Consolidated Financial Statements and
Independent Auditor's Report

ECC Capital Corporation and Subsidiaries

Year Ended December 31, 2022

ECC Capital Corporation and Subsidiaries

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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 (the Company), which comprise the consolidated balance sheet as of December 31, 2022, 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, 2022, 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 the Company 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 the Company's ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.

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Rogers & ASSOCIATES, LLC
Certified Public Accountants And Management Consultants

Independent Auditor's Report (Continued)

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 the Company's 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 the Company's 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 25, 2023

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2022
(in thousands, except share data)

ASSETS

Cash and cash equivalents	$	2,484
Restricted cash		2
Mortgage loans held for investment, net		134,890
Accrued mortgage loan interest		765
Mortgage servicing rights		2,159
Real estate owned		99
Prepaid expenses and other assets		913
Total assets	$	141,312

LIABILITIES AND STOCKHOLDERS' DEFICIT

Liabilities:		
Long-term debt	$	397,765
Accounts payable and accrued expenses		329
Total liabilities		398,094
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		378,885
Accumulated deficit		(635,774)
Total stockholders' deficit		(256,782)
Total liabilities and stockholders' deficit	$	141,312

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
For the year ended December 31, 2022
(in thousands)

Revenue		
Interest income	$	9,038
Interest expense		(5,335)
Net interest income		3,703
Provision for loan losses		(4,231)
Net income, after provision for loan losses		7,934
Change in value of mortgage servicing rights		1,096
Net revenues		9,030
Expenses		
Operating expenses		3,669
Servicing fees, net		582
Total expenses		4,251
Other income		136
Income from continuing operations before tax provision		4,915
Tax provision		6
Income from continuing operations		4,909
Loss from operations of discontinued operations		(5,619)
Gain from disposal of discontinued operations		1,890
Net income	$	1,180

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
For the year ended December 31, 2022
(in thousands)

	Number of Common Shares Outstanding	Common Stock	Additional Paid In Capital	Minority Interest	Accumulated Deficit	Total
Balance December 31, 2021	97,073	$107	$378,835	$436	$(637,389)	$(258,011)
Net income					1,180	1,180
Dividends					(1)	(1)
Minority interest member investment			50			50
Minority interest				(436)	436	-
Balance December 31, 2022	97,073	$107	$378,885	$0	$(635,774)	$(256,782)

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended December 31, 2022
(in thousands)

Cash Flows from Operating Activities:	
Net income	$ 1,180
Adjustments to Net income to Net Cash provided by Operating Activities:	
Changes in operating assets and liabilities	
Provision for loan losses	(4,231)
Change in fair value of loans held for sale	88
Depreciation and amortization	433
Loss on disposal of fixed assets	312
Gain on extinguishment of related party debt	(2,300)
Gain on sale of loans	(1,574)
Proceeds from sale of loans	96,853
Loans originated for sale	(88,324)
Change in value of mortgage servicing rights	(1,096)
Accrued interest	48
Accrued expenses	(52)
Prepaids and other assets	3
Net cash provided by operating activities	1,340
Cash Flows from Investing Activities:	
Amortization and payoff of mortgage loans held for investment	23,301
Net proceeds from sale of REO	988
Sales of fixed assets	38
Purchases of fixed assets	(176)
Net cash provided by investing activities	24,151
Cash Flows from Financing Activities:	
Dividends paid	(1)
Borrowings under related party note agreement	2,300
Payments on long-term debt	(26,189)
Minority investor contributions	50
Borrowings under repurchase agreements	84,964
Repayments under repurchase agreements	(91,850)
Net cash used in financing activities	(30,726)
Cash and equivalents-Beginning of Year	7,721
Net decrease in cash and equivalents	(5,235)
Cash and equivalents-End of Period	$ 2,486
Supplemental disclosure of cash flow information:	
Cash used to pay interest	$ 5,540
Cash used to pay income taxes	$ 6
Supplemental disclosure of non-cash investing and financing activities:	
Loans transferred to real estate owned due to foreclosure	$ 595

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, 2022:

	Securitization trusts	Non-trust entities	Company total
Assets:			
Cash and cash equivalents	$ -	$ 2,484	$ 2,484
Restricted cash	2	-	2
Mortgage loans held for investment, net	134,640	250	134,890
Accrued mortgage loan interest	762	3	765
Mortgage servicing rights	-	2,159	2,159
Real estate owned	99	-	99
Prepaid expenses and other assets	18	895	913
Total assets	135,521	5,791	141,312
Liabilities and equity:			
Long-term debt	397,765	-	397,765
Notes payable-other	-	-	-
Accounts payable and accrued expenses	-	329	329
		-	
Total liabilities	397,765	329	398,094
Net stockholders' equity (deficit)	$ (262,244)	$ 5,462	$ (256,782)

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, and majority-owned subsidiaries, Performance Real Estate, Inc., and Polaris Home Loans, LLC. Polaris Home Loans, LLC ceased operations during 2022. 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, 2022 consist of the following:

Cash and cash equivalents	$	2,484
Restricted cash		2
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	$	2,486

At December 31, 2022, restricted cash was 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.

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.

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

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, 2022, modifications were done on loans with an aggregate unpaid principal balance of approximately $11.4 million. As of December 31, 2022, the aggregate unpaid principal balance of modified loans was $202.7 million with an accompanying troubled debt restructuring reserve of approximately $103 million. The Company recorded $93,000 of interest capitalized during the loan modification process for the year ended December 31, 2022, however, such amount was fully reserved at December 31, 2022 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, 2022, the average balance of modified loans and the interest income recognized on such loans were approximately $197.7 million and $8.1 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, 2022, the Company held REO properties in its four on balance sheet securitizations valued at $99,000 resulting from foreclosing on loans held for investment.

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.

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

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 2022. Open tax return years are subject to future examination by tax authorities. Federal and state tax returns are open for years 2019 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.

Adoption of New Accounting Standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes existing guidance for accounting for leases under Topic 840, Leases. The FASB also subsequently issued the following additional ASUs, which amend and clarify Topic 842: ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASU 2018-10, Codification Improvements to Topic 842, Leases; ASU 2018-11, Leases (Topic 842): Targeted Improvements; ASU 2018-20, Narrow-scope Improvements for Lessors; and ASU 2019-01, Leases (Topic 842): Codification Improvements. The most significant change in the new leasing guidance is the requirement to recognize right-to-use (ROU) assets and lease liabilities for operating leases on the balance sheet.

The Company adopted these ASUs effective January 1, 2022 and utilized all of the available practical expedients. The adoption had a material impact on the Company's balance sheet but did not have a material impact on the income statement. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases. The accounting for finance leases remained substantially unchanged. Adoption of the standard required the Company to restate amounts as of January 1, 2022, resulting in an increase in operating lease ROU assets of $196,000, an increase in operating lease liabilities of $196,000.

NOTE 2—LOANS HELD FOR INVESTMENT

The components of mortgage loans held for investment at December 31, 2022 were as follows (in thousands):

Unpaid principal balance of mortgage loans	$	253,089
Servicing advances		1,023
Net deferred origination costs and discounts		273
Allowance for loan losses		(119,495)
	$	134,890

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, 2022 (in thousands):

Beginning balance	$	124,881
Reductions		(4,090)
Charge-offs, net		(1,296)
Ending balance	$	119,495

At December 31, 2022, the Company had loans held for investment in its four on balance sheet securitizations valued at $134,640,000. Additionally, as of December 31, 2022, the Company directly held unencumbered loans held for investment valued at $250,000. The aggregate weighted average coupon for loans held for investment at December 31, 2022 was 4.37%.

December 31, 2022, there were loans with an aggregate unpaid principal balance of $17,058,000 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—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, 2022 the prepayment rates used in evaluating cash flows for these fees was 8%. The discount rate used to value such service fee cash flows at December 31, 2022 was 10%. Mortgage servicing rights are classified as Level 3 assets at December 31, 2022.

The following table presents activity related to MSRs for the year ended December 31, 2022:

Fair value, beginning of year	$	1,063
Change in fair value		1,096
Fair value, end of year	$	2,159

Servicing expenses, net of servicing income, is reported in the Consolidated Statements of Operations. For the year ended December 31, 2022, the Company recognized $582,000 of net servicing expenses in the Consolidated Statements of Operations.

NOTE 4—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, 2022.

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, 2022 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	$ 2,159	$ -	$ -	$ 2,159
Total	$ 2,159	$ -	$ -	$ 2,159

NOTE 4—FAIR VALUE MEASUREMENTS (CONTINUED)

The changes in Level 3 assets measured on a recurring basis for the year ended December 31, 2022 are summarized in the following table (in thousands):

	Mortgage Servicing Rights
Beginning balance	$ 1,063
Purchases	-
Sales	-
Total gains or losses for the period	
Included in earnings	1,096
Included in other comprehensive income	-
Transfers into (out of) level 3	-
Ending balance	$ 2,159
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period.	$ 1,096

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, 2022 (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	$ 99,523	$ -	$ -	$ 99,523
Real estate owned	99	-	-	99
Total	$ 99,622	$ -	$ -	$ 99,622

There were no transfers between level 1 and level 2 during the year ended December 31, 2022.

NOTE 4—FAIR VALUE MEASUREMENTS (CONTINUED)

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2022, 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	$	2,159	Third party appraisal	Discounts to reflect estimated future cash flows	Prepayment rates 8%, Discount rate 10%
Impaired Loans	$	99,523	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	$	99	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 70.5% to 101.0%

NOTE 5—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, 2022 was 3.77%. 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, 2022, the balance of long-term debt consists of the following (in thousands):

Securitized bonds	$	396,383
Accrued interest on securitized bonds		1,382
Total financing on mortgage loans held for investment	$	397,765

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, 2022, net of accumulated amortization, was $18,000 and is included in prepaid expenses and other assets.

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 $191.8 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, 2022. 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 6 – RELATED PARTY

On November 19, 2021, Polaris Home Loans, LLC entered into a promissory note agreement with a third-party, 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. During 2022, Polaris Home Loans, LLC borrowed a total of $2,300,000 under the note agreement. After Polaris Home Loans, LLC ceased operations, this $2,300,000 was written off as gain on extinguishment of debt and recorded as gain from disposal of discontinued operations in the Consolidated Statements of Operations.

NOTE 7—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, 2022 (in thousands):

Income tax expense (benefit):		
Current tax expense (benefit)		
Federal	$	-
State		6
Deferred tax (benefit)		
Federal		1,525
State		(9,400)
Change in valuation allowance		7,875
	$	6

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, 2022 are as follows (in thousands):

Deferred tax assets/(liabilities):		
Net operating loss carryforward	$	94,247
Residual interests		1166
Servicing rights		(304)
Bad debt reserve		(347)
Other		(1)
Total deferred tax asset		94,761
Deferred tax asset valuation allowance		(94,761)
Net deferred tax asset	$	-

For the year ended December 31, 2022, the effective tax rate approximated the federal statutory rate of 21%.

As of December 31, 2022, the Company has approximately $340 million in estimated federal net operating loss carryforwards and a total of $549 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.

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 $94.8 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 8—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, 2022 was $451,000 and is included in prepaid expenses and other assets on the Consolidated Balance Sheet.

NOTE 9—LEASE

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 the initial August 14, 2021, maturity date. On July 26, 2021, the Company entered into a first amendment of the lease to exercise an option to extend the term of the lease for a 36 month 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.

The Company has elected to apply the short-term lease exception to all leases with a term of one year or less.

The following summarizes the line items in the consolidated balance sheet which include amounts for operating leases as of December 31:

Leases (in thousands)	Classification		2022
Assets			
Operating	Prepaid expense and other assets	$	123
Total operating lease assets		$	123
Liabilities			
Operating	Accounts payable and accrued expenses	$	125
Total operating lease liabilities		$	125

Note: As the lease does not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments.

The following summarizes the line items in statements of income which include the components of lease expense for the year ended December 31 (in thousands):

		2022
Operating lease, included in operating expenses	$	139
Short-term lease, included in operating expenses		58
Short-term leases, included in loss from operations of discontinued operations		282
Total lease costs	$	479

The following summarizes cash flow information related to lease for the year ended December 31 (in thousands):

		2022
Cash paid for amoutns included in the measurement of lease liabilities:		
Operaring cash flows from operating lease	$	71
Lease assets obtained in exchange for lease obligations:		
Operaring lease	$	196

NOTE 7 – LEASE (CONTINUED)

The following summarizes the weighted average remaining lease term and discount rate as of December 31:

		2022
Weighted Average Remaining Lease Term (Years)	$	2
Weighted Average Discount Rate		3.00%

Maturities of operating lease liabilities as of December 31, 2022 (in thousands):

Year Ending December 31		Amount
2023	$	78
2024		50
Total lease payments		128
Less: interest		(3)
Present value of lease liabilities	$	125

NOTE 10 - CONTINGENCIES

Litigation

On June 1, 2021, River City Mortgage, filed a claim against Polaris Home Loans, LLC's president and Polaris Home Loans, LLC under Massachusetts law for various tort and statutory claims. River City Mortgage amended its compliant to add ECC Capital and ECC Capital's president as defendants. Defendants denied all claims and in addition, Polaris Home Loans, LLC filed counterclaims against River City Mortgage and its president, alleging various tort and statutory claims. Prior to the completion of discovery, and without any determination of fault as to either side, this matter was resolved and dismissed with prejudice on December 29, 2022.

NOTE 11 – DISCONTINUED OPERATIONS

During September 2022, the Company decided to cease operation of Polaris Home Loans, LLC. The Company's financial statements have been prepared with this business displayed separately as "discontinued operations." The operating results of the discontinued operations are summarized as follows for the fiscal year ending December 31 (in thousands):

		2022
Revenue		
Interest income	$	120
Interest expense		219
Net interet income		(99)
Gain on origination and sale of loans		4,039
Fair value adjustment- loans held for sale		(88)
Net revenue		3,852
Expenses		
Operating expenses		9,475
Total expenses		9,475
Other income		4
Loss before tax provision		(5,619)
Tax provision		-
Loss from operations of discontinued operations		(5,619)
Gain from disposal of discontinued operations (net of tax of $0)		1,890
Net loss from discontinued operations	$	(3,729)

As of December 31, 2022, the Company's remaining assets and liabilities related to discontinued operations were as follows (in thousands):

Cash	$	6
Security deposits		27
Liabilities		-
Net assets of discontinued operations	$	33

NOTE 12 – SUBSEQUENT EVENTS

Subsequent events have been evaluated through April 25, 2023, which is the date the financial statements were available to be issued.

On January 31, 2023, subsequent to the year ended December 31, 2022, the Company entered into an agreement to sublease Polaris Home Loans, LLC's Massachusetts office commencing on February 1, 2023. The lease requires fixed monthly payments of approximately $8,250. The lease expires December 30, 2023.

On February 16, 2023, subsequent to the year ended December 31, 2022, the Company completed a loan sale consisting of the entire portfolio of performing second lien mortgages on an "AS IS" basis. Total proceeds of this sale were $380,859 while these loans had net book value of $100,559 on the Company's December 31, 2022 consolidated balance sheet.