Consolidated Financial Statements and
Independent Auditor's Report

ECC Capital Corporation and Subsidiaries

Year Ended December 31, 2023

ECC Capital Corporation and Subsidiaries

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Rogers & ASSOCIATES, LLC
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

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, 2023, 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, 2023, 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 24, 2024

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ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
December 31, 2023
(in thousands, except share data)

ASSETS

Cash and cash equivalents	$	2,005
Restricted cash		2
Mortgage loans held for investment, net		221,799
Accrued mortgage loan interest		721
Mortgage servicing rights		2,063
Real estate owned		109
Prepaid expenses and other assets		636
Total assets	$	227,335

LIABILITIES AND STOCKHOLDERS' DEFICIT

Liabilities:		
Long-term debt	$	380,215
Accounts payable and accrued expenses		267
Total liabilities		380,482
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		(532,139)
Total stockholders' deficit		(153,147)
Total liabilities and stockholders' deficit	$	227,335

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
For the year ended December 31, 2023
(in thousands)

Revenue	
Interest income	$ 8,439
Interest expense	(7,840)
Net interest income	599
Provision for loan losses	(105,835)
Net income, after provision for loan losses	106,434
Change in value of mortgage servicing rights	(97)
Net revenues	106,337
Expenses	
Operating expenses	1,788
Loss on sale of real estate owned	716
Servicing fees, net	533
Total expenses	3,037
Other income	348
Income before tax provision	103,648
Tax provision	12
Net income	$ 103,636

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT
For the year ended December 31, 2023
(in thousands)

	Number of Common Shares Outstanding	Common Stock	Additional Paid In Capital	Minority Interest	Accumulated Deficit	Total
Balance December 31, 2022	97,073	$107	$378,885	$0	$(635,774)	$(256,782)
Net income					103,636	103,636
Dividends					(1)	(1)
Balance September 30, 2023	97,073	107	378,885	$0	(532,139)	(153,147)

See notes to the consolidated financial statements

ECC CAPITAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended December 31, 2023
(in thousands)

Cash Flows from Operating Activities:	
Net income	$ 103,636
Adjustments to Net income to Net Cash used in Operating Activities:	
Changes in operating assets and liabilities	
Provision for loan losses	(105,835)
Depreciation and amortization	241
Gain on sale of loans held for investment	(281)
Change in value of mortgage servicing rights	96
Accrued interest	44
Accrued expenses	(62)
Prepaids and other assets	277
Net cash used by operating activities	(1,884)
Cash Flows from Investing Activities:	
Proceeds from sale of mortgage loans held for investment	381
Amortization and payoff of mortgage loans held for investment	16,835
Net proceeds from sale of REO	1,740
Net cash provided by investing activities	18,956
Cash Flows from Financing Activities:	
Dividends paid	(1)
Payments on long-term debt	(17,550)
Net cash used by financing activities	(17,551)
Cash and equivalents-Beginning of Year	2,486
Net decrease in cash and equivalents	(479)
Cash and equivalents-End of Period	$ 2,007
	-
Supplemental disclosure of cash flow information:	
Cash used to pay interest	$ 7,831
Cash used to pay income taxes	$ 12
Supplemental disclosure of non-cash investing and financing activities:	
Loans transferred to real estate owned due to foreclosure	$ 930

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, 2023 (in thousands):

	Securitization trusts	Non-trust entities	Company total
Assets:			
Cash and cash equivalents	$ -	$ 2,005	$ 2,005
Restricted cash	2	-	2
Mortgage loans held for investment, net	221,651	148	221,799
Accrued mortgage loan interest	714	7	721
Mortgage servicing rights	-	2,063	2,063
Real estate owned	109	-	109
Prepaid expenses and other assets	9	627	636
Total assets	222,485	4,850	227,335
Liabilities and equity:			
Long-term debt	380,215	-	380,215
Accounts payable and accrued expenses	-	267	267
Total liabilities	380,215	267	380,482
Net stockholders' equity (deficit)	$ (157,730)	$ 4,583	$ (153,147)

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. 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, 2023 consist of the following (in thousands):

Cash and cash equivalents	$	2,005
Restricted cash		2
Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	$	2,007

At December 31, 2023, 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 credit 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 Credit Losses on Mortgage Loans Held for Investment

Beginning January 1, 2023, the allowance for credit losses incorporates an estimate of lifetime expected credit losses and is recorded on each asset origination or acquisition. Adjustments to the allowance each period for changes in our estimate of lifetime expected credit losses are recognized in earnings through the provision for credit losses presented on our Consolidated Statement of Operations. The Company charges off uncollectible loans at the time of liquidation.

We estimate our allowance for lifetime expected credit losses for our loan portfolio using a probability of default/loss given default methodology. Our allowance for credit losses consists of a collective allowance and an asset-specific allowance. The collective allowance is established for loans in our portfolio that share similar risk characteristics and are therefore evaluated on a collective, or pool, basis in measuring expected credit losses. The asset-specific allowance is established for loans in our portfolio that do not share similar risk characteristics with other loans in our portfolio and are therefore evaluated on an individual basis in measuring expected credit losses. 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. Expected credit losses are estimated based on historical experience, current conditions and forecasts, if applicable, that affect the collectability of the reported amount.

At December 31, 2023, total accrued interest receivable on loans, which has been excluded from reported amortized cost basis on loans, was approximately $721,000, and included in accrued mortgage loan interest on the Consolidated Balance Sheet. Accrued mortgage loan interest represents, for the most part, the current month's interest, which will be included as a part of the borrower's next monthly loan payment. Interest receivable is accrued only if deemed collectible. Accrued interest is reversed or charged off in a timely manner in line with our non-accrual and past due policies for loans. An allowance was not carried on the accrued interest receivable.

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, 2023, the Company held REO properties in its four on balance sheet securitizations valued at $109,000 resulting from foreclosing on loans held for investment.

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.

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

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 2023. Open tax return years are subject to future examination by tax authorities. Federal and state tax returns are open for years 2020 and after.

<u>Concentrations of Credit Risk</u>

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.

<u>Adoption of New Accounting Standards</u>

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13" or "ASC 326"). ASU 2016-13 revises the accounting requirements related to the measurement of credit losses and requires organizations to measure all expected credit losses for financial assets based on historical experience, current conditions, and reasonable and supportable forecasts about collectability. Assets must be presented in the financial statements at the net amount expected to be collected. During 2019, the FASB issued additional ASUs amending certain aspects of ASU 2016-13.

On March 31, 2022, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2022-02, Financial Instruments–Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures. The amendments in this Update eliminate the troubled debt restructurings (TDRs) recognition and measurement guidance and, instead, require that an entity evaluate (consistent with the accounting for other loan modifications) whether the modification represents a new loan or a continuation of an existing loan. The amendments enhance the disclosure requirements for certain modifications of receivables made to borrowers experiencing financial difficulty.

On January 1, 2023, the Company adopted the above accounting standards and all of the related amendments prospectively. Adoption of the updated TDR accounting standards combined with management loss allowance estimates noted above resulted in a significant decrease in the allowance for credit losses on mortgage loans held for investment on the Consolidated Balance Sheet as of December 31, 2023, and as recorded in provision for loan losses on the Consolidated Statement of Operations for the year ended December 31, 2023.

NOTE 2—LOANS HELD FOR INVESTMENT

The components of mortgage loans held for investment at December 31, 2023 were as follows (in thousands):

Unpaid principal balance of mortgage loans	$	233,470
Servicing advances		1,084
Net deferred origination costs and discounts		565
Allowance for loan losses		(13,320)
	$	221,799

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, 2023 (in thousands):

Beginning balance	$	119,495
Reductions		(105,135)
Charge-offs, net		(1,041)
Ending balance	$	13,320

At December 31, 20232, the Company had loans held for investment in its four on balance sheet securitizations valued at $221,650,000. Additionally, as of December 31, 2023, the Company directly held unencumbered loans held for investment valued at $149,000. The aggregate weighted average coupon for loans held for investment at December 31, 2023 was 4.38%.

All non-accrual loans were associated with the four on balance sheet securitization trusts. The following table provides the amortized cost of loans on nonaccrual status and past due over 90 days still on accrual (in thousands).

(Dollars in thousands)	Nonaccrual		Past Due Over 90 Days Still Accruing
	1/1/2023	**12/31/2023**	**12/31/2023**
Residential real estate	$ 17,058	$ 14,226	$ -
Total	$ 17,058	$ 14,226	$ -

There is no interest income recognized on nonaccrual loans during 2023. There is no non-accrual loan for which no allowance for credit losses has been established as of December 31, 2023.

NOTE 3—LOANS MODIFICATIONS MADE TO BORROWERS EXPERIENCING FINANCIAL DIFFICULTY

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 loan modifications made to borrowers experiencing financial difficulty. An assessment of whether a borrower is experiencing financial difficulty is made on the date of modification. Loan modifications made to borrowers experiencing financial difficulty 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. At the current time, almost all modifications are to either capitalize accrued past due interest and occasionally advances for property taxes and insurance, or the deferral of past due interest-bearing principal to bring the loan current without changing the monthly payment or interest rate. The borrower with capitalized accrued past due interest and occasionally advances for property taxes and insurance have had those past due interest and advances for property taxes and insurance deferred to the contractual maturity of their loans. The borrowers with deferral of past due interest-bearing principal have had principal deferred to the earlier of contractual maturity of their loans or loan prepayment payoff in full. Because the effect of most modifications made to borrowers experiencing financial difficulty is already included in the allowance for loan losses because of the measurement methodologies used to estimate the allowance, a change to the allowance for loan losses is generally not recorded upon modification.

NOTE 3—LOANS MODIFICATIONS MADE TO BORROWERS EXPERIENCING FINANCIAL DIFFICULTY (CONTINUED)

The following table shows the amortized cost of loans at December 31, 2023, that were both experiencing financial difficulty and modified during the year ended December 31, 2023, segregated by portfolio segment and type of modification. The percentage of the amortized cost of loans that were modified to borrowers in financial distress as compared to the amortized cost of each segment of financial receivable is also presented below (dollars in thousands).

(Dollars in thousands)	Capitalize Accrued Past Due Interest and Occasionally Advances for Property Taxes and Insurance	% of Total Segment of Financing Receivable
Residential real estate	$ 3,178	1.36%
Total	$ 3,178	1.36%

(Dollars in thousands)	Deferral of Past Due Interest-Bearing Principal	% of Total Segment of Financing Receivable
Residential real estate	$ 8,643	3.69%
Total	$ 8,643	3.69%

There were no commitments to lend additional amounts to the borrowers included in the previous table.

Company closely monitors the performance of loans that have been modified to borrowers experiencing financial difficulty to understand the effectiveness of its modification efforts. The following table shows the performance of such loans that have been modified during the year ended December 31, 2023 (in thousands).

(Dollars in thousands)	Current	Greater Than 90 Days Past Due
Residential real estate	$ 10,936	$ 885
Total	$ 10,936	$ 885

Upon the Company's determination that a modified loan has subsequently been deemed uncollectible, the loan is written off. Therefore, the amortized cost of the loan is reduced by the uncollectible amount and the allowance for loan losses is adjusted by the same amount.

There is no financing receivable which experienced a payment default during the period and had been modified within the prior 12 months preceding the default when the borrower was experiencing financial difficulty at the time of the modification.

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, 2023 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, 2023 was 10%. Mortgage servicing rights are classified as Level 3 assets at December 31, 2023.

The following table presents activity related to MSRs for the year ended December 31, 2023 (in thousands):

Fair value, beginning of year	$	2,159
Change in fair value		(96)
Fair value, end of year	$	2,063

Servicing expenses, net of servicing income, is reported in the Consolidated Statements of Operations. For the year ended December 31, 2023, the Company recognized $533,000 of net servicing expenses in the Consolidated Statements of Operations.

NOTE 5—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, 2023.

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 5—FAIR VALUE MEASUREMENTS (CONTINUED)

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 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, 2023 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	$ 2,063	$ -	$ -	$ 2,063
Total	$ 2,063	$ -	$ -	$ 2,063

The changes in Level 3 assets measured on a recurring basis for the year ended December 31, 2023 are summarized in the following table (in thousands):

	Mortgage Servicing Rights
Beginning balance	$ 2,159
Purchases	-
Sales	-
Total gains or losses for the period	
Included in earnings	(96)
Included in other comprehensive income	-
Transfers into (out of) level 3	-
Ending balance	$ 2,063
Change in unrealized gains or losses for the period included in earnings for assets held at the end of the reporting period.	$ (96)

NOTE 5—FAIR VALUE MEASUREMENTS (CONTINUED)

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, 2023 (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)
Real estate owned	$ 109	$ -	$ -	$ 109
Total	$ 109	$ -	$ -	$ 109

There were no transfers between level 1 and level 2 during the year ended December 31, 2023.

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2023, the significant unobservable inputs used in the fair value measurements were as follows:

(Dollars in thousands)	Fair Value at December 31, 2023	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Mortgage Servicing Rights	$ 2,063	Third party appraisal	Discounts to reflect estimated future cash flows	Prepayment rates 8%, Discount rate 10%
Real estate owned	$ 109	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 69.7% to 89.1%

NOTE 6—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, 2023 was 4.07%. 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, 2023, the balance of long-term debt consists of the following (in thousands):

Securitized bonds	$ 378,469
Accrued interest on securitized bonds	1,746
Total financing on mortgage loans held for investment	$ 380,215

NOTE 6—LONG-TERM DEBT (CONTINUED)

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, 2023, net of accumulated amortization, was $9,000 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 $190.0 million in losses through to bondholders of certain subordinate security classes and reduced the amount showing as outstanding for such classes as of December 31, 2023. 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 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, 2023 (in thousands):

Income tax expense (benefit):		
Current tax expense (benefit)		
Federal	$	-
State		12
Deferred tax (benefit)		
Federal		7,300
State		9,016
Change in valuation allowance		(16,316)
	$	12

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, 2023 are as follows (in thousands):

Deferred tax assets/(liabilities):		
Net operating loss carryforward	$	87,296
Residual interests		0
Servicing rights		25
Bad debt reserve		(8,875)
Other		(2)
Total deferred tax asset		78,444
Deferred tax asset valuation allowance		(78,444)
Net deferred tax asset	$	-

For the year ended December 31, 2023, the effective tax rate approximated the federal statutory rate of 21%.

As of December 31, 2023, the Company has approximately $342 million in estimated federal net operating loss carryforwards and a total of $558 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.

NOTE 7—INCOME TAXES (CONTINUED)

The Company is required to record a valuation allowance to reduce its deferred tax assets to the amount that it believes is more likely than not to be realized. In assessing the need for a valuation allowance, the Company considered all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial performance. As a result of the operating losses of the Company in the current and prior years, management concluded that a full valuation allowance of $78.4 million, against the deferred tax asset 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, 2023 was $425,000 and is included in prepaid expenses and other assets on the Consolidated Balance Sheet. On April 18, 2024, subsequent to the year ended December 31, 2023, the Company opted to terminate the COLI and received cash surrender value proceeds of $419,000.

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 (in thousands):

Leases (in thousands)	**Classification**		**2023**
Assets			
Operating	Prepaid expense and other assets	$	48
Total operating lease assets		$	48
Liabilities			
Operating	Accounts payable and accrued expenses	$	49
Total operating lease liabilities		$	49

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):

		2023
Operating lease, included in operating expenses	$	115
Short-term lease, included in operating expenses		171
Total lease cost	$	286

NOTE 9 – LEASE (CONTINUED)

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

		2023
Cash paid for amoutns included in the measurement of lease liabilities:		
Operaring cash flows from operating lease	$	76
Lease assets obtained in exchange for lease obligations:		
Operaring lease	$	-

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

	2023
Weighted Average Remaining Lease Term (Years)	1
Weighted Average Discount Rate	3.00%

Maturities of operating lease liabilities as of December 31, 2023 (in thousands):

Year Ending December 31		**Amount**
2024	$	50
Less: interest		(1)
Present value of lease liabilities	$	49

NOTE 10 – SUBSEQUENT EVENTS

On April 9, 2024, subsequent to year ended December 31, 2023, PhenixFIN Corporation ("PhenixFIN") has acquired 84,000,000 newly issued shares, representing approximately 44% of the outstanding shares of the Company, for $0.05 per share.

As part of the aforementioned transaction with PhenixFIN, the Company acquired from PhenixFIN 100% of the membership units of Kemmerer Holdings, LLC ("Kemmerer") and indirectly acquired its wholly-owned subsidiary, Kemmerer Operations, LLC. Kemmerer Operations, LLC, located in Kemmerer, Wyoming, runs an open pit mine that produces sub-bituminous coal for electrical generation and industrial uses.

Additionally, PhenixFIN provided senior secured seller take-back $34 million debt financing to the Company as consideration for the Company's acquisition of Kemmerer. Interest on this promissory note is accrued at a variable rate per annum equal to the sum of the applicable three-month term SOFR rate plus 500 basis points. The unpaid principal balance of this note shall be due and payable from the excess cash flow according to the senior secured promissory note agreement. The note matures December 31, 2031, without regard to cash flows and is secured by substantially all assets of the Company. As contemplated and as a part of the transaction, on April 10th, 2024 the Company paid down the financing balance by $12.7 million leaving a current outstanding balance of $21.3 million.

Subsequent events have been evaluated through April 24, 2024, which is the date the financial statements were available to be issued.