Consolidated Financial Statements and
Independent Auditor's Report

ECC Capital Corporation and Subsidiaries

Year Ended December 31, 2021

ECC Capital Corporation and Subsidiaries

Table of Contents

Title	Page
Independent Auditor's Report	2-3
Consolidated Balance Sheet	4
Consolidated Statement of Operations	5
Consolidated Statement of Stockholders' Equity	6
Consolidated Statement of Cash Flows	7
Notes to the Consolidated Financial Statements	8-21

Independent Auditor's Report

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

Opinion

We have audited the accompanying consolidated financial statements of ECC Capital Corporation (a Maryland corporation) and subsidiaries, which comprise the consolidated balance sheet as of December 31, 2021, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, 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, 2021, 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.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ECC Capital Corporation and subsidiaries and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ECC Capital Corporation and subsidiaries' ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.

www.rogersllc.com

9600 Blackwell Road, Suite 250 **Office: 301 527-1300**
Rockville, MD 20850 **Fax: 301 279-2819**

Rogers & ASSOCIATES, LLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 ECC Capital Corporation and subsidiaries' internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ECC Capital Corporation and subsidiaries' ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Rogers & Associates, LLC

Rockville, MD
April 13, 2022

www.rogersllc.com

9600 Blackwell Road, Suite 250 **Office: 301 527-1300**
Rockville, MD 20850 **Fax: 301 279-2819**

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2021
(in thousands, except share data)

ASSETS

Cash and cash equivalents	$	7,419
Restricted cash		302
Mortgage loans held for sale-at fair value		7,043
Mortgage loans held for investment, net		155,109
Accrued mortgage loan interest		813
Mortgage servicing rights		1,063
Real estate owned		307
Prepaid expenses and other assets		1,154
Total assets	$	173,210

LIABILITIES AND STOCKHOLDERS' DEFICIT

Liabilities:		
Long-term debt	$	423,954
Repurchase agreements		6,886
Accounts payable and accrued expenses		381
Total liabilities		431,221
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		378,835
Minority interest		436
Accumulated deficit		(637,389)
Total stockholders' deficit		(258,011)
Total liabilities and stockholders' deficit	$	173,210

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
For the year ended December 31, 2021
(in thousands)

Revenue		
Interest income	$	10,559
Interest expense		(2,585)
Net interest income		7,974
Provision for loan losses		(13,530)
Net income, after provision for loan losses		21,504
Fair market adjustment-loans held for sale		87
Gain on origination and sale of loans		1,010
Change in value of mortgage servicing rights		(183)
Net revenues		22,418
Expenses		
Operating expenses		8,703
Servicing fees, net		650
Total expenses		9,353
Other income		275
Loss on sale of investments		(285)
Income before tax provision		13,055
Tax provision		301
Net income	$	12,754

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
For the year ended December 31, 2021
(in thousands)

	Number of Common Shares Outstanding	Common Stock	Additional Paid In Capital	Minority Interest	Accumulated Deficit	Total
Balance December 31, 2020	97,073	$ 107	$ 375,335	$ -	$ (649,701)	$ (274,259)
Net income					12,754	12,754
Dividends					(6)	(6)
Minority interest member investment			3,500			3,500
Minority interest				436	(436)	-
Balance December 31, 2021	97,073	$ 107	$ 378,835	$ 436	$ (637,389)	$ (258,011)

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended December 31, 2021
(in thousands)

Cash Flows from Operating Activities:	
Net income	$ 12,754
Adjustments to Net income to Net Cash used in Operating Activities:	
Changes in operating assets and liabilities	
Provision for loan losses	(13,530)
Change in fair value of loans held for sale	(88)
Depreciation and amortization	258
Gain on sale of loans	(439)
Proceeds from sale of loans	21,942
Loans originated for sale	(28,458)
Loss on sale of real estate and other investments	285
Change in value of mortgage servicing rights	183
Accrued interest	277
Accrued expenses	(104)
Prepaids and other assets	286
Net cash used in operating activities	(6,634)
Cash Flows from Investing Activities:	
Cash received from sale of real estate and other investments	350
Amortization and payoff of mortgage loans held for investm	36,418
Net proceeds from sale of REO	479
Purchases of furniture and equipment	(258)
Net cash provided by investing activities	36,989
Cash Flows from Financing Activities:	
Dividends paid	(6)
Payments on long-term debt	(43,032)
Minority investor contributions	3,500
Borrowings under repurchase agreements	28,386
Repayments under repurchase agreements	(21,500)
Net cash used in financing activities	(32,652)
Net decrease in cash and equivalents	(2,297)
Cash and equivalents-Beginning of Year	10,018
Cash and equivalents-End of Period	$ 7,721
Supplemental disclosure of cash flow information:	
Cash used to pay interest	$ 2,567
Cash used to pay income taxes	$ 301
Supplemental disclosure of non-cash investing and financing activities:	
Loans transferred to real estate owned due to foreclosure	$ 1,556

See notes to the consolidated financial statements

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, 2021:

	Securitization trusts	Non-trust entities	Company total
Assets:			
Cash and cash equivalents	$ -	$ 7,419	$ 7,419
Restricted cash	2	300	302
Mortgage loans held for sale at fair value	-	7,043	7,043
Mortgage loans held for investment, net	154,840	269	155,109
Accrued mortgage loan interest	804	9	813
Mortgage servicing rights	-	1,063	1,063
Real estate owned	307	-	307
Prepaid expenses and other assets	32	1,122	1,154
Total assets	155,985	17,225	173,210
Liabilities and equity:			
Long-term debt	423,954	-	423,954
Repurchase agreements	-	6,886	6,886
Accounts payable and accrued expenses	-	381	381
		-	
Total liabilities	423,954	7,267	431,221
Net stockholders' equity (deficit)	$ (267,969)	$ 9,958	$ (258,011)

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., Performance Credit, LLC, ECC Rancho Plaza, Inc., and majority-owned subsidiaries, Performance Real Estate, Inc., and Polaris Home Loans, LLC.

On April 30, 2021, the Company entered into stock purchase agreement to sell 100% of the issued and outstanding capital stock in ECC Rancho Plaza, Inc. to the Company's employee. After the sale of ECC Rancho Plaza, Inc.'s stock, 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. (while it was owned), and majority-owned subsidiaries, Performance Real Estate, Inc., and Polaris Home Loans, LLC. 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, 2021 consist of the following:

Cash and cash equivalents	$	7,419
Restricted cash		302
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	$	7,721

At December 31, 2021, restricted cash primarily consisted of $300,000 reserve account in accordance with certain master repurchase agreements and deposited in a separate account at the financial institution.

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.

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, 2021, modifications were done on loans with an aggregate unpaid principal balance of approximately $20.9 million. As of December 31, 2021, the aggregate unpaid principal balance of modified loans was $192.7 million with an accompanying troubled debt restructuring reserve of approximately $106 million. The Company recorded $442,000 of interest capitalized during the loan modification process for the year ended December 31, 2021, however, such amount was fully reserved at December 31, 2021 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, 2021, the average balance of modified loans and the interest income recognized on such loans were approximately $196.2 million and $7.9 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, 2021, the Company held REO properties in its four on balance sheet securitizations valued at $307,000 resulting from foreclosing on loans held for investment.

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

Loans originated and held for sale

Mortgage loans are originated for sale to investors. Loans originated are intended for eventual sale into the secondary market. As such, these loans must meet the origination and underwriting criteria established by secondary market investors. Polaris Home Loans, LLC, a subsidiary of the Company, sells its mortgage loans that it originates to investors on a servicing released basis.

The Corporation adopted Accounting Standards Codification ("ASC") 820, "Fair Value Measurements and Disclosures," and elected the fair value option (ASC 825, "Financial Instruments") on loans held for sale. ASC 825 allows for the option to report certain financial assets and liabilities at fair value initially and at subsequent measurement dates with changes in fair value included in earnings. The option may be applied instrument by instrument, but it is irrevocable. Changes in fair value of loans held for sale are included in "Fair market adjustment – loans held for sale" on the consolidated statement of operations.

Gain on origination and sale of loans consists of fee income earned on all loan originations, including loan origination fees and points and gains or losses on the sale of loans. Fees associated with the origination of mortgage loans are recognized when earned, which is the date the loan is originated. Gains or losses on the sale of loans are recognized at the time of sale and are determined by the difference between the net sales proceeds and the book value of the loans sold.

Income Taxes

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 2021. Open tax return years are subject to future examination by tax authorities. Federal and state tax returns are open for years 2018 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 outstanding loan balance held for investment portfolio as reported on the Consolidated Balance Sheet.

NOTE 2—LOANS HELD FOR INVESTMENT

The components of mortgage loans held for investment at December 31, 2021 were as follows (in thousands):

Unpaid principal balance of mortgage loans	$	276,132
Servicing advances		3,378
Net deferred origination costs and discounts		480
Allowance for loan losses		(124,881)
	$	155,109

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, 2021 (in thousands):

Beginning balance	$	139,357
Reductions		(14,096)
Charge-offs, net		(380)
Ending balance	$	124,881

At December 31, 2021, the Company had loans held for investment in its four on balance sheet securitizations valued at $154,839,000. Additionally, as of December 31, 2021, the Company directly held unencumbered loans held for investment valued at $270,000. The aggregate weighted average coupon for loans held for investment at December 31, 2021 was 4.39%.

December 31, 2021, there were loans with an aggregate unpaid principal balance of $21,206,000 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 – LOANS HELD FOR SALE

Polaris Home Loans, LLC sells its originated mortgage loans to investors. All loans are sold on a servicing released basis.

All of the loans held for sale as of December 31, 2021 are performing loans and all such loans are pledged as collateral on the repurchase agreements (see Note 8).

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 subservicer who performs all servicing functions for the loans underlying the MSRs. The Company splits the servicing fee with subservicer. 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, 2021 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, 2021 was 20%. Mortgage servicing rights are classified as Level 3 assets at December 31, 2021.

NOTE 4—MORTGAGE SERVICING RIGHTS (CONTINUED)

The following table presents activity related to MSRs for the year ended December 31, 2021:

Fair value, beginning of year	$	1,246
Change in fair value		(183)
Fair value, end of year	$	1,063

Servicing expenses, net of servicing income, is reported in the Consolidated Statements of Operations. For the year ended December 31, 2021, the Company recognized $183,000 of net servicing expenses in the Consolidated Statements of Operations.

NOTE 5 – INVESTMENTS

On October 8, 2021, the Company sold all of its investment in the Class A membership interest in Patriot Financial Investment, LLC for approximately $253,000. Prior to that the Company had a 4% investment in the Class A membership interest in Patriot Financial Investment, LLC, which was 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.

On April 2, 2021, the Company entered into assignment agreement to sell all of its shares of common stock of City Twig, Inc. for $100,000. The Company had a 1% investment in the common stock of City Twig, Inc., which was carried at cost. City Twig, Inc. is a business data platform.

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, 2021.

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.

NOTE 6—FAIR VALUE MEASUREMENTS (CONTINUED)

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.

Loans held for sale - The Company adopted ASC 820, “Fair Value Measurements and Disclosures,” and elected the fair value option pursuant to ASC 825, “Financial Instruments” on loans originated for sale. ASC 825 permits entities to elect to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis (the “Fair Value Option”) at specified election dates. The fair value option was elected for mortgage loans held for sale as the Company believes fair value best reflects its expected future economic performance. The fair value is determined using quoted secondary market prices such as mandatory loan sale commitments (Level 2). At each subsequent reporting date, an entity is required to report unrealized gains and losses on items in earnings for which the fair value option has been elected.

The following table describes the difference at the dates indicated between the aggregate fair value and the aggregate unpaid principal balance of loans held for sale at fair value (in thousands):

	Fair Value	Unpaid Principal Balance	Net Unrealized Gain (Loss)
Loans held for sale, at fair value	$ 7,043	$ 6,955	$ 88

The Company records mortgage servicing rights and loans held for sale 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, 2021 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	$ 1,063	$ -	$ -	$ 1,063
Loans held for sale	7,043	-	7,043	-
Total	$ 8,106	$ -	$ 7,043	$ 1,063

NOTE 6—FAIR VALUE MEASUREMENTS (CONTINUED)

The changes in Level 3 assets measured on a recurring basis for the year ended December 31, 2021 are summarized in the following table (in thousands):

	Mortgage Servicing Rights
Beginning balance	$ 1,246
Purchases	-
Sales	-
Total gains or losses for the period	
Included in earnings	(183)
Included in other comprehensive income	-
Transfers into (out of) level 3	-
Ending balance	$ 1,063
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period.	$ (183)

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, 2021 (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	$ 87,191	$ -	$ -	$ 87,191
Real estate owned	307	-	-	307
Total	$ 87,498	$ -	$ -	$ 87,498

There were no transfers between level 1 and level 2 during the year ended December 31, 2021.

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, 2021, the significant unobservable inputs used in the fair value measurements were as follows:

(Dollars in thousands)	Fair Value at December 31, 2021		Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Mortgage Servicing Rights	$	7,043	Third party appraisal	Discounts to reflect estimated future cash flows	Prepayment rates 15%, Discount rate 20%
Impaired Loans	$	87,191	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	$	307	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 66.4% to 92.5%

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, 2021 was 1.02%. 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, 2021, the balance of long-term debt consists of the following (in thousands):

Securitized bonds	$	422,794
Accrued interest on securitized bonds		1,160
Total financing on mortgage loans held for investment	$	423,954

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, 2021, net of accumulated amortization, was $32,000 and is included in prepaid expenses and other assets.

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 $194.6 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, 2021. 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 – BORROWING UNDER REPURCHASE AGREEMENTS

Polaris Home Loans, LLC has entered into repurchase agreements with two separate financial institutions, for the purposes of funding the origination of mortgage loans.

On June 2, 2021, Polaris Home Loans, LLC entered into a Tier II Master Repurchase Agreement with a financial institution with an aggregate purchase price outstanding at any one time of $10,000,000 (the “Facility Amount”). On October 18, 2021, Polaris Home Loans, LLC signed a first amendment to the Tier II Master Repurchase Agreement to temporarily increase this facility amount to $15,000,000 from October 18, 2021 through April 30, 2022. Interest rates on the borrowings are equal to the note rates on the underlying mortgage loans in accordance with the Tier II Master Repurchase Agreement.

On September 27, 2021, Polaris Home Loans, LLC entered into a Master Repurchase Agreement with another financial institution with an aggregate purchase price outstanding at any one time of $15,000,000. Interest rates on the borrowings are LIBOR plus a certain percentage which varies based on the type of underlying mortgage loan in accordance with the Master Repurchase Agreement.

Other terms and conditions, such as relating to events of default, are typically governed under the master repurchase agreements. Polaris Home Loans, LLC has received no notices of default under either of the master repurchase agreements.

As of December 31, 2021, the fair value of loans held for sale transferred as collateral under outstanding borrowings under repurchase agreements was $7,043,000.

NOTE 9 – RELATED PARTY

On November 19, 2021, Polaris Home Loans, LLC entered into a purchase agreement with EF Holdco RER Assets LLC to sell 35% of its Class A member interests for $3,500,000.

On November 19, 2021, Polaris Home Loans, LLC entered into a promissory note agreement with Ellington Financial REIT, an affiliate of EF Holdco RER Assets LLC, to borrow from time to time in an aggregate principal amount of up to $3,000,000. Interest rate on the note is 9% per annum from the date such advance was made until the advances is paid in full. Interest is payable quarterly. The aggregate outstanding principal amount of the loan together with all accrued and unpaid interest and all other amounts payable under this note shall be due and payable on November 19, 2024, the maturity date. The note is secured by a first priority security interest in the assets of Polaris Home Loans, LLC. As of December 31, 2021, there were no borrowings under the note agreement.

NOTE 10—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, 2021 (in thousands):

Income tax expense (benefit):		
Current tax expense (benefit)		
Federal	$	85
State		216
Deferred tax (benefit)		
Federal		730
State		336
Change in valuation allowance		(1,066)
	$	301

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, 2021 are as follows (in thousands):

Deferred tax assets/(liabilities):		
Net operating loss carryforward	$	103,147
Residual interests		486
Servicing rights		56
Bad debt reserve		(1,075)
Depreciation and amortization		9
Other		13
Total deferred tax asset		102,636
Deferred tax asset valuation allowance		(102,636)
Net deferred tax asset	$	-

For the year ended December 31, 2021, the effective tax rate approximated the federal statutory rate of 21%.

As of December 31, 2021, the Company has approximately $337 million in estimated federal net operating loss carryforwards and a total of $545 million in state net operating loss carryforwards available to reduce future taxable income, which begins to expire in 2025. Such losses may not be fully deductible due to the uncertainty of taxable income in future periods.

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 $102.6 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 11—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, 2021 was $487,000 and is included in prepaid expenses and other assets on the Consolidated Balance Sheet.

NOTE 12—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 through August 14, 2021, maturity date. On July 26, 2021, the Company entered into first amendment to lease to exercise the option to extend the term of the lease for 36 months period, commencing on August 15, 2021 and expiring on August 14, 2024. The lease required fixed monthly payments of $6,264 plus operating expenses from August 15, 2021 through August 14, 2022, $6,452 from August 15, 2022 through August 14, 2023, and $6,646 from August 15, 2023 through August 14, 2024.

Polaris Home Loans, LLC leases its Massachusetts office under an operating sublease agreement which commenced on May 1, 2021. The lease requires fixed monthly payments of $13,500 from May 1, 2021 to April 30, 2022 with annual escalation on the month of May of every year. The lease expires December 30, 2023.

Polaris Home Loans, LLC leases its Arizona office under a 36 month operating lease which commenced on July 19, 2021. The lease requires fixed monthly payments of $5,069 for the first twelve months with annual escalation. The lease expires July 31, 2024.

On December 14, 2021, Polaris Home Loans, LLC entered into a three year lease agreement for its Tennessee office which commenced on January 1, 2022. The lease requires fixed monthly payments of $4,381 for 2022 with annual escalation. The lease expires December 31, 2024.

Polaris Home Loans, LLC leases its Jacksonville, Florida office under an operating lease which commenced on September 15, 2021. The lease requires fixed monthly payments of $3,574 for the first twelve months with 3% annual escalation. The lease expires September 30, 2024. After two years, Polaris Home Loans, LLC has an option to terminate such lease subject to an early termination payment of five months' rent.

Polaris Home Loans, LLC also lease offices in both Tennessee and Florida on a month-to-month basis. Total monthly payment under month-to-month leases was $3,744.

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 $278,000 for the year ended December 31, 2021.

Future minimum rental commitments under all non-cancelable operating leases at December 31, 2021 were as follows (in thousands):

	Future Minimum Rent	
2022	$	401
2023		414
2024		148
	$	963

NOTE 13 – 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.

NOTE 13 – STOCK-BASED COMPENSATION (CONTINUED)

Restricted stock activity under the Plan for the year ended December 31, 2021 is summarized as follows:

	Number of Shares (in Thousand)		Weighted Average Grant Date Fair Value	
Balance January 1, 2021	$	2,363	$	-
Grant		-		-
Vested		(2,363)		-
Cancelled		-		-
Balance December 31, 2021	$	-	$	-

For the year ended December 31, 2021, 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, 2021.

NOTE 14 – STOCK PURCHASE AGREEMENT

On April 30, 2021, the Company sold its interest in the property management subsidiary ECC Rancho Plaza, Inc. for $300,000 in cash plus a $100,000 note receivable at 6% per quarter year, payable in 4 equal parts maturing April 30, 2022. All installments were paid in full on September 22, 2021.

NOTE 15 - CONTINGENCIES

COVID-19

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.

Litigation

On June 1, 2021, River City Mortgage, former employer of Polaris Home Loans, LLC's president, filed a claim against Polaris Home Loans, LLC's president and Polaris Home Loans, LLC under Massachusetts law for various tort and statutory claims. The complaint alleges that Polaris Home Loans, LLC's president, prior to his departure from River City Mortgage and before joining Polaris Home Loans, LLC, allegedly misappropriated certain of River City Mortgage's trade secrets and confidential information. The parties engaged in motion practice over various issues. River City Mortgage amended its compliant to add ECC Capital and ECC Capital's president as defendants. Polaris Home Loans, LLC has filed counterclaims against River City Mortgage and its president, alleging various tort and statutory claims, including tortious interference with contract and unfair trade practices. The parties are in the process of conducting fact discovery, which is expected to be completed later in the year. No provision has been made in the accompanying financial statement for any potential receipts or payments as a result of a future possible settlement.

NOTE 16 – SUBSEQUENT EVENTS

On January 15, 2022, subsequent to year ended December 31, 2021, Polaris Home Loans, LLC entered into a three years lease agreement for its California office commencing on February 1, 2022. The lease requires fixed monthly payments of $2,750. The lease expires January 31, 2025. Polaris Home Loans, LLC has the right to extend the lease for one option of three years. Rent during the term renewal option will be $2,750 with annual escalation.

NOTE 16 – SUBSEQUENT EVENTS (CONTINUED)

On January 11, 2022, subsequent to year ended December 31, 2021, Polaris Home Loans, LLC borrowed $500,000 from Ellington Financial REIT in accordance with the promissory note agreement dated November 19, 2021. Polaris borrowed an additional $1.0 million under this note agreement on March 25, 2022.

Polaris Home Loans, LLC received a letter, dated February 25, 2022, from a lawyer representing a company named Polaris Home Funding Corporation ("PHFC"), in which PHFC alleges trademark infringement. Management believes it will not have a material effect on the Company’s operations.

Subsequent events have been evaluated through April 13, 2022, which is the date the financial statements were available to be issued.