INFINITY PROPERTY & CASUALTY CORP
Form 8-K
February 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d)

of the Securities Act of 1934

Date of Report (Date of earliest event reported): February 13, 2018

INFINITY PROPERTY AND CASUALTY CORPORATION

(Exact name of Registrant as specified in its Charter)

Ohio	000-50167	03-0483872
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

2201 4th Avenue North, Birmingham, Alabama 35203

(Address of Principal Executive Offices) (Zip Code)

(205) 870-4000

Registrant s telephone number, including area code

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act 17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Item 1.01 Entry into a Material Definitive Agreement

(1) *Merger Agreement*

On February 13, 2018, Infinity Property and Casualty Corporation, an Ohio corporation (the Company) entered into a definitive agreement and plan of merger (the Merger Agreement) with Kemper Corporation, a Delaware corporation (Parent) and Vulcan Sub, Inc., an Ohio corporation and a wholly owned subsidiary of Parent (Merger Sub). The Merger Agreement provides that, subject to the satisfaction or waiver of certain conditions set forth therein, Merger Sub will merge with and into the Company in accordance with the Ohio General Corporation Law (the Merger), with the Company surviving such Merger as a wholly owned subsidiary of Parent (such entity, the Surviving Company). The Company expects the closing of the Merger to occur in the third quarter of 2018.

Merger Consideration. Subject to the terms and conditions of the Merger Agreement, at the effective time of the Merger (the Effective Time), each issued and outstanding share of common stock of the Company, no par value per share (the Company Shares) (other than shares held by Parent or any of its wholly owned subsidiaries or the Company or any of its subsidiaries and shares held by any holder of Company Shares who is entitled to demand and properly demands appraisal of such shares under Ohio law), will convert into $51.60 in cash and 1.2019 of a share of validly issued, fully paid and non-assessable shares of Parent common stock (the Merger Consideration). The Merger Agreement also contains an election procedure to allow each Company shareholder to elect to receive for each Company Share either (i) all cash, or $129.00, or (ii) all shares of Parent common stock, or 2.0031 shares, subject to the proration and adjustment procedures set forth in the Merger Agreement.

Company Stock Awards. Pursuant to the Merger Agreement, at the Effective Time, (i) each outstanding award of performance share units with respect to Company Shares granted under any Company stock plan that are outstanding and unvested immediately prior to the Effective Time, shall vest with respect to the target number of Company Shares subject to such award and be converted at the exchange ratio into shares of Parent stock, which generally may not be sold or transferred for one year; (ii) each outstanding award of restricted Company Shares held by any non-employee member of the Company s board of directors granted under any Company stock plan that are outstanding and unvested immediately prior to the Effective Time, shall immediately vest in full and be eligible to receive the Merger Consideration; and (iii) each outstanding award of restricted stock held by any employee of the Company that is outstanding and unvested immediately prior to the Effective Time will be cancelled without any acceleration and in exchange, after the Effective Time, Parent shall grant to such employee a number of restricted stock units determined by multiplying the number of cancelled restricted shares by the exchange ratio,with such restricted stock units vesting in accordance with any applicable award or other agreement between the recipient of such restricted stock units and Parent.

Representations, Warranties, and Covenants. The Merger Agreement contains various representations and warranties from each of the Company, Parent and Merger Sub. The Company has also agreed to various covenants, including but not limited to, using its reasonable best efforts to conduct its business in the ordinary course and not engage in certain types of transactions during the period between the execution of the Merger Agreement and the closing of the Merger. The Company also covenants (1) to cause a shareholder meeting to be held to obtain approval of the Merger by Company shareholders, (2) to not solicit, initiate

or knowingly enter into discussions concerning, or provide confidential information in connection with, alternative transactions, subject to a customary exception that allows the Company under certain circumstances to provide information to and participate in discussions with third parties with respect to unsolicited alternative acquisition proposals that the Company s board of directors has determined in good faith, after consultation with its financial advisors and outside legal counsel, constitutes or would reasonably be expected to lead to a superior proposal, and (3) subject to certain exceptions, that its board of directors will recommend that the shareholders of the Company vote in favor of the approval of the Merger Agreement. However, the Company s board of directors may, subject to certain procedural requirements set forth in the Merger Agreement, change its recommendation to Company shareholders to approve the Merger in respect of (i) a superior proposal, if the board of directors of the Company has determined, after consultation with the Company s financial advisors and outside legal counsel and in accordance with certain notice procedures, that failure to take such action would constitute a breach of the directors fiduciary duties under applicable law or (ii) a material intervening event that first arises or becomes known to the board of directors after the date of the Merger Agreement and prior to receipt of the Company shareholder approval, if the board of directors of the Company has determined in good faith, after consultation with the Company s outside legal counsel, that failure to take such action would constitute a breach of the directors fiduciary duties under applicable law.

Conditions to Closing. The closing of the Merger is subject to certain conditions, including, among others (i) the adoption of the Merger Agreement by holders of at least a majority of the outstanding Company Shares entitled to vote thereon and a majority of the shares of common stock of Parent entitled to vote thereon and present in person or represented by proxy at a shareholder meeting called for such purpose; (ii) the expiration or earlier termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and certain regulatory approvals by various state insurance regulators; (iii) the absence of any temporary restraining order, preliminary or permanent injunction or other order issued by any court of competent jurisdiction or other legal restraint or prohibition preventing the consummation of the Merger; (iv) no more than 10% of the outstanding Company Shares having properly elected appraisal rights; (v) the shares of Parent common stock issuable to the Company s shareholders having been approved for listing on the NYSE; (vi) the Form S-4 having been declared effective by the SEC; and (vii) the satisfaction of certain employee and management retention conditions.

Termination of the Merger Agreement. The Merger Agreement contains specified termination rights for both the Company and Parent. Either of the Company and Parent (as applicable) must pay a termination fee of $49,598,810 if the Merger Agreement is terminated under certain specified circumstances, including (i) termination of the Merger Agreement following a change by the Company s or Parent s board of directors of its recommendation that Company or Parent shareholders (as applicable) adopt the Merger Agreement; (ii) termination of the Merger Agreement by the Company or Parent (as applicable) in order to enter into a definitive agreement to effect a superior proposal; (iii) termination because of a material breach of the non-solicitation provisions by the other party; and (iv) if an alternative acquisition proposal has been made public and not withdrawn, following a termination of the Merger Agreement because of (a) a failure of the Company or Parent to obtain the requisite shareholder approvals, (b) an uncured material breach by the other party, or (c) failure to close the Merger prior to the outside date set forth in the Merger Agreement, and the Company or Parent (as applicable) enters into a transaction with respect to a competing proposal within 12 months of the termination.

The Company and Parent are also obligated to pay the other party s documented out-of-pocket expenses, up to $14,171,089 in the event the Merger Agreement is terminated because of a failure of the Company or Parent, as applicable, to obtain the requisite shareholder approval.

Retention Agreements. In connection with the Merger Agreement and at the request of Parent, each of the Company s Chief Executive Officer, Chief Financial Officer, and President and General Counsel agreed to enter into a letter agreement (a Retention Agreement) with Parent to continue his employment with the Company following the closing of the Merger for a period of two years, at an annual base salary not less than such executive s current annual base salary. In exchange for such commitment, each executive is entitled to the payment of a retention bonus in the form of a lump-sum amount equal to the amount that would have been received by such executive had such executive been terminated for a reason other than cause as set forth in such executive s employment agreement. In addition, the Retention Agreement grants each executive with a one-time award of time-vested restricted stock units having a grant date value of $1,000,000, which will vest in full provided that the executive is continuously employed by Parent at the expiration of the Retention Agreement.

The foregoing description of the Merger Agreement and the transactions contemplated thereby does not purport to be complete and is subject to and qualified in its entirety by reference to the Merger Agreement, a copy of which is filed as Exhibit 2.1 to this Current Report on Form 8-K and is incorporated herein by reference.

The representations, warranties, and covenants of the Company, Parent and Merger Sub contained in the Merger Agreement have been made solely for the benefit of the parties thereto. In addition, such representations, warranties, and covenants (a) have been made only for purposes of the Merger Agreement, (b) have been qualified by (i) matters specifically disclosed in the Company s filings with the SEC on or before February 9, 2018 and (ii) confidential disclosures made in the disclosure letters delivered in connection with the Merger Agreement, (c) are subject to materiality qualifications contained in the Merger Agreement which may differ from what may be viewed as material by investors, (d) were made only as of the date of the Merger Agreement or such other date as is specified in the Merger Agreement and (e) have been included in the Merger Agreement for the purpose of allocating risk between the contracting parties rather than establishing matters as fact. Accordingly, the Merger Agreement is included with this filing only to provide investors with information regarding the terms of the Merger Agreement, and not to provide investors with any other factual information regarding the Company, Parent or Merger Sub or their respective businesses. Investors should not rely upon the representations and warranties in the Merger Agreement as characterizations of actual facts or circumstances as of the date of the Merger Agreement or as of any other date. Moreover, information concerning the subject matter of the representations and warranties may change after the date of the Merger Agreement, which subsequent information may or may not be fully reflected in the Company s public disclosures.

(2) *Voting And Support Agreements*

As an inducement to Parent entering into the Merger Agreement, on February 13, 2018, all of the Company s directors and named executive officers who beneficially own Company Shares entered into Voting and Support Agreements with Parent (collectively, the

Company Voting and Support Agreements), pursuant to which such directors and named executive officers have agreed to vote Company Shares that they beneficially own for the adoption of the Merger Agreement and approval of the transactions contemplated thereby and against any competing proposal or other proposal, action or transaction that would reasonably be expected to in any manner materially impede, frustrate, prevent or nullify the Merger or the Merger Agreement. The Company Voting and Support Agreements terminate upon certain events, including (a) the closing of the transactions contemplated by the Merger Agreement, (b) any termination of the Merger Agreement in accordance with its terms, (c) following a change by the Company s board of directors of its recommendation that Company shareholders adopt the Merger Agreement in compliance with the Merger Agreement, (d) upon delivery of notice by the shareholder signatory thereto following any amendment or waiver of any provision of the Merger Agreement that (i) reduces the cash component or the stock component of the consideration or changes the form of consideration payable to the shareholders of the Company pursuant to the terms of the Merger Agreement, or (ii) is otherwise materially adverse to the shareholders of the Company.

As an inducement to the Company entering into the Merger Agreement, on February 13, 2018, all of Parent s directors and named executive officers who beneficially own Parent common shares entered into Voting and Support Agreements with the Company (collectively, the Parent Voting and Support Agreements), pursuant to which such directors and named executive officers have agreed to vote any shares of Parent voting common shares that they beneficially own for the approval of the share issuance as contemplated by the Merger Agreement and against any competing proposal or other proposal, action or transaction that would reasonably be expected to in any manner materially impede, frustrate, prevent or nullify the share issuance or the Merger Agreement. The Parent Voting and Support Agreements terminate upon certain events, including (a) the closing of the transactions contemplated by the Merger Agreement, (b) any termination of the Merger Agreement in accordance with its terms, (c) following a change by the Parent s board of directors of its recommendation that Parent shareholders approve the share issuance as contemplated by the Merger Agreement and (d) upon delivery of notice by the shareholder signatory thereto following any amendment or waiver of any provision of the Merger Agreement that (i) increases the cash component or the stock component of the consideration or changes the form of consideration payable to the shareholders of the Company pursuant to the terms of the Merger Agreement, or (ii) is otherwise materially adverse to the shareholder.

The foregoing summary of the Company Voting and Support Agreements and the Parent Voting and Support Agreements contained in this Item 1.01 does not purport to be a complete description and is qualified in its entirety by reference to the terms and conditions of such agreements, copies of the form of which are attached as Exhibit 10.1 and Exhibit 10.2 and are incorporated herein by reference.

Item 9.01 Financial Statements and Exhibits

(d) Exhibits

Exhibit Number	**Description**
2.1	Agreement and Plan of Merger, dated as of February 13, 2018 by and among Kemper Corporation, Vulcan Sub, Inc., and Infinity Property and Casualty Corporation.*
10.1	Form of Voting and Support Agreement, dated as of February 13, 2018 between Kemper Corporation and each director and named executive officer of Infinity Property and Casualty Corporation that is a signatory thereto.
10.2	Form of Voting and Support Agreement, dated as of February 13, 2018 between Infinity Property and Casualty Corporation and each director and named executive officer of Kemper Corporation that is a signatory thereto.

* Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. A copy of any omitted schedules will be furnished supplementally to the Securities and Exchange Commission upon request.

Cautionary Note Regarding Forward-Looking Statements

Certain statements herein may include projections, goals, assumptions and statements that may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and the Company may make related oral, forward-looking statements on or following the date hereof. These projections, goals, assumptions and statements are not historical facts but instead represent only the Company s belief regarding future events, many of which, by their nature, are inherently uncertain and outside the Company s control. These projections, goals, assumptions and statements include statements preceded by, followed by or including words such as will, believe, anticipate, expect, intend, plan, focused on achieving, view, target, goal, or esti the Company s actual results and financial condition will differ, possibly materially, from the results and financial condition indicated in these projections, goals, assumptions and statements.

The proposed transaction is subject to risks and uncertainties and factors that could cause the Company s actual results to differ, possibly materially, from those in the specific projections, goals, assumptions and statements include, but are not limited to (i) that the Company may be unable to complete the proposed transaction because, among other reasons, conditions to the closing of the proposed transaction may not be satisfied or waived; (ii) uncertainty as to the timing of completion of the proposed transaction; (iii) the inability to complete the proposed transaction due to the failure to obtain Company shareholder approval for the proposed transaction or the failure to satisfy other conditions to completion of the proposed transaction, including that a governmental entity may prohibit, delay or refuse to grant approval for the consummation of the transaction; (iv) the occurrence of any event, change or other circumstances that could give rise to the termination of the Merger Agreement; (v) risks related to disruption of management s attention from the Company s ongoing business operations due to the proposed transaction; (vi) the effect of the announcement of the proposed transaction on the Company s relationships with its clients, operating results and business generally; (vii) the outcome of any legal proceedings to the extent initiated against the Company or others following the announcement of the proposed transaction, as well as Company management s response to any of the aforementioned factors; and (viii) industry conditions.

The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein and elsewhere, including the risk factors included in the Company s most recent reports on Form 10-K and Form 10-Q and other documents of the Company on file with or furnished to the SEC. Any forward-looking statements made in this material are qualified by these cautionary statements, and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company or its business or operations. Except as required by law, the Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

Additional Information about the Proposed Transaction and Where to Find It

In connection with the proposed transaction, Parent will file with the SEC a Registration Statement on Form S-4 that will include a Joint Proxy Statement of Parent and the Company, and a Prospectus of Parent, as well as other relevant documents concerning the proposed transaction. The proposed transaction involving Parent and the Company will be submitted to Parent and Company shareholders for their consideration. This communication does not constitute an offer to sell or the solicitation of an offer to buy any securities or a solicitation of any vote or approval. SHAREHOLDERS OF PARENT AND THE COMPANY ARE URGED TO READ THE REGISTRATION STATEMENT AND THE JOINT PROXY STATEMENT/PROSPECTUS REGARDING THE TRANSACTION WHEN IT BECOMES AVAILABLE AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC, AS WELL AS ANY AMENDMENTS OR SUPPLEMENTS TO THOSE DOCUMENTS, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION. Shareholders will be able to obtain a free copy of the definitive joint proxy statement/prospectus, as well as other filings containing information about Parent and the Company, without charge, at the SEC s website (http://www.sec.gov). Copies of the joint proxy statement/prospectus and the filings with the SEC that will be incorporated by reference in the joint proxy statement/prospectus can also be obtained, without charge, by directing a request to Parent at investors@kemper.com, (312) 661-4930, or to the Company at investor.relations@infinityauto.com, (205) 803-8186.

Participants in the Solicitation

Parent, the Company, their respective directors and executive officers and other persons may be deemed to be participants in the solicitation of proxies in respect of the proposed transaction. Information regarding Parent s directors and executive officers is available in Parent s proxy statement for its 2017 Annual Meeting of Shareholders filed with the SEC on March 24, 2017, and Parent s Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on February 13, 2018. Information regarding the Company s directors and executive officers is available in the Company s proxy statement for its 2017 Annual Meeting of Shareholders filed with the SEC on April 11, 2017, and the Company s Annual Report on Form 10-K for the year ended December 31, 2016, which was filed with the SEC on February 28, 2017. Other information regarding the participants in the proxy solicitation and a description of their direct and indirect interests, by security holdings or otherwise, will be contained in the joint proxy statement/prospectus and other relevant materials filed with the SEC. Free copies of this document may be obtained as described in the preceding paragraph.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

INFINITY PROPERTY AND CASUALTY

CORPORATION

BY: /s/ Samuel J. Simon
Samuel J. Simon

President and General Counsel

February 14, 2018

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EXPLANATORY NOTE REGARDING THIS ANNUAL REPORT

As previously announced, as part of a plan to reorganize our business operations so that, among other things, we could elect to qualify as a real estate investment trust (a "REIT") for federal income tax purposes, effective May 20, 2013, Owens Mortgage Investment Fund, a California Limited Partnership (the "Predecessor" or "OMIF") merged with and into Owens Realty Mortgage, Inc., a Maryland corporation (the "Registrant") with the Registrant as the surviving corporation (the "Merger") and the Registrant commenced conducting all of the business conducted by the Predecessor. Upon consummation of the Merger, limited partners of the Predecessor received one share of common stock, par value $0.01 per share, of the Registrant (the "Common Stock"), for every 25 limited partner units of the Predecessor that they owned, and certain units of the Predecessor representing the general partner interest of Owens Financial Group, Inc. were also exchanged for Common Stock as is discussed in further detail in our consolidated financial statements under "Note 1 - Organization" of this Annual Report on Form 10-K. The rights of the stockholders of the Registrant are governed by Maryland law and the charter, bylaws and other governing documents of the Registrant.

The shares of Common Stock issued pursuant to the Merger were registered under the Securities Act of 1933, as amended, pursuant to a Registration Statement on Form S-4 (File No. 333-184392), which was declared effective by the Securities and Exchange Commission on February 12, 2013. Pursuant to Rule 12g-3(a) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Registrant is deemed to be the successor issuer to the Predecessor and the Registrant's Common Stock was subsequently registered under Section 12(b) of the Exchange Act and is listed on the NYSE MKT, LLC.

References to Owens Realty Mortgage, Inc. and its subsidiaries, "ORM," the "Company," "we", "us", or "our" in this Annual Report on Form 10-K (including in the consolidated financial statements and notes thereto in this report) have the following meanings, unless we specifically state or the context requires otherwise:

- For periods prior to May 20, 2013: the Predecessor and its subsidiaries;
- For periods from and after May 20, 2013: ORM and its subsidiaries.

PART I

Item 1. BUSINESS

We are a specialty finance company that focuses on the origination, investment and management of commercial real estate loans, primarily in the Western U.S. We provide customized, short-term loans to small and middle-market investors and developers that require speed and flexibility. We also hold investments in real estate property. Our investment objective is to provide investors with attractive current income and long-term shareholder value. Our Common Stock is traded on the NYSE MKT under the symbol "ORM".

We are externally managed and advised by Owens Financial Group, Inc. ("OFG" or "the Manager"), a specialized commercial real estate management company that has originated, serviced and managed alternative commercial real estate investments since 1951. OFG provides us with all of the services vital to our operations and our executive officers and other staff are all employed by OFG pursuant to the management agreement between the Company and the Manager (the "Management Agreement") and the Company's charter. The Management Agreement requires OFG to

manage our business affairs in conformity with the policies and investment guidelines that are approved and monitored by our Board of Directors. Our Board of Directors is composed of a majority of independent directors. The Audit, Nominating and Corporate Governance and Compensation Committees of the Board are composed exclusively of independent directors.

The Company was incorporated in Maryland on August 9, 2012. Effective May 20, 2013, OMIF, a California Limited Partnership formed in 1984 merged with and into the Company, with the Company as the surviving corporation (the "Merger"), and the Company commenced conducting all of the business conducted by OMIF at the effective time of the Merger. The Merger was conducted to reorganize our business operations so that, among other things, we could elect to qualify as a real estate investment trust (a "REIT") for federal income tax purposes. As a qualified REIT we are generally not subject to federal income tax on that portion of our REIT taxable income that is distributed to our stockholders, provided that at least 90% of taxable income is distributed and provided that certain other requirements are met. Certain of our assets that produce non-qualifying income are held in taxable REIT subsidiaries. Unlike other subsidiaries of a REIT, the income of a taxable REIT subsidiary is subject to federal and state income taxes.

OFG arranges, services and maintains the loan and real estate portfolios for the Company. Our loans are secured by mortgages or deeds of trust on unimproved, improved, income-producing and non-income-producing real property, such as condominium projects, apartment complexes, shopping centers, office buildings, and other commercial or industrial properties. No single Company loan may exceed 10% of our assets as of the date the loan is made.

The following table shows the total Company stockholders' equity, loans, real estate properties and net income (loss) attributable to the Company as of and for the years ended December 31, 2014, 2013, 2012, 2011 and 2010:

	ORM Stockholders' Equity	Loans	Real Estate Properties	Net Income (Loss)
2014	$ 184,571,858	$ 68,033,511	$ 163,016,805	$ 7,929,629
2013	$ 179,874,410	$ 58,796,293	$ 135,315,964	$ 8,732,897
2012	$ 179,459,931	$ 70,262,262	$ 127,773,349	$ (1,679,820)
2011	$ 181,045,959	$ 69,421,876	$ 145,591,660	$ (24,744,255)
2010	$ 219,101,364	$ 157,665,495	$ 97,066,199	$ (22,837,520)

As of December 31, 2014, we held investments in 34 loans, secured by liens on title and leasehold interests in real property. Seventy-eight percent (78%) of the loans are located in Northern California. The remaining 22% are located in Southern California, Arizona, Hawaii, Oregon and Washington.

The following table sets forth the types and maturities of loans held by us as of December 31, 2014:

TYPES AND MATURITIES OF LOANS
(As of December 31, 2014)

	Number of Loans	Amount	Percent
Senior loans	33	$ 65,533,511	96.33%
Junior loans*	1	2,500,000	3.67%
	34	$ 68,033,511	100.00%

* The junior loans in our portfolio at December 31, 2014 are junior to existing senior loans held by us and are secured by the same collateral.

	Number of Loans	Amount	Percent
Maturing on or before December 31, 2014	3	$ 9,476,081	13.93%
Maturing on or between January 1, 2015 and December 31, 2016	22	39,167,007	57.57%
Maturing on or between January 1, 2017 and March 1, 2028	9	19,390,423	28.50%
	34	$ 68,033,511	100.00%
Commercial	25	$ 52,531,537	77.21%
Residential	7	13,491,906	19.83%
Land	2	2,010,068	2.96%
	34	$ 68,033,511	100.00%

We have established an allowance for loan losses of approximately $2,869,000 as of December 31, 2014. The above amounts reflect the gross amounts of our loans without regard to such allowance.

The average loan balance of the loan portfolio is $2,001,000 as of December 31, 2014. Of such investments, 6.3% earn a variable rate of interest and 93.7% earn a fixed rate of interest. All were negotiated according to our investment standards.

We have other assets in addition to loans, comprised principally of the following, as of December 31, 2014:

- $7,662,000 in cash and cash equivalents and restricted cash required to transact our business and/or in conjunction with contingency and escrow reserve requirements;
- $163,017,000 in real estate held for sale and investment;
- $2,143,000 in investment in limited liability company;
- $1,482,000 in interest and other receivables;
- $1,318,000 in deferred financing costs, net; and
- $1,138,000 in other assets.

Delinquencies

Management does not regularly examine the existing loan portfolio to see if acceptable loan-to-value ratios are being maintained because the majority of loans in our portfolio mature in a period of only 1-2 years. Management performs an internal review on a loan secured by property in the following circumstances:

- payments on the loan become delinquent;
- the loan is past maturity;
- it learns of physical changes to the property securing the loan or to the area in which the property is located; or
- it learns of changes to the economic condition of the borrower or of leasing activity of the property securing the loan.

A review normally includes conducting a physical evaluation of the property securing the loan and the area in which the property is located, and obtaining information regarding the property's occupancy. In some circumstances, management may determine that a more extensive review is warranted, and may obtain an updated appraisal, updated financial information on the borrower or other information. As of December 31, 2014, we obtained updated appraisals on certain of the properties securing our trust deed investments and certain of our wholly- and majority- owned real estate properties.

As of December 31, 2014 and 2013, we had six and ten loans, respectively, that were impaired totaling approximately $22,316,000 and $31,738,000, respectively. This included two and five matured loans totaling $8,614,000 and $16,908,000, respectively. In addition, one and three loan(s) totaling approximately $862,000 and $1,290,000 were past maturity but less than 90 days delinquent in monthly payments as of December 31, 2014 and 2013, respectively (combined total of impaired and past maturity loans of $23,178,000 and $33,028,000, respectively). Of the impaired and past maturity loans, approximately $0 and $6,981,000, respectively, were in the process of foreclosure and none involved borrowers who were in bankruptcy as of December 31, 2014 and 2013. We foreclosed on three and six loans during the years ended December 31, 2014 and 2013, respectively, with aggregate principal balances totaling $7,671,000 and $26,187,000, respectively, and obtained the properties via the trustee's sales.

During the year ended December 31, 2014, the terms of one impaired loan were modified as a troubled debt restructuring. The loan was rewritten as the borrower had paid the principal balance down partially from sale proceeds. The maturity date was extended by six months to April 2015. All other terms of the loan remained the same.

Management believes that no specific loan loss allowance is needed on this modified loan given the estimated underlying collateral value.

During the year ended December 31, 2013, the terms of two impaired loans were modified as troubled debt restructurings. One such impaired loan was modified to combine all principal, delinquent interest and advances into principal and provide for amortizing payments at a reduced interest rate over an extended maturity of 15 years. The borrower is now delinquent in making payments on this modified loan. The other impaired loan was rewritten during the year whereby the Company repaid the unrelated first deed of trust on the subject property of approximately $5,899,000 and refinanced its second deed of trust by combining them into one first deed of trust in the amount of $9,625,000 with interest at 10% per annum due in five years. As part of the modification, approximately $659,000 of past due interest on our original note was paid from the proceeds of the rewritten loan, which was recorded as a discount against the principal balance of the new loan because the loan was impaired (net principal balance of $8,966,000). In addition, we loaned the borrower an additional $2,500,000 to fund certain improvements to the property (aggregate principal balance of $11,466,000). Management believes that no specific loan loss allowance is needed on either of these modified loans given the estimated underlying collateral values.

Of the $31,738,000 in loans that were impaired as of December 31, 2013, $22,316,000 remained impaired as of December 31, 2014, $6,981,000 of such loans were foreclosed on and became real estate owned by the Company during 2014, and $2,441,000 were paid off by the borrowers.

Following is a table representing our delinquency/impairment experience and foreclosures as of and during the years ended December 31, 2014, 2013, 2012, 2011 and 2010:

	2014	2013	2012	2011	2010
Delinquent/Impaired Loans	$22,316,000	$31,738,000	$49,252,000	$ 52,327,000	$121,565,000
Loans Foreclosed	$ 7,671,000	$26,187,000	$ 2,000,000	$ 61,438,000	$ 36,174,000
Total Loans	$68,034,000	$58,796,000	$70,262,000	$ 69,422,000	$157,665,000
Percent of Delinquent Loans to Total Loans	32.80%	53.98%	70.10%	75.38%	77.10%

If the delinquency rate increases on loans held by us, our interest income will be reduced by a proportionate amount. If a loan held by us is foreclosed on, we will acquire ownership of real property and the inherent benefits and detriments of such ownership.

Compensation to the Manager

The Manager receives various forms of compensation and reimbursement of expenses from the Company and compensation from borrowers as set forth in the Company's charter and summarized below.

Compensation and Reimbursement from the Company

Management Fees

Management fees are paid by the Company to the Manager monthly and cannot exceed 2.75% annually of the average unpaid balance of our loans at the end of each of the 12 months in the calendar year. Since this fee is paid monthly, it could exceed 2.75% in one or more months, but the total fee in any one year is limited to a maximum of 2.75%, and any amount paid above this must be repaid by the Manager to the Company. The Manager is entitled to receive a management fee on all loans, including those that are delinquent. The Manager believes this is justified by the added effort associated with such loans. In certain past years, the Manager has chosen not to take the maximum allowable compensation; however, due to reduced levels of loans held by the Company in recent years, the Manager has elected to take close to the maximum compensation that it is able to take and will likely continue to take the maximum compensation for the foreseeable future.

Servicing Fees

The Manager may act as servicing agent on any or all of the loans held by the Company and expects to continue to service all such loans. In consideration for acting as the servicing agent, the Manager receives from the Company a monthly servicing fee, which, when added to all other fees paid in connection with the servicing of a particular loan, does not exceed the lesser of the customary, competitive fee in the community where the loan is placed for the provision of such services on that type of loan or up to 0.25% per year of the unpaid balance of loans held by the Company at the end of each month. The Manager has historically been paid the maximum servicing fee allowable.

Reimbursement of Other Expenses

The Manager is reimbursed by the Company for the actual cost of goods and materials used for or by the Company and obtained from unaffiliated entities and the actual cost of services of non-management and non-supervisory personnel related to the administration of the Company (subject to certain limitations contained in the charter).

Compensation from Borrowers

In addition to compensation from the Company, the Manager also receives compensation from borrowers under our loans arranged by the Manager.

Acquisition and Origination Fees

The Manager is entitled to receive and retain all acquisition and origination fees paid or payable by borrowers for services rendered in connection with the evaluation and consideration of potential investments of the Company (including any selection fee, mortgage placement fee, nonrecurring management fee, and any origination fee, loan fee, or points paid by borrowers, or any fee of a similar nature). The acquisition and origination fees are paid by borrowers, and thus, are not an expense of the Company. These fees may be paid at the placement, extension or refinancing of the loan or at the time of final repayment of the loan. The amount of these fees is determined by competitive conditions and the Manager and may have a direct effect on the interest rate borrowers are willing to pay the Company.

Late Payment Charges

The Manager is entitled to receive all late payment charges paid by borrowers on delinquent loans held by the Company (including additional interest and late payment fees). The late payment charges are paid by borrowers and collected by the Company with regular monthly loan payments or at the time of loan payoff. These are recorded as a liability (Due to Manager) when collected and are not recognized as an expense of the Company. Generally, on the majority of our loans, the late payment fee charged to the borrower for late payments is 10% of the payment amount. In addition, on the majority of our loans, the additional interest charge required to be paid by borrowers once a loan is past maturity is in the range of 3%-5% (paid in addition to the pre-default interest rate).

Other Miscellaneous Fees

We remit other miscellaneous fees to the Manager, which are collected from loan payments, loan payoffs or advances from loan principal (i.e. funding, demand and partial release fees).

The Manager may voluntarily accept compensation that is less than the maximum fees and compensation described above, so long as no such change will result in a significant adverse impact on the stockholders of the Company.

Principal Investment Objectives

Our principal investment objectives are to preserve the capital of the Company and to provide periodic cash distributions to stockholders. It is not our intent to provide tax-sheltered income.

We invest in real estate loans primarily in the Western United States. The loans we invest in are selected for us by OFG from loans originated by OFG or non-affiliated mortgage brokers. When OFG or a non-affiliated mortgage broker originates a loan for us, the borrower is identified, the loan application is processed and the loan is made available to us. We believe that our loans are attractive to borrowers because of the expediency of OFG’s loan approval process, which is approximately ten to twenty days.

We generally employ the same or similar underwriting standards as conventional lenders, such as banks. However, as a specialty finance lender, we are more willing to invest in real estate loans to borrowers that conventional lenders may have rejected for not being creditworthy. When making these loans we attempt to mitigate the added risk by requiring greater equity in the property. Borrowers are willing to pay us higher interest rates than conventional lenders charge to obtain these loans. In addition, we usually are able to generate higher fees and charge

higher interest rates for our loans because we typically can underwrite and close a loan more rapidly than a conventional lender. The loans we invest in are typically short in duration, usually less than three years, and bridge the acquisition or improvement of properties that undergo an economic transformation. The short maturity terms of our loans add a degree of risk, as the borrowers are forced to find suitable replacement financing or to sell their property in order to pay off the loan.

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Investment in Real Estate Loans

Our acquisition and investment policies are to invest at least 86.5% of our capital in real estate loans and activities related thereto. Due to the declining economy and reductions in real estate values prior to 2013, we have experienced increased foreclosures which have resulted in our ownership of significantly more real estate than in the past. Therefore, while we initially adhered to our policies of investing at least 86.5% of our capital in real estate loans, economic conditions beyond our control have resulted in less than 86.5% of our capital being accounted for as investments in real estate loans. As of December 31, 2014, approximately 27% of our assets were classified as investments in real estate loans (net of allowance for loan losses). Additionally, we must maintain a contingency reserve in an aggregate amount of at least 1.5% of our capital.

Our loans are predominantly secured by first mortgage or deed of trust liens on the underlying properties purchased or developed with the funds that we make available. We sometimes refer to these real properties as the security properties. We invest primarily in loans on commercial, industrial and multi-family residential income-producing real property. Substantially all loans are arranged by OFG, which is licensed by the State of California as a real estate broker and California Finance Lender. During the course of its business, OFG is continuously evaluating prospective investments. OFG originates loans from mortgage brokers, previous borrowers, and by personal solicitations of new borrowers. We may purchase or participate in existing loans that were originated by other lenders. Such a loan might be obtained by us from a third party at an amount equal to or less than its face value. OFG evaluates all potential loan investments to determine if the security for the loan, loan-to-value ratio and other applicable factors meets our investment criteria and policies. OFG locates, identifies and arranges virtually all loans we invest in and makes all investment decisions on our behalf. In evaluating prospective loan investments, OFG considers such factors as the following:

- the ratio of the amount of the investment to the value of the property by which it is secured;
- the property’s potential for capital appreciation;
- expected levels of rental and occupancy rates;
- current and projected cash flow generated by the property;
- potential for rental rate increases;
- the marketability of the investment;
- geographic location of the property;
- the condition and use of the property;
- the property’s income-producing capacity;
- the quality, experience and creditworthiness of the borrower;
- general economic conditions in the area where the property is located; and
- any other factors that OFG believes are relevant.

Types of Loans

We invest in first, second, and third mortgage and deed of trust loans, wraparound and participating mortgage and deed of trust loans, construction mortgage and deed of trust loans on real property, and loans on leasehold interest mortgages and deeds of trust. We do not ordinarily make or invest in mortgage and deed of trust loans with a maturity of more than 15 years, and most loans have terms of one to three years. Virtually all loans provide for monthly payments of interest and some also provide for principal amortization. Most of our loans provide for payments of interest only and a payment of principal in full at the end of the loan term. OFG does not originate loans with negative amortization provisions. We do not have any policies directing the portion of our assets that may be invested in construction or rehabilitation loans, loans secured by leasehold interests and second, third and wrap-around mortgage and deed of trust loans. However, OFG recognizes that these types of loans are riskier than first deeds of trust on income-producing, fee simple properties and will seek to minimize the amount of these types of loans in our portfolio. Additionally, OFG will consider that these loans are riskier when determining the rate of interest on the loans.

First Mortgage Loans

First mortgage and deed of trust loans are secured by first deeds of trust on real property. Such loans are generally for terms of one to three years. In addition, such loans do not usually exceed 75% of the appraised value of improved real property and 50% of the appraised value of unimproved real property.

Second and Wraparound Mortgage Loans

Second and wraparound mortgage and deed of trust loans are secured by second or wraparound deeds of trust on real property which is already subject to prior mortgage indebtedness, in an amount which, when added to the existing indebtedness, does not generally exceed 75% of the appraised value of the secured property. A wraparound loan is one or more junior mortgage loans having a principal amount equal to the outstanding balance under the existing mortgage loans, plus the amount actually to be advanced under the wraparound mortgage loan. Under a wraparound loan, we generally make principal and interest payments on behalf of the borrower to the holders of the prior mortgage loans.

Third Mortgage Loans

Third mortgage and deed of trust loans are secured by third deeds of trust on real property which is already subject to prior first and second mortgage indebtedness, in an amount which, when added to the existing indebtedness, does not generally exceed 75% of the appraised value of the secured property.

Construction and Rehabilitation Loans

Construction and rehabilitation loans are loans made for both original development and renovation of property. Construction and rehabilitation loans invested in by us are generally secured by first deeds of trust on real property for terms of six months to two years. In addition, if the secured property is being developed, the amount of such loans generally will not exceed 75% of the post-development appraised value. We will not usually disburse funds on a construction or rehabilitation loan until work in the previous phase of the project has been completed, and an independent inspector has verified completion of work to be paid for. In addition, we require the submission of signed labor and material lien releases by the contractor in connection with each completed phase of the project prior to making any periodic disbursements of loan proceeds. As of December 31, 2014, our loan portfolio contains eleven construction/rehabilitation loans with aggregate principal balances totaling $15,288,000.

Leasehold Interest Loans

Loans on leasehold interests are secured by an assignment of the borrower's leasehold interest in the particular real property. Such loans are generally for terms of from six months to 15 years. Leasehold interest loans generally do not exceed 75% of the value of the leasehold interest at origination. The leasehold interest loans are either amortized over a period that is shorter than the lease term or have a maturity date prior to the date the lease terminates. These loans permit OFG to cure any default under the lease. As of December 31, 2014, our loan portfolio does not contain any leasehold interest loans.

Prepayment Penalties and Exit Fees

Generally, the loans we invest in do not contain prepayment penalties or exit fees. If our loans are at a high rate of interest in a market of falling interest rates, the failure to have a prepayment penalty provision or exit fee in the loan allows the borrower to refinance the loan at a lower rate of interest, thus providing a lower yield to us on the reinvestment of the prepayment proceeds. While our loans do not contain prepayment penalties, many instead require the borrower to notify OFG of the intent to payoff within a specified period of time prior to payoff (usually 30 to 120 days). If this notification is not made within the proper time frame, the borrower may be charged interest for that

number of days that notification was not received.

Balloon Payment

As of December 31, 2014, 99.6% of our loans provided for a "balloon payment" on the principal amount due upon maturity of the loan (including both interest only and amortizing loans with a balloon payment). As of December 31, 2014, one loan (0.4% of total loans) was a fully amortizing loan with a principal balance of approximately $254,000 and a remaining term of 158 months. There are no specific criteria used in evaluating the credit quality of borrowers for loans requiring balloon payments. Furthermore, a substantial period of time may elapse between the review of the financial statements of the borrower and the date when the balloon payment is due. As a result, there is no assurance that a

borrower will have sufficient resources to make a balloon payment when due. To the extent that a borrower has an obligation to pay the loan principal in a large lump sum payment, its ability to repay the loan may be dependent upon its ability to sell the property, obtain suitable refinancing or otherwise raise a substantial amount of cash. As a result, these loans can involve a higher risk of default than amortizing loans (where principal is paid at the same time as the interest payments).

Repayment of Loans on Sales of Properties

We may require a borrower to repay a loan upon the sale of the secured property rather than allow the buyer to assume the existing loan. This may be done if OFG determines that repayment appears to be advantageous to us based upon then-current interest rates, the length of time that the loan has been held by us, the credit-worthiness of the buyer and our objectives and policies. The net proceeds from any sale or repayment are invested in new loans, held as cash or distributed at such times and in such intervals as OFG, in its sole discretion, determines.

Fixed Rate Loans

Approximately 93.7% ($63,718,000) and 82.5% ($48,526,000) of our loans as of December 31, 2014 and 2013, respectively, bear interest at a fixed rate. The weighted average interest rate of such loans as of December 31, 2014 and 2013 was approximately 8.7% and 8.9%, respectively.

Variable Rate Loans

Approximately 6.3% ($4,315,000) and 17.5% ($10,270,000) of our loans as of December 31, 2014 and 2013, respectively, bear interest at a variable rate. Variable rate loans may use indices such as the one, five and ten year Treasury Constant Maturity Index, the Prime Rate Index or the Monthly Weighted Average Cost of Funds Index for Eleventh District Savings Institutions (Federal Home Loan Bank Board). OFG may negotiate spreads over these indices of from 2.0% to 6.5%, depending upon market conditions at the time the loan is made.

The following is a summary of the various indices described above as of December 31, 2014 and 2013:

	December 31, 2014	December 31, 2013
One-year Treasury Constant Maturity Index	0.25%	0.13%
Five-year Treasury Constant Maturity Index	1.65%	1.75%
Ten-year Treasury Constant Maturity Index	2.17%	3.04%
Prime Rate Index	3.25%	3.25%
Monthly Weighted Average Cost of Funds for Eleventh District Savings Institutions	0.69%	0.78%

It is possible that the interest rate index used in a variable rate loan will rise (or fall) more slowly than the interest rate of other loan investments available to us. OFG attempts to minimize this interest rate differential by tying variable rate loans to indices that are sensitive to fluctuations in market rates. Additionally, most variable rate loans originated by OFG contain provisions under which the interest rate cannot fall below the initial rate.

Variable rate loans generally have interest rate caps. We anticipate that the interest rate cap will be a ceiling that is 2% to 4% above the starting rate with a floor rate equal to the starting rate. For these loans, there is the risk that the market rate may exceed the interest cap rate.

Variable rate loans of five to ten year maturities are not assumable without the prior consent of OFG. We do not expect to invest in or purchase a significant amount of assumable loans. To minimize our risk, any borrower assuming an existing loan will be subject to the same underwriting criteria as the original borrower.

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Debt Coverage Standard for Loans

Loans on commercial property generally require the net annual estimated cash flow to equal or exceed the annual payments required on the loan.

Loan Limit Amount

We limit the amount of our investment in any single loan, and the amount of our investment in loans to any one borrower, to 10% of our total assets as of the date the loan is made or purchased.

Loans to Affiliates

We will not provide loans to OFG or an affiliate except for in connection with any advance of expenses or indemnification permitted by our charter, bylaws and the Management Agreement.

Purchase of Loans from Affiliates

We may purchase loans deemed suitable for acquisition from OFG or its affiliates only if:

- OFG makes or purchases such loans in its own name and temporarily holds title thereto for the purpose of facilitating the acquisition of such loans, and provided that such loans are purchased by us for a price no greater than the cost of such loans to OFG (except for compensation in accordance with the terms of the Management Agreement and the charter);
- There is no other benefit arising out of such transactions to OFG;
- Such loans are not in default, and;
- Such loans otherwise satisfy, among other things, the following requirements:
- We will not make or invest in loans on any one property if at the time of acquisition of the loan the aggregate amount of all loans outstanding on the property, including loans by the Company, would exceed an amount equal to 80% of the appraised value of the property as determined by independent appraisal, unless substantial justification exists because of the presence of other documented underwriting criteria.
- We will limit any single loan and limit the loans to any one borrower to not more than 10% of our total assets as of the date the loan is made or purchased.
- We will not invest in or make loans on unimproved real property in an amount in excess of 25% of our total assets.

Competition

Our major competitors in providing specialty finance loans are other mortgage REIT's, specialty finance companies, banks, savings and loan associations, thrifts, conduit lenders, institutional investors, and other entities. No particular competitor dominates the market. Many of the companies against which we compete have substantially greater financial, technical and other resources than us. In addition, there are numerous mortgage REIT's with investment objectives similar to ours, and others may be organized in the future. Competition in the our market niche depends upon a number of factors, including price and interest rates of the loan, speed of loan processing, cost of capital, reliability, quality of service and support services. We are competitive in large part because OFG generates substantially all loans and is able to provide expedited loan approval, processing and funding. OFG has been in the

business of making or investing in loans since 1951.

Regulation of the Manager

We are managed by OFG. OFG, in its capacity as our Manager, is subject to the oversight of our Board of Directors pursuant to the terms and conditions of the Management Agreement and our charter. OFG's operations as a mortgage broker are subject to extensive regulation by federal, state and local laws and governmental authorities. OFG conducts its real estate mortgage business under a license issued by the State of California. Under applicable California law, the division has broad discretionary authority over OFG's activities.

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Employees

The Company does not have employees, other than three full-time and two part-time employees that work directly for its wholly-owned subsidiary, Brannan Island, LLC. OFG provides all of the employees (including our officers) necessary for our operations pursuant to the Management Agreement. As of December 31, 2013, OFG had twelve full-time and five part-time employees. All employees are at-will employees and none are covered by collective bargaining agreements.

Distribution of Company Information

Our Internet address is www.owensmortgage.com. We use our web site as a routine channel for distribution of important information, including news releases, U.S. Securities and Exchange Commission (SEC) filings, and certain other financial information. We post filings on our web site as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC, including our annual and quarterly reports on Forms 10-K and 10-Q and current reports on Form 8-K; our proxy statements; and any amendments to those reports or statements. All such postings and filings are available on our web site free of charge. The SEC's web site, www.sec.gov, contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. We also make available our code of business conduct and ethics, corporate governance guidelines, committee charters, certain Company presentations and fact sheets, and press releases. The content on any web site referred to in this Annual Report on Form 10-K is not incorporated by reference in this Annual Report unless expressly noted.

Our Investor Relations Department can be contacted at 2221 Olympic Blvd., Walnut Creek, CA 94595, Attn: Investor Relations, or by email at investors@owensmortgage.com.

Item 1A. RISK FACTORS

You should consider carefully the risks described below, together with the other information contained in this Annual Report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and related notes. If any of the identified risks actually occurs, or is adversely resolved, our consolidated financial statements could be materially adversely impacted in a particular fiscal quarter or year and our business, financial condition and results of operations may suffer materially. As a result, the trading price of our Common Stock and your investment in the Company may suffer.

The risks described below are not the only risks we face. Additional risks and uncertainties, including those not currently known to us or that we currently deem to be immaterial also could materially adversely affect our business, financial condition and results of operations.

Risks Related to Our Business

We will rely on our Manager, Owens Financial Group, Inc., to manage our day-to-day operations and select our loans for investment.

Our ability to achieve our investment objectives and to make distributions to you depends upon OFG's performance in obtaining, processing, making and brokering loans for us to invest in and determining the financing arrangements for borrowers. You will have no opportunity to evaluate the financial information or creditworthiness of borrowers, the terms of loans, the real property that is our collateral or other economic or financial data concerning our loans. We are obligated to pay OFG an annual management fee up to 2.75% of the average unpaid balance of our outstanding loans at the end of each month. OFG has no fiduciary obligations to us or our stockholders, is not required to devote its employees full time to our business and may devote time to business interests competitive with our business.

We depend on key personnel of our Manager with long standing business relationships, the loss of whom could threaten our ability to operate our business successfully.

Our future success depends, to a significant extent, upon the continued services of OFG as our manager and OFG's officers and employees. The loss of services of one or more members of OFG's management team could harm our business and prospects, including the services of William C. Owens (Chief Executive Officer), Bryan H. Draper (Chief Financial Officer), William E. Dutra (Executive Vice President), Daniel J. Worley (Senior Vice President), Brian M. Haines (Senior Vice President), and Melina A. Platt (Controller), each of whom would likely be difficult to replace because of their extensive experience in the field, extensive market contacts and familiarity with our business. None of these individuals is subject to an employment, non-competition or confidentiality agreement with us or OFG, and we do not maintain "key man" life insurance policies on any of them. Our future success also depends in large part upon OFG's ability to hire and retain additional highly skilled managerial and operational personnel. OFG may require additional operations people who are experienced in obtaining, processing, making and brokering loans and who also have contacts in the relevant markets. If OFG were unable to attract and retain key personnel, the ability of OFG to make prudent investment decisions on our behalf may be impaired.

Our management has very limited experience operating a REIT, and we cannot assure you that our management's past experience will be sufficient to successfully manage our business as a REIT. If we fail to comply with REIT requirements, we would incur U.S. federal income taxes at the corporate level, which would reduce our distributions to you.

We have a very short operating history as a REIT, and our management has very limited experience in complying with the income, asset and other limitations imposed by the REIT provisions of the Internal Revenue Code of 1986, as amended (the "Code"). These provisions are complex, and the failure to comply with these provisions in a timely manner could prevent us from qualifying as a REIT or could force us to pay unexpected taxes and penalties. In such event, our net income would be reduced and we would have less funds available for distribution to you.

If we fail to qualify as a REIT, we would be subject to U.S. federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and therefore would have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our Common Stock. In addition, we would no longer be required to make distributions to our stockholders to maintain preferential U.S. federal income taxation as a REIT.

We do not have a policy that expressly prohibits our directors, officers, security holders or affiliates from engaging for their own account in business activities of the types conducted by us.

We do not have a policy that expressly prohibits our directors, officers, security holders or affiliates from engaging for their own account in business activities of the types conducted by us. However, our code of business conduct and ethics contains a conflicts of interest policy that, unless waived in accordance with the code, prohibits our directors and executive officers, as well as personnel of OFG who provide services to us, from engaging in any transaction that involves an actual conflict of interest with us. In addition, our Management Agreement with OFG does not prevent our Manager and its affiliates from engaging in additional management or investment opportunities, some of which could compete with us.

Our Manager's liability is limited under the Management Agreement, and we have agreed to indemnify our Manager against certain liabilities. As a result, we could experience poor performance or losses for which our Manager would not be liable.

Pursuant to the Management Agreement, OFG does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our Board of Directors in following or declining to follow its advice or recommendations. Under the terms of the Management Agreement, none of OFG, its officers, stockholders, directors, employees or advisors, among others, will be liable to us or any subsidiary of ours, to our Board of Directors, or to our or any subsidiary's stockholders, members or partners for any acts or omissions made pursuant to the Management Agreement, except for acts or omissions constituting bad faith, willful misconduct, gross negligence or reckless disregard of OFG's duties under the Management Agreement, as determined by a final court order. In addition, we have agreed to indemnify, to the fullest extent permitted by law, OFG, its officers, stockholders, directors, employees and advisors, among others, from all losses (including attorneys' fees) arising from any acts or omissions of such person made in good faith in the performance of OFG's duties under the Management Agreement and not constituting bad faith, willful misconduct, gross negligence or reckless disregard of such duties.

Under the Management Agreement, termination of our Manager for cause requires that we provide 30 days' prior written notice to our Manager.

Termination of the Management Agreement with our Manager for cause, including in the event that OFG engages in fraud or embezzlement, misappropriates funds or intentionally breaches the Management Agreement, requires us to

provide 30 days' prior written notice to OFG. Accordingly, if OFG engages in any of the foregoing activities (or any other activities resulting in a for cause termination), our inability to terminate the Management Agreement for at least 30 days may result in inefficiencies and uncertainties that could ultimately have a material adverse effect on our business, financial condition and results of operations.

Our Manager’s lack of experience with certain real estate markets could impact its ability to make prudent investments on our behalf.

While we invest in real estate loans throughout the United States, the majority of our loans are in the Western United States. Real estate markets vary greatly from location to location, and the rights of secured real estate lenders vary from state to state. OFG may originate loans for us in markets where they have limited experience. In those circumstances, OFG intends to rely on independent real estate advisors and local legal counsel to assist them in making prudent investment decisions. You will not have an opportunity to evaluate the qualifications of such advisors, and no assurance can be given that they will render prudent advice to OFG.

Loan defaults, delinquencies and foreclosures will decrease our revenues and net income and your distributions.

We are in the business of investing in real estate loans, and, as such, we are subject to risk of defaults by borrowers. Our performance will be directly impacted by any defaults on the loans in our portfolio. As a specialty finance lender willing to invest in loans to borrowers who may not meet the credit standards of conventional lenders, the rate of default on our loans could be higher than those generally experienced in the real estate lending industry. Any sustained period of increased defaults could adversely affect our business, financial condition, liquidity and the results of our operations, and ultimately your distributions. We seek to mitigate the risk by estimating the value of the underlying collateral and insisting on low loan-to-value ratios. However, we cannot assure you that these efforts will fully protect us against losses on defaulted loans. Any subsequent decline in real estate values on defaulted loans could result in less security than anticipated at the time the loan was originally made, which may result in our not recovering the full amount of the loan. Any failure of a borrower to repay loans or interest on loans will reduce our revenues and your distributions and the value of your interest in the Company. Our appraisals are generally dated within 12 months of the date of loan origination and may not reflect a decrease in the value of the real estate due to events subsequent to the date of the appraisals.

As of December 31, 2014, our portfolio had approximately $22,316,000 in impaired loans, which included approximately $10,728,000 of non-performing loans in non-accrual status. In addition, our investment in loans that were past maturity (delinquent in principal) but less than 90 days delinquent in monthly payments was approximately $862,000 as of December 31, 2014 (combined total of delinquent and/or impaired loans of $23,178,000 compared to $33,028,000 as of December 31, 2013). We also had approximately $51,320,000 of non-income producing real estate held for sale or investment for a total of $62,048,000 in non-performing assets, which represented approximately 34% of our total capital as of December 31, 2014.

It is possible that we will continue to experience reduced net income or further losses in the future, thus negatively impacting future distributions. As non-delinquent loans are paid off by borrowers, interest income received by us may be reduced. In addition, we may foreclose on more delinquent loans, thereby obtaining ownership of more real estate that may result in larger operating losses. Management will attempt to sell many of these properties but may need to sell them for losses or wait until market values recover in the future.

Our underwriting standards may be more lenient than those of conventional lenders, which could result in a higher percentage of foreclosed properties, which could reduce the amount of distributions to you.

Our underwriting standards and procedures may be more lenient than those of conventional lenders in that we will invest in loans secured by property that may not meet the underwriting standards of conventional real estate lenders or make loans to borrowers who may not meet the credit standards of conventional lenders. This may lead to more non-performing assets in our loan portfolio and create additional risks to your return. We approve real estate loans more quickly than other lenders. We rely on third-party reports and information such as appraisals and environmental reports to assist in underwriting loans. We may accept documentation that was not specifically prepared for us or commissioned by us. This creates a greater risk of the information contained therein being out of date or incorrect.

Generally, we will spend less time than conventional lenders assessing the character and credit history of our borrowers and the property that secures our loans. Due to the accelerated nature of our loan approval process, there is a risk that the credit inquiry we perform will not reveal all material facts pertaining to the borrower and the security. There may be a greater risk of default by our borrowers, which may impair our ability to make timely distributions to you and which may reduce the amount we have available to distribute to you.

Loan repayments are less likely in a volatile market environment.

In a market in which liquidity is essential to our business, loan repayments have been a significant source of liquidity for us. However, many financial institutions have curtailed new lending activity and real estate owners are having difficulty refinancing their loans at maturity. If borrowers are not able to refinance our loans at their maturity, the loans could go into default and the liquidity that we would receive from such repayments will not be available. Furthermore, without a properly functioning commercial real estate finance market, borrowers that are performing on their loans may be forced to extend such loans if allowed, which will further delay our ability to access liquidity through repayments.

We depend upon real estate security to secure our real estate loans, and we may suffer a loss if the value of the underlying property declines.

We depend upon the value of real estate security to protect us on the loans that we make. We utilize the services of independent appraisers to value the security underlying our loans. However, notwithstanding the experience of the appraisers, mistakes can be made, or the value of the real estate may decrease due to subsequent events. Our appraisals are generally dated within 12 months of the date of loan origination and may have been commissioned by the borrower. Therefore, the appraisals may not reflect a decrease in the value of the real estate due to events subsequent to the date of the appraisals. For a construction loan most of the appraisals will be prepared on an as-if developed basis. If the loan goes into default prior to completion of the project, the market value of the property may be substantially less than the appraised value. Additional capital may be required to complete a project in order to realize the full value of the property. If a default occurs and we do not have the capital to complete a project, we may not recover the full amount of our loan.

Foreclosures create additional ownership risks.

When we acquire property by foreclosure, we have economic and liability risks as the owner, such as:

- earning less income and reduced cash flows on foreclosed properties than could be earned and received on loans;
- not being able to realize sufficient amounts from sales of the properties to avoid losses;
- properties being acquired with one or more co-owners (called tenants-in-common) where development or sale requires written agreement or consent by all; without timely agreement or consent, we could suffer a loss from being unable to develop or sell the property;
- maintaining occupancy of the properties;
- controlling operating expenses;
- coping with general and local market conditions;
- complying with changes in laws and regulations pertaining to taxes, use, zoning and environmental protection;
- possible liability for injury to persons and property; and
- possible liability for environmental remediation.

During the years ended December 31, 2014 and 2013, we recorded impairment losses on one and two of our real estate properties held for sale and investment in the aggregate amount of approximately $179,000 and $666,000, respectively.

Development on properties we acquire creates risks of ownership we do not have as a lender.

When we acquire property by foreclosure or otherwise as a lender, we may develop the property, either singly or in combination with other persons or entities. This could be done in the form of a joint venture, limited liability company or partnership, with OFG and/or unrelated third parties. This development can create the following risks:

- Reliance upon the skill and financial stability of third party developers and contractors;

- Inability to obtain governmental permits;

- Delays in construction of improvements;

- Increased costs during development and the need to obtain additional financing to pay for the development; and

- Economic and other factors affecting sale or leasing of developed property.

Larger loans result in less diversity and may increase risk.

As of December 31, 2014, we were invested in a total of 34 loans, with an aggregate book value of approximately $68,034,000. The average book value of those loans was approximately $2,001,000, and the median book value was $1,138,000. Nine of such loans had a book value each of 3% or more of the aggregate book value of all loans, and the largest loan relationship had a total book value of 17% of all loans.

As a general rule, we can decrease risk of loss from delinquent loans by investing in a greater total number of loans. Investing in fewer, larger loans generally decreases diversification of the portfolio and increases risk of loss and possible reduction of return to investors in the case of a delinquency of such a loan.

Incorrect original collateral assessment (valuation) could result in losses and decreased distributions to you.

Appraisals are obtained from qualified, independent appraisers on all properties securing trust deeds, which may have been commissioned by the borrower and may precede the placement of the loan with us. However, there is a risk that the appraisals prepared by these third parties are incorrect, which could result in defaults and/or losses related to these loans.

Completed, written appraisals are not always obtained on our loans prior to original funding, due to the quick underwriting and funding required on the majority of our loans. Although the loan officers often discuss value with the appraisers and perform other due diligence and calculations to determine property value prior to funding, there is a risk that we may make a loan on a property where the appraised value is less than estimated, which could increase the loan’s loan-to-value, or LTV, ratio and subject us to additional risk.

We may make a loan secured by a property on which the borrower previously commissioned an appraisal. Although we generally require such appraisal to have been made within one year of funding the loan, there is a risk that the appraised value is less than the actual value, increasing the loan’s LTV ratio and subjecting us to additional risk.

Geographical concentration of loans may result in additional delinquencies.

Northern California real estate secured approximately 78% of the total loans held by us as of December 31, 2014. Northern California consists of Monterey, Kings, Fresno, Tulare and Inyo counties and all counties north of those. In addition, 13%, 3%, 2%, 2% and 2% of total loans were secured by Arizona, Washington, Southern California, Hawaii and Oregon real estate, respectively. These concentrations may increase the risk of delinquencies on our loans when the real estate or economic conditions of one or more of those areas are weaker than elsewhere, for reasons such as:

- economic recession in that area;

- overbuilding of commercial or residential properties; and

- relocations of businesses outside the area due to factors such as costs, taxes and the regulatory environment.

These factors also tend to make more commercial or residential real estate available on the market and reduce values, making suitable loans less available to us. In addition, such factors could tend to increase defaults on existing loans.

Investments in construction and rehabilitation loans may be riskier than loans secured by operating properties.

Our loan portfolio contains eleven construction or rehabilitation loans with principal balances aggregating $15,288,000 as of December 31, 2014 (including two fully funded loans in the aggregate amount of $3,535,000) and we have commitments to fund an additional $5,935,000 on such loans in the future (including interest reserves on these and other loans) as of December 31, 2014. We may make additional construction and rehabilitation loan commitments in the future. Construction and rehabilitation loans may be riskier than loans secured by properties with an operating history, because:

- the application of the loan proceeds to the construction or rehabilitation project must be assured;
- the completion of planned construction or rehabilitation may require additional financing by the borrower; and
- permanent financing of the property may be required in addition to the construction or rehabilitation loan.

Investments in loans secured by leasehold interests may be riskier than loans secured by fee interests in properties.

Although our loan portfolio does not contain any loans secured by leasehold interests as of December 31, 2014, we have made such loans in the past, and we may resume leasehold-secured lending in the future. Loans secured by leasehold interests are riskier than loans secured by real property because the loan is subordinate to the lease between the property owner (lessor) and the borrower, and our rights in the event the borrower defaults are limited to stepping into the position of the borrower under the lease, subject to its requirements of rents and other obligations and period of the lease.

Investments in second, third and wraparound mortgage and deed of trust loans may be riskier than loans secured by first deeds of trust.

Second, third and wraparound mortgage and deed of trust loans (those under which we generally make the payments to the holders of the prior liens) are riskier than first mortgage and deed of trust loans because:

- their position is subordinate in the event of default; and
- there could be a requirement to cure liens of a senior loan holder, and, if this is not done, we would lose our entire interest in the loan.

As of December 31, 2014, our loan portfolio contained 4% in second mortgage and deed of trust loans and 0% in third mortgage and deed of trust loans. The second deed of trust loan in our portfolio as of December 31, 2014 is junior to an existing first deed of trust held by us and is secured by the same collateral. As of December 31, 2014, we were not invested in any wraparound mortgage or deed of trust loans.