidated Statement of Operations.

The Company uses certain assumptions and estimates to determine the fair value of MSRs. These assumptions include estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, and late fees, among other considerations. These assumptions are reviewed periodically by management. If these assumptions change, the related asset and income would be affected. At December 31, 2020 the prepayment rates used in evaluating cash flows for these fees was 15%. The discount rate used to value such service fee cash flows at December 31, 2020 was 20%. Mortgage servicing rights are classified as Level 3 assets at December 31, 2020.

The following table presents activity related to MSRs for the year ended December 31, 2020:

Fair value, beginning of year	\$	1,493
Change in fair value		(247)
Fair value, end of year	\$	<u>1,246</u>

Servicing expenses, net of servicing income, is reported in the Consolidated Statements of Operations. For the year ended December 31, 2020, the Company recognized \$247,000 of net servicing expenses in the Consolidated Statements of Operations.

**NOTE 5 – INVESTMENTS**

The Company has a 4% investment in the Class A membership interest in Patriot Financial Investment, LLC, which is carried at cost. Patriot Financial Investment, LLC acquired interest in Elderlife Financial Services which is engaged in the business of arranging and making loans to consumers. The aggregate carrying amount of the Company's investment is \$250,000 at December 31, 2020.

The Company has a 1% investment in the common stock of City Twig, Inc., which is carried at cost. City Twig, Inc. is a business data platform. The aggregate carrying amount of the Company's investment is \$250,000 at December 31, 2020.

The Company has a 3.98% investment in the Class B membership interest in Starboard MacArthur Square, LP, which is carried at cost. Starboard MacArthur Square, LP is a residential development company. On July 31, 2020, the Company sold all of its share of interest in Starboard MacArthur Square, LP for \$469,000.

Investments were not evaluated for impairment because (a) it is not practicable to estimate their fair values due to insufficient information being available and (b) management did not identify any events or changes in circumstances that might have a significant adverse effect on the fair values of those investments.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 6—FAIR VALUE MEASUREMENTS**

The framework for measuring fair value 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) and the lowest priority to unobservable inputs (Level 3). Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The three levels of the fair value hierarchy under Topic 820 are described as follows:

- Level 1 - Inputs to the valuation methodology are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as:
  - a. Quoted prices for similar assets or liabilities in active markets
  - b. Quoted prices for identical or similar assets or liabilities in inactive markets
  - c. Inputs other than quoted prices that are observable for the asset or liability
  - d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
 If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 - Inputs that are unobservable inputs for the asset or liability.

The Company determines fair value based upon quoted prices when available or through the use of alternative approaches, such as discounting the expected cash flows using market interest rates commensurate with the credit quality and duration of the investment. A description of the valuation techniques applied to the Company's major categories of assets and liabilities measured at fair value follows. There have been no changes in the methodologies used at December 31, 2020.

*Mortgage servicing rights* - Fair value of mortgage servicing rights is determined by discounting estimated future cash flows over the estimated remaining life of the underlying loans, using discount and interest rates, loss and prepayment assumptions based on available market data. Since one or more of these assumptions are unobservable, these assets are classified as Level 3 of the fair value hierarchy.

*Loans held for investment*- The Company does not record loans at fair value with the exception of impaired loans which are measured for impairment in accordance with FASB ASC 310-10-35 (formerly SFAS 114). Impaired loans are valued on a pool basis using discounted future cash flows, less amounts reserved for interest capitalized in the modification process. Since observable inputs are not used for these assets, the impaired loans are classified as Level 3 of the fair value hierarchy.

*Real estate owned ("REO")* — Real estate owned is valued using the lower of cost or market value, less estimated costs to sell. The estimated market price is obtained either from third party broker price opinion or property sale price. Real estate owned is classified as Level 3 in the hierarchy since the assets are valued using third party sale price estimates, adjusted by additional unobservable inputs, less estimated selling costs.

The Company records mortgage servicing rights at fair value on a recurring basis. Certain other assets such as impaired loans and REO are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are evaluated for impairment and for which any impairment is recorded in the period in which the re-measurement is performed.

A distribution of asset and liability fair values according to the fair value hierarchy at December 31, 2020 is provided in the table below. (in thousands):

Fair Value Measurements at the End of the Reporting Period Using:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Mortgage servicing rights	\$ 1,246	\$ -	\$ -	\$ 1,246
Total	\$ 1,246	\$ -	\$ -	\$ 1,246

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 6—FAIR VALUE MEASUREMENTS (CONTINUED)**

The changes in Level 3 assets measured on a recurring basis for the year ended December 31, 2020 are summarized in the following table (in thousands):

	Residual Interests in Securizations	Mortgage Servicing Rights
Beginning balance	\$ 2,263	\$ 1,493
Purchases	-	-
Sales	(3,590)	-
Total gains or losses for the period		
Included in earnings	1,437	(247)
Included in other comprehensive income	-	-
Accretion of residual interests	-	-
Cash received from residual interests	(110)	-
Transfers into (out of) level 3	-	-
Ending balance	<u>\$ -</u>	<u>\$ 1,246</u>
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period.	<u>\$ 1,437</u>	<u>\$ (247)</u>

Accretion of residual interests is in interest income. From time to time, the Company may be required to report certain assets at fair value on a non-recurring basis. These include assets measured at the lower of cost or market or that were recognized at a fair value below cost at the end of the reporting period. The following table presents such assets measured on a non-recurring basis as of December 31, 2020 (in thousands):

Fair Value Measurements at the End of the Reporting Period Using:

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	\$ 95,617	\$ -	\$ -	\$ 95,617
Real estate owned	84	-	-	84
Total	<u>\$ 95,701</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 95,701</u>

There were no transfers between level 1 and level 2 during the year ended December 31, 2020.



**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 6—FAIR VALUE MEASUREMENTS (CONTINUED)**

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2020, the significant unobservable inputs used in the fair value measurements were as follows:

(Dollars in thousands)	Fair Value at December 31, 2020	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Mortgage Servicing Rights	\$ -	Third party appraisal	Discounts to reflect estimated future cash flows	Prepayment rates 15%, Discount rate 20%
Impaired Loans	\$ 95,617	Discounted Cash Flows	Discounts to reflect current market conditions and ultimate collectability	Discounted cash flows at note rates from 4.0% to 12.1% and weighted average maturity
Real estate owned	\$ 84	Actual historical liquidation loss percentages are multiplied by each portfolio's outstanding balance	Actual historical liquidation loss percentages	Actual historical liquidation loss percentages ranging from 64.7% to 92.0%

**NOTE 7—LONG-TERM DEBT**

Long-term debt consists of mortgage-backed securities secured solely by mortgages transferred to the related securitization trust and are non-recourse to the Company. The principal and interest payments on the mortgages, reduced by 50 basis points of the outstanding principal balance used to pay contractual obligations of the trust provide the funds to pay debt service on the securities. The interest rate on the securities resets monthly and is based upon one-month LIBOR. The weighted-average interest rate payable on the Company's long-term debt at December 31, 2020 was 1.04%. As principal payments on the underlying mortgages are paid through to reduce principal on the bonds, the term of the bonds is ultimately a function of the rate at which principal is paid on the mortgages. The Company estimates that the bonds will be paid at maturity, 2035. The bonds have a "clean-up call" provision which allows the Company to dissolve the Trust and repay outstanding bonds when the remaining principal balance of the underlying loans is 10% or less of their original balance. As of December 31, 2020, the balance of long-term debt consists of the following (in thousands):

Securitized bonds	\$ 465,828
Accrued interest on securitized bonds	1,158
Total financing on mortgage loans held for investment	<u>\$ 466,986</u>

Costs associated with issuing long-term debt were capitalized and are being amortized as a component of interest expense over the estimated term of the debt, expecting that the debt will be paid fully from the cash flows from the underlying collateral. The balance of deferred bond issue costs at December 31, 2020, net of accumulated amortization, was \$51,000 and is included in prepaid expenses and other assets.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 7—LONG-TERM DEBT (CONTINUED)**

The discount on bonds reflects the difference between the proceeds received from the sale of the bonds and the face amount to be repaid over the life of the bonds. The discount is being amortized as an adjustment to interest expense over the estimated life of the bonds. Mortgage losses depleted the over-collateralization on the four trusts. As a result, the trustee passed a total cumulative of \$198.0 million in losses through to bondholders of certain subordinate security classes and reduced the amount showing as outstanding for such classes as of December 31, 2020. The Company recognizes that a legal release of liability to such bondholders has not yet occurred since these bonds could receive payments from future cash flows of the underlying mortgages. Until such time as the bonds are called or mature, the Company will continue to report bond balances for bond classes affected by losses as reconciling items from related balances reported by the trusts. The carrying value of the long-term debt has not been reduced by the losses passed through to bond holders as reported by the trusts.

**NOTE 8—INCOME TAXES**

ECC Capital Corporation is a C-corporation which is subject to federal and state taxes on their income.

The components of the Company income tax provision, all of which has been allocated to continuing operations, are as follows for the year ended December 31, 2020 (in thousands):

Income tax expense (benefit):	
Current tax expense (benefit)	
Federal	\$ 20
State	63
Deferred tax (benefit)	
Federal	35,282
State	11,172
Change in valuation allowance	<u>(46,454)</u>
	<u>\$ 83</u>

Deferred taxes and deferred tax liabilities are recognized for temporary differences between the basis of assets and liabilities for financial statements and income tax purposes. The components of the deferred tax liabilities and assets as of December 31, 2020 are as follows (in thousands):

Deferred tax assets/(liabilities):	
Net operating loss carryforward	\$ 103,839
Servicing rights	76
Bad debt reserve	(209)
Other	<u>(4)</u>
Total deferred tax asset	103,702
Deferred tax asset valuation allowance	<u>(103,702)</u>
Net deferred tax asset	<u>\$ -</u>

For the year ended December 31, 2020, the effective tax rate approximated the federal statutory rate of 21%.

As of December 31, 2020, the Company has approximately \$339 million in estimated federal net operating loss carryforwards and a total of \$553 million in state net operating loss carryforwards available to reduce future taxable income, which begins to expire in 2027. Such losses may not be fully deductible due to the uncertainty of taxable income in future periods.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 8—INCOME TAXES (CONTINUED)**

The Company is required to record a valuation allowance to reduce its deferred tax assets to the amount that it believes is more likely than not to be realized. In assessing the need for a valuation allowance, the Company considered all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial performance. As a result of the operating losses of the Company in the current and prior years, management concluded that a full valuation allowance of \$103.7 million, against the deferred tax assets was appropriate. In view of the recent losses, there is no assurance that there will be sufficient future taxable income to realize the benefit of the deferred tax asset.

**NOTE 9—CORPORATE OWNED LIFE INSURANCE**

The Company purchased a split-dollar Corporate Owned Life Insurance policy (or “COLI”) to cover the participant of the plan. The Company is a beneficiary of the life insurance plan. The cash surrender value of the plan at December 31, 2020 was \$526,000 and is included in prepaid expenses and other assets on the Consolidated Balance Sheet.

**NOTE 10—LEASE COMMITMENTS**

The Company leases its California office space under a noncancelable operating lease requiring fixed monthly payments of \$5,905 plus operating expenses from August 15, 2018 and through August 14, 2019, \$6,082 from August 15, 2019 through August 14, 2020, and \$6,264 from August 15, 2020 through August 14, 2021. The lease expires August 14, 2021. Such lease also contains one additional 36 month period renewal option, which is not considered a future commitment, as the Company is not obligated to renew the lease.

The Company leases another office space under an operating lease requiring fixed monthly payments of \$1,950 commencing on August 1, 2018 and terminating on June 1, 2020. After the lease termination date, the Company continues rent this office space on a month-to-month basis.

Total rent expense related to these leases was approximately \$126,000 for the year ended December 31, 2020.

Future minimum rental commitments under all non-cancelable operating leases at December 31, 2020 were as follows (in thousands):

	Future Minimum Rent	
2021	\$	47

**NOTE 11—GOODWILL**

The gross carrying amounts of goodwill, accumulated amortization, and accumulated impairment loss for the years ended December 31, 2020, are as follows (amounts in thousands):

Goodwill	\$	850
Accumulated amortization		(411)
Accumulated impairment loss		-
Goodwill, net	\$	439

Amortization expense for 2020 was \$170,000 and is included in operating expenses on the Consolidated Statement of Operations. Goodwill includes \$850,000 added in 2018 attributable to the acquisition of Rancho Plaza Realty, Inc. by ECC Rancho Plaza, Inc., a subsidiary of the Company. Goodwill net of amortization is included in prepaid expenses and other assets on the Consolidated Balance Sheet. The Company amortizes goodwill on the straight-line method over five years.

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 12 – STOCK-BASED COMPENSATION**

The Company’s 2019 Restricted Stock Plan provided for the issuance of restricted stock awards to eligible directors and employees. Under the Plan, awards vest over periods of up to one and a half year.

The estimated compensation cost associated with the granting of restricted stock and restricted stock units is based on the fair value of the Company’s common stock on the date of grant. The Company recognizes the compensation cost arising from the issuance of restricted stock and restricted stock units over the vesting period.

Restricted stock activity under the Plan for the year ended December 31, 2020 is summarized as follows:

	Number of Shares (in Thousand)	Weighted Average Grant Date Fair Value
Balance January 1, 2020	\$ 7,088	\$ 0.001
Grant	-	-
Vested	(4,725)	(0.001)
Cancelled	-	-
Balance December 31, 2020	\$ 2,363	\$ 0.000

For the year ended December 31, 2020, the Company recorded no compensation expense related to the vesting of 9,450,000 shares of restricted stock granted in current year. The Company has no remaining unamortized expense related to restricted stock awards as of December 31, 2020.

**NOTE 13 – STOCK REDEMPTION**

On December 17, 2020, the Company redeemed all its shares of common stock of Intus Capital Corporation for distributed assets value total \$2,514,516. The distributed assets consist of 100% of the outstanding equity of ECC Rancho Plaza, Inc., Performance Credit, LLC, and ECC Investment Corp., loans held for investment, accrued interest on loans, notes receivable, and cash.

**NOTE 14 – PAYROLL PROTECTION PROGRAM (“PPP”) LOAN**

On April 12, 2020, the Company subsidiary ECC Rancho Plaza, Inc. received a SBA Payroll Protection Program (“PPP”) loan pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), with Farmers & Merchants Bank of Long Beach for \$66,820. No payments are due on the Loan for six months (the “Deferment Period”) from the date of first disbursement of the Loan. Interest will continue to accrue during the Deferment Period. The PPP loan bears interest at 1.0% per annum, with monthly payments of principal and interest beginning in the month immediately following the end of the Deferment Period. Upon the end of the Payment Deferral Period and beginning seven months from the date of this Note, Borrower shall pay eighteen equal consecutive monthly payments of principal and interest. The final payment of all outstanding principal plus all accrued unpaid interest will be due on April 12, 2022 (the “Maturity Date”). The Paycheck Protection Program provides that the PPP loan may be partially or fully forgiven if the funds are used for certain qualifying expenses as described in the CARES Act. The Company used the proceeds from the PPP Loan for qualifying expenses as defined in the PPP Loan and plan to apply for forgiveness of the PPP Loan in accordance with the terms of the CARES Act. However, the Company cannot assure at this time that the PPP Loan will be forgiven partially or in full. Accordingly, we have recorded the full amount of the PPP Loan as debt and is included in accounts payable and accrued expenses on the Consolidated Balance Sheet.

Annual maturities of note payable as of December 31, 2020 are as follows:

	Year Ending December 31	Amount
2021		\$ 51,971
2022		14,849
		\$ 66,820

**ECC CAPITAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**For The Year Ended December 31, 2020**

**NOTE 11 - CONTINGENCIES**

In March 2020, significant mitigation efforts began taking effect in the United States in an attempt to curtail the spread of the coronavirus (COVID-19) pandemic. Such efforts have included travel restrictions, business closures, and event cancellations. Capital markets have seen significant volatility in the wake of the pandemic and significant economic disruptions are likely to occur. In response, the Company has altered its operations by reducing personnel on-site and by working remotely where possible. Management cannot reasonably estimate the related financial impact and duration of the situation at this time. However, the Company believes it has sufficient cash to sustain operations in the event of continued disruption. Management intends to monitor the situation on an ongoing basis and to continue efforts to reduce its impact on the Company's operations and financial resources.

**NOTE 16 – SUBSEQUENT EVENTS**

On April 2, 2021, subsequent to the year ended December 31, 2020, the Company sold all of its investment in the common stock of City Twig, Inc. for \$100,000. Additionally, if within 90 days of the closing date, the financial benefit related to interest ownership is greater than \$100,000, the Company will entitle to half of the financial benefit until the Company receives up to \$250,000 in total compensations.

On April 30, 2021, subsequent to the year ended December 31, 2020, the Company sold its interest in the property management subsidiary ECC Rancho Plaza, Inc. for \$400,000 in cash plus a \$100,000 note receivable at 6% per quarter year, payable in 4 equal parts maturing April 30, 2022.

Subsequent events have been evaluated through May 12, 2021, which is the date the financial statements were available to be issued.