

**BLACKBURNE & SONS REALTY CAPITAL  
CORPORATION AND AFFILIATE  
FINANCIAL STATEMENTS  
SEPTEMBER 30, 2018 AND 2017**

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

Financial Statements  
September 30, 2018 and 2017

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3005 Douglas Blvd., Ste. 115

Roseville, CA 95661

(916) 774-1040

(916) 774-1177 Fax

## INDEPENDENT AUDITOR'S REPORT

To the Boards of Directors  
Blackburne & Sons Realty Capital Corporation  
and Affiliate  
Sacramento, CA

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Blackburne & Sons Realty Capital Corporation and Affiliate which comprise the balance sheets as of September 30, 2018 and 2017, and the related statements of income and retained earnings and cash flows for the years then ended, and the related notes to the financial statements.

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

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

### **Auditor's Responsibility**

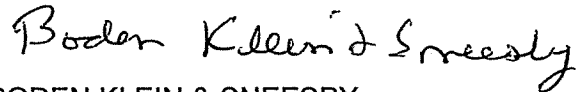
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about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

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

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

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Blackburne & Sons Realty Capital Corporation and Affiliate as of September 30, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "Boden Klein & Sneesby".

BODEN KLEIN & SNEESBY  
Certified Public Accountants  
Roseville, California

December 21, 2018

## BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

### Balance Sheets

September 30, 2018 and 2017

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#### ASSETS

	<u>2018</u>	<u>2017</u>
Current assets:		
Cash	\$ 5,778	\$ 5,067
Mortgage servicing rights	582,030	729,324
Prepaid expenses	10,580	5,958
Prepaid income taxes	4,494	3,667
Other receivables	<u>116,195</u>	<u>14,962</u>
Total current assets	<u>719,077</u>	<u>758,978</u>
Property and equipment, net	<u>21,251</u>	<u>15,652</u>
Other assets:		
Investment in partnerships	159,625	103,388
Intangible asset, net	65,652	74,152
Mortgage servicing rights - net of current portion	<u>557,210</u>	<u>689,823</u>
Total other assets	<u>782,487</u>	<u>867,363</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 1,522,815</u></b>	<b><u>\$ 1,641,993</u></b>
Borrower and investor custodial accounts	<u>\$ 1,448,926</u>	<u>\$ 1,894,368</u>
(segregated in special accounts - excluded from corporate assets)		

See notes to financial statements.

**BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE**

Balance Sheets

September 30, 2018 and 2017

**LIABILITIES AND STOCKHOLDERS' EQUITY**

	<u>2018</u>	<u>2017</u>
Current liabilities:		
Accounts payable	\$ 45,609	\$ 73,721
Accrued expenses	33,468	32,015
Lease payable	2,964	-
Shareholder note payable	160,048	152,250
Line of credit	<u>76,000</u>	<u>-</u>
Total current liabilities	<u>318,089</u>	<u>257,986</u>
Non-current liabilities:		
Lease payable, net of current portion	4,470	-
Deferred income taxes	<u>310,925</u>	<u>296,798</u>
Total non-current liabilities	<u>315,395</u>	<u>296,798</u>
Total liabilities	<u>633,484</u>	<u>554,784</u>
Stockholders' equity:		
Common stock - no par value, authorized, issued and outstanding, 100 shares	312	312
Additional paid-in capital	100	100
Retained earnings	<u>888,919</u>	<u>1,086,797</u>
Total stockholders' equity	<u>889,331</u>	<u>1,087,209</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$ 1,522,815</u></b>	<b><u>\$ 1,641,993</u></b>
 Borrower and investor custodial accounts (segregated in special accounts - excluded from corporate assets)	 <u>\$ 1,448,926</u>	 <u>\$ 1,894,368</u>

See notes to financial statements.

**BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE**

Statements of Income and Retained Earnings  
For the Years Ended September 30, 2018 and 2017

Revenues:	2018	2017
Servicing fees	\$ 1,049,171	\$ 991,216
Loan commissions	351,616	529,658
Property management fees	154,679	115,818
Software licensing fees	122,260	106,661
Fund management fees	128,586	56,320
Video and manual sales	20,589	36,091
Amortization of mortgage servicing rights	<u>(279,907)</u>	<u>(35,989)</u>
Total revenue	<u>1,546,994</u>	<u>1,799,775</u>
Expenses:		
Salaries	697,832	776,923
Salaries - George Blackburne	250,488	250,488
Salaries - Francisca Blackburne	53,328	53,328
Marketing	110,071	117,083
Other expenses	102,692	93,121
Payroll taxes	71,110	75,730
Outside consultants	67,406	90,303
Insurance	59,602	48,957
Employee benefits	45,818	73,893
Office expense	35,395	29,530
Office rent	34,456	38,256
Telephone and utilities	32,529	22,338
Legal	29,601	55,287
Retirement plan contributions	39,168	42,064
Automobile	19,332	17,917
Tax and license	16,637	35,836
Loan arrangement fees	16,649	15,096
Accounting	16,473	17,969
Depreciation	13,424	13,347
Maintenance and repairs	10,479	14,295
Education	5,386	6,980
Travel	4,488	12,883
Equipment lease	4,447	3,556
Unrecovered costs	<u>-</u>	<u>4,838</u>
Total expenses	<u>1,736,811</u>	<u>1,910,018</u>
(Loss) from operations	<u>(189,817)</u>	<u>(110,243)</u>

See notes to financial statements.

**BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE**

Statements of Income and Retained Earnings  
For the Years Ended September 30, 2018 and 2017

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	<u>2018</u>	<u>2017</u>
(Loss) from operations (continued)	\$ (189,817)	\$ (110,243)
Other income (expense):		
Interest expense	(10,946)	(8,493)
Income (loss) from partnerships	1,237	(4,688)
Other fees and income	<u>17,375</u>	<u>20,043</u>
Total other income (expense)	<u>7,666</u>	<u>6,862</u>
(Loss) before income taxes	(182,151)	(103,381)
Income tax expense (benefit)	<u>15,727</u>	<u>(15,544)</u>
<b>NET (LOSS)</b>	(197,878)	(87,837)
Retained earnings, beginning of year	<u>1,086,797</u>	<u>1,174,634</u>
<b>RETAINED EARNINGS, END OF YEAR</b>	<u>\$ 888,919</u>	<u>\$ 1,086,797</u>

See notes to financial statements.



**BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE**

Statements of Cash Flows

For the Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Net (loss)	\$ (197,878)	\$ (87,837)
Adjustments to reconcile net (loss) to net cash (used) in operating activities:		
Depreciation	13,424	13,347
Amortization & impairment of mortgage servicing rights	789,339	814,226
Additions to mortgage servicing rights	(509,432)	(778,237)
Accrued interest, shareholder note payable	7,798	
(Income) loss from partnerships	(1,237)	4,688
Deferred income taxes	14,127	(19,992)
Changes in operating assets and liabilities:		
Prepaid expenses	(4,622)	4,327
Prepaid income taxes	(827)	(3,527)
Other receivables	(101,233)	12,033
Accounts payable	(28,112)	73,721
Other payable	-	(64)
Accrued expenses	1,453	(52,076)
Income taxes payable	-	(7,077)
Net cash (used) in operating activities	<u>(17,200)</u>	<u>(26,468)</u>
Cash flows from investing activities:		
Investment in partnership	(55,000)	(44,536)
Purchase of property and equipment	<u>(10,523)</u>	<u>-</u>
Net cash (used) in investing activities	<u>(65,523)</u>	<u>(44,536)</u>
Cash flows from financing activities:		
Advances on line of credit	874,500	760,500
(Payments) on line of credit	(798,500)	(843,000)
Capital lease financing	7,434	-
Proceeds from note payable	<u>-</u>	<u>152,250</u>
Net cash provided by financing activities	<u>83,434</u>	<u>69,750</u>
Net increase (decrease) in cash	711	(1,254)
Cash, beginning of year	<u>5,067</u>	<u>6,321</u>
<b>CASH, END OF YEAR</b>	<u><b>\$ 5,778</b></u>	<u><b>\$ 5,067</b></u>

See notes to financial statements.

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

Notes to Financial Statements  
September 30, 2018 and 2017

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## NOTE 1 - STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES:

a. Organization -

Blackburne & Sons Realty Capital Corporation (formerly Blackburne & Brown Mortgage Company, Inc.) (the Company) was incorporated in 1980 in the state of California. The Company is engaged in the origination and servicing of real estate loans secured by deeds of trust throughout the United States.

b. Principles of consolidation -

The consolidated financial statements include the accounts of Blackburne & Sons Realty Capital Corporation and its affiliate, C-Loans, Incorporated. All material inter-company transactions have been eliminated in consolidation.

c. Standards of reporting -

The Company prepares its financial statements using the accrual method of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Loan servicing and origination revenue represents fees earned for servicing and originating mortgage loans. Servicing and origination revenue is recognized as earned, unless collection is doubtful.

d. Use of estimates -

In preparing financial statements in conformity with generally accepted accounting principles, management must make estimates based on future events that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

e. Financial instruments -

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate their fair values.

f. Cash equivalents -

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

g. Mortgage servicing rights, amortization and impairment -

The Company recognizes as separate assets the rights to service mortgage loans for others based on their relative fair values. Amortization of mortgage servicing rights (MSRs) is based on the ratio of net servicing income received in the current period to total net servicing income projected to be realized from the MSRs. Projected net servicing income is in turn determined

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

## Notes to Financial Statements September 30, 2018 and 2017

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on the basis of the estimated future balance of the underlying mortgage loan portfolio, which declines over time from prepayments and scheduled loan amortization. The Company estimates future prepayment rates based on current interest rate levels, other economic conditions and market forecasts, as well as relevant characteristics of the servicing portfolio, such as loan types, interest rate stratification and recent prepayment experience. MSRs are periodically assessed for impairment, which is recognized in the statement of income during the period in which impairment occurs as an adjustment to the corresponding valuation allowance. For purpose of performing its impairment evaluation, the Company analyzes its portfolio on the basis of certain risk characteristics including loan type and note rate.

### h. Property and equipment -

Property and equipment are stated at cost. The policy of the Company is to provide for depreciation over the estimated useful lives of the assets using the straight line method. The estimated useful lives range from five to seven years.

Maintenance and repairs are charged to expense when incurred. Expenditures for additions and improvements, where significant in amount, are capitalized.

### i. Income taxes -

The Company accounts for income taxes under generally accepted accounting principles, which require recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax assets and liabilities result from temporary differences in reporting for tax purposes and financial purposes. Deferred tax assets and liabilities are identified separately as current or noncurrent based on the classification of the related asset or liability. A deferred tax asset or liability not associated with an asset or liability for financial reporting purposes is classified as current or noncurrent according to the expected reversal date of the temporary difference.

The Company adopted accounting for uncertainty in income taxes and thereafter recognizes the tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. There was no impact to the Company's financial statements as a result of the implementation of this principle.

The Company files tax returns in the United States federal jurisdiction and in the state of California. The Organization's federal income tax returns for the tax years 2014 and forward remain subject to examination by the Internal Revenue Service. The Company's California income tax returns for the years 2013 and forward remain subject to examination by the Franchise Tax Board.

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

Notes to Financial Statements  
September 30, 2018 and 2017

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j. Advertising -

The Company's policy is to expense advertising costs as they are incurred.

k. Borrower and investor custodial accounts -

Borrower and investor custodial accounts consists of trust fund cash accounts which are segregated from other corporate assets and maintained by the Company in accordance with Sections 2830 and 2834 of the Regulations of the California Real Estate Commissioner.

## NOTE 2 - PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

	2018	2017
Furniture and fixtures	\$ 37,674	\$ 37,674
Equipment	49,447	38,924
Computer equipment	19,028	19,028
Vehicles	51,005	51,005
Software	55,832	55,832
Total	<u>212,986</u>	<u>202,463</u>
Less: accumulated depreciation	<u>191,735</u>	<u>186,811</u>
Net property and equipment	<u>\$ 21,251</u>	<u>\$ 15,652</u>

## NOTE 3 - INTANGIBLE ASSET:

Intangible asset consists of internet domain names with a cost of \$127,500. Management reviews the intangible asset for impairment annually. Impairment losses are recorded in other expense on the income statement.

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

Notes to Financial Statements  
September 30, 2018 and 2017

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## NOTE 4 - MORTGAGE SERVICING RIGHTS:

The activity in MSR's was as follows:

	2018	2017
Balance at beginning of period	\$ 1,419,147	\$ 1,455,136
Additions	509,432	778,237
Scheduled amortization & reduction due to early loan payoffs	(789,339)	(814,226)
Reserve for impairment	-	-
Mortgage servicing rights, net	<u>\$ 1,139,240</u>	<u>\$ 1,419,147</u>

The estimated fair value of recognized MSR's for the years ended September 30, 2018 and 2017 was \$1,139,240 and \$1,419,147, respectively. The fair value was determined by discounting estimated net future cash flows from mortgage servicing activities using appropriate discount and prepayment rates. The gross amount of expected future servicing revenue (net of related servicing costs) before applicable discounting for the years ending September 30, 2018 and 2017 was approximately \$1,707,393 and \$2,015,424, respectively.

## NOTE 5 - LINE OF CREDIT:

The Company has a \$150,000 available line of credit with First Northern Bank, which is due May 5, 2019. Interest is payable monthly at the bank's base commercial loan rate (6.75% at September 30, 2018) plus 1.25 percent. The line is secured by receivables and equipment of the Company.

## NOTE 6 - SHAREHOLDER NOTE PAYABLE

The Company has an unsecured note payable in the amount of \$160,048 and \$152,250 at September 30, 2018 and 2017, respectively, to the principal officer and sole shareholder of the Company. The note was originally due on July 9, 2018, but the due date has been extended to July 9, 2019 with interest at 8%. The Company accrued \$7,798 and \$2,250 of interest expense for the years ended September 30, 2018 and 2017, respectively.

## NOTE 7 - TRANSACTIONS WITH RELATED PARTY:

During the years ended September 30, 2018 and 2017, the Company received servicing revenue of \$20,098 and \$38,828, respectively, and collected management fees, including shared expenses, in the amount of \$41,000 and \$45,000, respectively from Blackburne & Brown Mortgage Fund I (the Fund). The Fund is a California limited partnership, whose general partner is the Company. The Company's capital balance with the fund was \$50,786 and \$51,185 at September 30, 2018 and 2017, respectively, and is included on the balance sheet as Investment in Partnerships.

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

## Notes to Financial Statements September 30, 2018 and 2017

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The Company has an ownership interest in Blackburne & Brown Mortgage Fund II (Fund II), a California limited partnership, and provides various management services to Fund II. The Company collected management fees in the amount of \$15,500 and \$11,320 for the years ended September 30, 2018 and 2017, respectively. Additionally, the Company received \$28,622 in mortgage servicing fees from Fund II for the year ended September 30, 2018. Servicing fees for the year ended September 30, 2017 were waived. The Company's capital balance with Fund II was \$67,947 and \$66,311 at September 30, 2018 and 2017, respectively, and is included on the balance sheet as Investment in Partnerships.

The Company has a profits and loss interest in Blackburne & Brown Equity Preservation Fund, LLC (LLC), manages the LLC and receives various fees for services performed. The Company received \$16,080 in management fees for the year ended September 30, 2018 and no management fees for the year ended September 30, 2017 from the LLC.

### NOTE 8 - INCOME TAX EXPENSE (BENEFIT):

The components of deferred tax liabilities (assets) at September 30, 2018 and 2017 are as follows:

	2018	2017
Mortgage servicing rights	\$ 339,949	\$ 338,324
Receivables	28,494	1,995
Depreciation and amortization	5,003	2,664
Accounts payable and accrued expenses	(21,961)	(20,262)
State taxes	(20,795)	(17,481)
Net operating loss	(19,765)	(8,442)
	<hr/>	<hr/>
Net deferred tax liability	\$ 310,925	\$ 296,798

The provision for income tax expense (benefit) consists of the following components:

	2018	2017
Current		
Federal	\$ -	\$ 2,848
State	1,600	1,600
	<hr/>	<hr/>
Total current	1,600	4,448
Deferred		
Federal	9,860	(12,142)
State	4,267	(7,850)
	<hr/>	<hr/>
Total deferred	14,127	(19,992)
	<hr/>	<hr/>
Total income tax expense (benefit)	\$ 15,727	\$ (15,544)

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

## Notes to Financial Statements September 30, 2018 and 2017

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Deferred income taxes are recognized for tax consequences of "temporary differences" by applying enacted statutory rates, applicable to future years, to differences between the financial reporting and the tax basis of existing assets and liabilities. The tax effects of temporary differences that give rise to the deferred tax liability results from the use of accelerated methods of depreciation of property and equipment and the cash basis of accounting for tax purposes.

During the current year, the Company adopted ASU 2015-17 which relates to the balance sheet classification of deferred taxes. This change has been applied retrospectively. Also, during the current year, the tax rate applied in determining deferred tax assets and liabilities changed as a result of recent federal tax rates changes. The change of the tax rate on deferred tax assets and liabilities is accounted for in income tax expense.

### NOTE 9 - COMMITMENTS:

#### Operating Lease

The Company leases its main office space under an operating lease with monthly base payments of \$2,899 expiring on December 31, 2020. Additionally, during 2017, the Company leased office space in Indiana under a month to month lease from the Company's sole shareholder, with monthly payments of \$1,200. During 2017, the Company terminated its lease for the Indiana office. Office rent expense was \$34,456 and \$38,256, respectively for the years ended September 30, 2018 and 2017.

The estimated minimum lease commitments for the succeeding years are as follows:

<u>Year Ended September 30,</u>	
2019	\$ 37,059
2020	40,084
2021	<u>10,209</u>
Total	<u>\$ 87,352</u>

#### Capital Lease

During 2018, the Company entered into a capital lease agreement for the purchase of computer equipment. The lease began in January 2018 and requires 36 monthly payments of \$248. The cost of the computer equipment is \$8,921 and is included in the balance sheet as property and equipment. Accumulated amortization of the lease equipment was \$2,104 at September 30, 2018 and is included in depreciation expense.

The minimum lease payments required under the lease are as follows:

<u>Year Ended September 30,</u>	
2019	\$ 2,964
2020	2,964
2021	<u>1,506</u>
Total	<u>\$ 7,434</u>

# BLACKBURNE & SONS REALTY CAPITAL CORPORATION AND AFFILIATE

Notes to Financial Statements  
September 30, 2018 and 2017

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## NOTE 10 - RETIREMENT PLAN:

On October 1, 1993, the Company established a profit sharing plan that covers substantially all employees. The Company may contribute to the plan an amount designated by the Board of Directors to the extent permissible under the Internal Revenue Code. The Company contributed \$10,000 to the plan for each year ended September 30, 2018 and 2017.

On October 1, 2006, the Company adopted a 401(k) defined contribution plan. The plan covers all employees meeting certain eligibility requirements. The Company contributes an amount, (i.e. safe harbor contribution) determined by the Internal Revenue Code. For the years ended September 30, 2018 and 2017, the Company contributed \$29,168 and \$30,169, respectively, to the plan.

## NOTE 11 - CONCENTRATIONS OF CREDIT RISK:

The Company originates and services loans secured by real estate. The Company performs credit evaluations of the potential borrowers and, generally, requires no additional collateral from them.

## NOTE 12 - CASH FLOWS:

For purposes of the statement of cash flows, interest paid by the Company was \$3,148 and \$6,243 for the years ended September 30, 2018 and 2017, respectively. Additionally, the Company paid \$800 and \$15,130 in income taxes for the years ended September 30, 2018 and 2017, respectively.

## NOTE 13 - CONTINGENCIES:

The Company is involved in various lawsuits in the normal course of business. Management cannot predict the outcome of the lawsuits or estimate the amount of any loss that may result. Accordingly, no provision for any contingent liabilities that may result has been made in the financial statements. Management believes that losses resulting from these matters, if any, would be covered under the Company's insurance policy and would not have a material effect on the financial position of the Company.

## NOTE 14 – SUBSEQUENT EVENTS:

Management has evaluated the potential for subsequent events through the available for issuance date of the financial statements, December 21, 2018.