Owens Realty Mortgage, Inc.
Form 10-Q
November 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2013

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to __________

Commission file number 000-54957

OWENS REALTY MORTGAGE, INC.
(Exact Name of Registrant as Specified in Its Charter)

Maryland (State or Other Jurisdiction of Incorporation or Organization)	46-0778087 (I.R.S. Employer Identification No.)
2221 Olympic Boulevard Walnut Creek, California (Address of Principal Executive Offices)	94595 (Zip Code)

(925) 935-3840
Registrant's Telephone Number, Including Area Code

NOT APPLICABLE
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of November 6, 2013
Common Stock, $.01 par value	10,934,364 shares

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Item 1. Financial Statements

OWENS REALTY MORTGAGE, INC.
Consolidated Balance Sheets as Recast (1)
(UNAUDITED)

	September 30, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	$ 24,726,665	$ 21,131,505
Restricted cash	3,984,474	6,264,110
Loans, net of allowance for losses of $5,184,856 in 2013 and $24,417,897 in 2012	48,434,100	45,844,365
Interest and other receivables	1,501,004	3,485,061
Other assets, net of accumulated depreciation and amortization of $952,709 in 2013 and $877,589 in 2012	1,100,526	1,126,723
Investment in limited liability company	2,180,349	2,141,777
Real estate held for sale	5,925,595	56,173,094
Real estate held for investment, net of accumulated depreciation of $9,077,635 in 2013 and $6,518,160 in 2012	126,511,332	71,600,255
Total Assets	$ 214,364,045	$ 207,766,890
LIABILITIES AND EQUITY		
LIABILITIES:		
Dividends payable	$ 180,000	$ 1,234,352
Due to Manager	271,391	298,349
Accounts payable and accrued liabilities	5,342,705	4,012,650
Deferred gains	3,635,310	1,327,406
Notes payable	14,160,565	13,384,902
Total Liabilities	23,589,971	20,257,659
Commitments and Contingencies (Note 12)		
EQUITY:		
Stockholders' equity:		
Preferred stock, $.01 par value per share, 5,000,000 shares authorized, no shares issued and outstanding at September 30, 2013 and December 31, 2012	—	—
Common stock, $.01 par value per share, 50,000,000 shares authorized, 11,198,119 shares issued, 11,161,259 and 11,198,119 shares outstanding at September 30, 2013 and December 31, 2012, respectively	111,981	111,981
Additional paid-in capital	182,437,522	182,985,281
Treasury stock, at cost – 36,860 shares at September 30, 2013	(459,634)	—
Retained earnings (accumulated deficit)	2,714,664	(3,637,331)
Total stockholders' equity	184,804,533	179,459,931
Non-controlling interests	5,969,541	8,049,300
Total Equity	190,774,074	187,509,231
Total Liabilities and Equity	$ 214,364,045	$ 207,766,890

(1) As recast to reflect the balances of Owens Mortgage Investment Fund, LP combined with the balances of Owens Realty Mortgage, Inc. beginning January 1, 2012, as required under the accounting guidelines for a transfer of an entity under common control (refer to Note 1).

The accompanying notes are an integral part of these consolidated financial statements.

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Operations as Recast (1)
(UNAUDITED)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
Revenues:				
Interest income on loans	$ 749,929	$ 859,636	$ 2,360,891	$ 2,009,445
Gain on foreclosure of loan	—	—	952,357	—
Rental and other income from real estate properties	2,887,984	3,427,716	8,408,351	10,105,320
Income from investment in limited liability company	38,946	37,921	118,572	116,094
Other income	98	1,574	1,620	5,168
Total revenues	3,676,957	4,326,847	11,841,791	12,236,027
Expenses:				
Management fees to Manager	373,067	405,324	1,264,668	1,301,201
Servicing fees to Manager	33,915	41,158	115,333	123,300
General and administrative expense	496,088	370,706	1,193,954	1,148,608
Rental and other expenses on real estate properties	2,071,900	2,626,057	6,403,757	7,786,233
Depreciation and amortization	539,532	371,937	1,941,887	1,846,158
Interest expense	129,229	131,360	385,064	392,735
Environmental remediation expense	—	—	—	100,000
(Reversal of) provision for loan losses	(419,860)	551,570	(7,376,344)	399,179
Impairment losses on real estate properties	—	614,786	—	1,033,266
Total expenses	3,223,871	5,112,898	3,928,319	14,130,680
Operating income (loss)	453,086	(786,051)	7,913,472	(1,894,653)
Gain on sales of real estate, net	251,887	1,859,230	2,712,096	2,652,542
Net income and comprehensive income	704,973	1,073,179	10,625,568	757,889
Less: Net (income) loss attributable to non-controlling interests	(3,899)	41,149	(2,063,545)	(515,289)
Net income and comprehensive income attributable to common stockholders	$ 701,074	$ 1,114,328	$ 8,562,023	$ 242,600
Per common share data:				
Basic and diluted earnings per common share	$ 0.06	$ 0.10	$ 0.76	$ 0.02
Basic and diluted weighted average number of common shares outstanding	11,196,646	11,198,119	11,197,622	11,198,119
Dividends declared per share of common stock	$ 0.05	$ 0.03	$ 0.20	$ 0.06

(1) As recast to reflect the balances of Owens Mortgage Investment Fund, LP combined with the balances of Owens Realty Mortgage, Inc. beginning January 1, 2012, as required under the accounting guidelines for a transfer of an entity under common control (refer to Note 1).

The accompanying notes are an integral part of these consolidated financial statements.

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Stockholders’ Equity as Recast (1)
(UNAUDITED)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Amount	Retained Earnings (Accumulated Deficit)	Total Stockholders’ Equity	Non-controlling Interests	
Balances, December 31, 2011	11,198,119	$ 111,981	$ 180,933,978	—	$ —	$ —	$ 181,045,959	$ 17,519,828	$
Net income	—	—	—	—	—	242,600	242,600	515,289	
Offering costs incurred	—	—	(521,111)	—	—	—	(521,111)	—	
Change in ownership interests in consolidated LLC (Note 6)	—	—	2,759,767	—	—	—	2,759,767	(9,959,767)	(
Dividends declared	—	—	—	—	—	(627,868)	(627,868)	—	
Distributions to non-controlling interests	—	—	—	—	—	—	—	(16,187)	
Balances, September 30, 2012	11,198,119	$ 111,981	$ 183,172,634	—	$ —	$ (385,268)	$ 182,899,347	$ 8,059,163	$
Balances, December 31, 2012	11,198,119	$ 111,981	$ 182,985,281	—	—	$ (3,637,331)	$ 179,459,931	$ 8,049,300	$
Net income	—	—	—	—	—	8,562,023	8,562,023	2,063,545	
Offering costs incurred	—	—	(527,785)	—	—	—	(527,785)		—
Distribution to stockholders for fractional shares upon conversion	—	—	(19,974)	—	—	—	(19,974)		—
Dividends declared	—	—	—	—	—	(2,210,028)	(2,210,028)		—
Purchase of treasury stock	—	—	—	(36,860)	(459,634)	—	(459,634)		—
Distributions to non-controlling interests	—	—	—	—	—	—	—	(4,143,304)	

Balances, September 30, 2013	11,198,119	$ 111,981	$ 182,437,522	(36,860)	$ (459,634)	$ 2,714,664	$ 184,804,533	$ 5,969,541	$

(1) As recast to reflect the balances of Owens Mortgage Investment Fund, LP combined with the balances of Owens Realty Mortgage, Inc. beginning January 1, 2012, as required under the accounting guidelines for a transfer of an entity under common control (refer to Note 1).

The accompanying notes are an integral part of these consolidated financial statements.

OWENS REALTY MORTGAGE, INC.
Consolidated Statements of Cash Flows as Recast (1)
(UNAUDITED)

	For the Nine Months Ended September 30, 2013	September 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 10,625,568	$ 757,889
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Gain on sales of real estate, net	(2,712,096)	(2,652,542)
Gain on foreclosure of loan	(952,357)	—
Income from investment in limited liability company	(118,572)	(116,094)
(Reversal of) provision for loan losses	(7,376,344)	399,179
Impairment losses on real estate properties	—	1,033,266
Depreciation and amortization	1,941,887	1,846,158
Changes in operating assets and liabilities:		
Interest and other receivables	580,868	(601,573)
Other assets	(35,441)	(529,623)
Accounts payable and accrued liabilities	(2,213,885)	485,770
Due to Manager	(26,958)	(46,500)
Net cash (used in) provided by operating activities	(287,330)	575,930
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal collected on loans	13,978,529	5,585,586
Investment in loans	(12,878,852)	—
Investment in real estate properties	(2,032,333)	(2,436,773)
Net proceeds from disposition of real estate properties	11,108,406	8,866,691
Purchases of vehicles and equipment	(13,482)	(24,656)
Transfer from restricted to unrestricted cash	2,279,636	21,000
Maturities of certificates of deposit	—	1,993,197
Purchases of certificates of deposit	—	(996,000)
Distribution received from investment in limited liability company	80,000	65,000
Net cash provided by investing activities	12,521,904	13,074,045
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on note payable	(224,337)	(116,676)
Distributions to non-controlling interests	(4,143,304)	(16,187)
Purchase of member’s interest in consolidated LLC	—	(7,200,000)
Offering costs incurred and paid	(527,785)	(521,111)
Distributions to stockholders for fractional shares	(19,974)	—
Purchase of treasury stock	(459,634)	—
Dividends paid	(3,264,380)	(701,452)
Net cash used in financing activities	(8,639,414)	(8,555,426)
Net increase in cash and cash equivalents	3,595,160	5,094,549
Cash and cash equivalents at beginning of period	21,131,505	12,232,121
Cash and cash equivalents at end of period	$ 24,726,665	$ 17,326,670
Supplemental Disclosure of Cash Flow Information		
	$ 469,510	$ 394,671

Cash paid during the period for interest (including amounts capitalized)		
Supplemental Disclosure of Non-Cash Activity		
Increase in real estate from loan foreclosures	18,650,121	—
Increase in accounts payable and accrued liabilities from loan foreclosure	(660,000)	—

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Increase in notes payable from loan foreclosure	(1,000,000)	—
Decrease in loans, net of allowance for loan losses, from loan foreclosures	(15,609,812)	—
Decrease in interest and other receivables from loan foreclosures	(1,380,309)	—
Increase in loans from sales of real estate	11,900,000	1,320,000
Increase in deferred gains from sales of real estate	(2,344,052)	—
Decrease in non-controlling interest from change in ownership interests	—	2,759,767
Change in capital expenditures financed through accounts payable	(2,833,940)	—

(1) As recast to reflect the balances of Owens Mortgage Investment Fund, LP combined with the balances of Owens Realty Mortgage, Inc. beginning January 1, 2012, as required under the accounting guidelines for a transfer of an entity under common control (refer to Note 1).

The accompanying notes are an integral part of these consolidated financial statements.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1 – ORGANIZATION

Owens Realty Mortgage, Inc. (the “Company”) was incorporated on August 9, 2012, under the laws of the State of Maryland and was authorized to issue 1,000,000 shares of $0.01 par value common stock at the time of its incorporation. At the time of its incorporation, William C. Owens was issued 1,000 shares of common stock, $.01 par value per share, in exchange for cash consideration of $1.00 per share (for total consideration of $1,000). Per the Articles of Amendment and Restatement of the Company dated January 23, 2013, the authorized shares of common stock were increased to 50,000,000 shares, $0.01 par value per share. In addition, the Company is now authorized to issue 5,000,000 shares of preferred stock at $0.01 par value per share. The Company was created to effect the merger (the “Merger”) of Owens Mortgage Investment Fund, a California Limited Partnership (“OMIF”) with and into the Company as described in the Registration Statement on Form S-4, as amended, of the Company, declared effective on February 12, 2013 (File No. 333-184392). The Merger was part of a plan to reorganize the business operations of OMIF so that it could elect to qualify as a real estate investment trust for Federal income tax purposes. The Merger was approved by OMIF limited partners on April 16, 2013 and was completed on May 20, 2013.

Upon effectiveness of the Merger, the outstanding 1,000 shares of common stock of the Company held by William C. Owens were cancelled in exchange for $1,000, and every 25 limited partner units of OMIF were converted into one share of common stock of the Company. Additionally, the units representing the general partner interests of Owens Financial Group, Inc. (“OFG”) were treated as follows: i) the 1,496,000 units representing the interest that was an expense of OMIF were cancelled, and ii) the 1,378,256 units representing the interest relating to cash contributions made by OFG to the capital of OMIF were converted into shares of common stock of the Company in the same manner limited partnership units were converted into shares of common stock. No fractional shares were issued in the Merger; instead, cash adjustments were paid in respect of shares otherwise issuable. The Company now, by virtue of the Merger, directly or indirectly owns all of the assets and business formerly owned by OMIF and is a deemed successor issuer to OMIF pursuant to Rule 12g-3(a) under the Securities Exchange Act of 1934, as amended. For accounting purposes, the merger of OMIF with and into the Company has been treated as a transfer of assets and exchange of shares between entities under common control. The accounting basis used to initially record the assets and liabilities in the Company is the carryover basis of OMIF. The consolidated financial statements included in this Form 10-Q reflect the extinguishment of OMIF’s partners’ capital and replacement with 11,198,119 shares of common stock and additional paid –in capital as if the Merger occurred on December 31, 2011. In addition, capitalized offering costs incurred during 2012 were reclassified from Other Assets to Additional Paid-in Capital in the accompanying consolidated financial statements.

The Company intends to elect and qualify to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”), commencing with the Company’s taxable year ended December 31, 2013. As a REIT, the Company will be permitted to deduct distributions made to its stockholders, allowing its income and gain represented by such distributions to avoid taxation at the entity level and to be taxed generally only at the stockholder level. The Company intends to distribute substantially all of its income and gain. As a REIT, however, the Company will be subject to separate, corporate-level tax, including potential 100% penalty taxes under various circumstances, as well as certain state and local taxes. In addition, the Company’s taxable REIT subsidiaries will be subject to full corporate income tax. Furthermore, the Company’s ability to qualify as a REIT will depend upon its continuing satisfaction of various requirements, such as those related to the diversity of its stock ownership, the nature of its assets, the sources of its income and the distributions to its stockholders, including a requirement that the Company distribute to its stockholders at least 90% of its REIT taxable income on an annual basis (determined without regard to the dividends paid deduction and by excluding net capital gain).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In the opinion of the management of the Company, the accompanying unaudited financial statements contain all adjustments, consisting of normal, recurring adjustments, necessary to present fairly the financial information included therein. Certain information and footnote disclosures presented in the annual consolidated financial statements are not included in these interim financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Form 10-K of OMIF (the predecessor entity) for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission ("SEC"). The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the operating results to be expected for the full year ending December 31, 2013. The Company evaluates subsequent events up to the date it files its Form 10-Q with the SEC.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

Basis of Presentation

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned taxable REIT subsidiary (TRS) and its majority- and wholly-owned limited liability companies (see notes 5 and 6). The Company is in the business of providing mortgage lending services and manages its business as one operating segment. Due to foreclosure activity, the Company also owns and manages real estate assets.

Certain reclassifications, not affecting previously reported net income or total stockholders' equity, have been made to the previously issued consolidated financial statements to conform to the current period presentation.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates relate principally to the determination of the allowance for loan losses, including the valuation of impaired loans, the valuation of real estate held for sale and investment, and the estimate of the environmental remediation liability (see notes 4 and 12). Fair value estimates are derived from information available in the real estate markets including similar property and often require the experience and judgment of third parties such as real estate appraisers and brokers. The estimates figure materially in calculating the value of the property at acquisition, the level of charge to the allowance for loan losses and any subsequent valuation reserves or write-downs. Such estimates are inherently imprecise and actual results could differ significantly from such estimates.

Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents include funds on deposit with financial institutions.

Restricted Cash

Restricted cash includes contingency reserves required pursuant to the Company's charter, cash reserved for Company purchases of its own common stock and escrow deposits for property taxes to be paid on certain Company real estate properties.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and loans. The Company places its cash and cash equivalents with financial institutions and, at times, cash held may exceed the Federal Deposit Insurance Corporation, or "FDIC", insured limit. The Company has exposure to credit risk on its loans and other investments. The Company's manager, OFG, will seek to manage credit risk by performing analysis of underlying collateral assets.

Loans

Loans are stated at the principal amount outstanding. The Company's portfolio consists primarily of real estate loans generally collateralized by first, second and third deeds of trust. Interest income on loans is accrued by the simple interest method. Loans are generally placed on nonaccrual status when the borrowers are past due greater than ninety days or when full payment of principal and interest is not expected. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest remains accrued until the loan becomes current, is paid off or is foreclosed upon. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Cash receipts on nonaccrual loans are used to reduce any outstanding accrued interest, and then are recorded as interest income, except when such payments are specifically designated as principal reduction or when management does not believe the Company's investment in the loan is fully recoverable.

Allowance for Loan Losses

Loans and the related accrued interest and advances are analyzed by management on a periodic basis for ultimate recovery. The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired.

Regardless of a loan type, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement or when monthly payments are delinquent for more than 90 days on a loan. All loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, management estimates impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. These valuations are generally updated during the fourth quarter but may be updated during interim periods if deemed appropriate by management.

A restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDR's are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole.

The Company maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, residential real estate and land loans. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet. The reserve for loans that are not impaired consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses, and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

Commercial and Residential Real Estate Loans –Adverse economic developments or an overbuilt market impact commercial and residential real estate projects and may result in troubled loans. Trends in vacancy rates of properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Land Loans – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified costs and time lines. Trends in the construction industry significantly impact the credit quality of these loans as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Rental Income

The Company leases multifamily rental units under operating leases with terms of generally one year or less. Rental revenue is recognized, net of rental concessions, on a straight-line method over the related lease term. Rental income on commercial property is recognized on a straight-line basis over the term of each operating lease. Recognition of gains on the sale of real estate is dependent upon the transaction meeting certain criteria related to the nature of the property and the terms of the sale including potential seller financing.

Real Estate Held for Sale

Real estate held for sale includes real estate acquired in full or partial settlement of loan obligations, generally through foreclosure, and is being marketed for sale. Real estate held for sale is recorded at acquisition at the property's estimated fair value less estimated costs to sell. Any excess of the recorded investment in the loan over the net realizable value is charged against the allowance for loan losses.

After acquisition, costs incurred relating to the development and improvement of property are capitalized to the extent they do not cause the recorded value to exceed the net realizable value, whereas costs relating to holding and disposition of the property are expensed as incurred. After acquisition, real estate held for sale is analyzed periodically for changes in fair values and any subsequent write down is charged to impairment losses on real estate properties. Any recovery in the fair value subsequent to such a write down is recorded (not to exceed the net realizable value at acquisition) as an offset to impairment losses on real estate properties. Recognition of gains on the sale of real estate is dependent upon the transaction meeting certain criteria related to the nature of the property and the terms of the sale including potential seller financing.

Real Estate Held for Investment

Real estate held for investment includes real estate acquired in full or partial settlement of loan obligations, generally through foreclosure, and is not being marketed for sale and is either being operated, such as rental properties; is being managed through the development process, including obtaining appropriate and necessary entitlements, permits and construction; or are idle properties awaiting more favorable market conditions. Real estate held for investment is recorded at acquisition at the property's estimated fair value, less estimated costs to sell.

After acquisition, costs incurred relating to the development and improvement of the property are capitalized, whereas costs relating to operating or holding the property are expensed. Subsequent to acquisition, management periodically compares the carrying value of real estate to expected undiscounted future cash flows for the purpose of assessing the recoverability of the recorded amounts. If the carrying value exceeds future undiscounted cash flows, the assets are reduced to estimated fair value.

Depreciation of real estate properties held for investment is provided on the straight-line method over the estimated remaining useful lives of buildings and improvements (5-39 years). Depreciation of tenant improvements is provided on the straight-line method over the lives of the related leases.

The Company reclassifies real estate properties from held for investment to held for sale in the period in which all of the following criteria are met: 1) Management commits to a plan to sell the property; 2) The property is available for immediate sale in its present condition; 3) An active program to locate a buyer has been initiated; 4) The sale of the property is probable and the transfer of the property is expected to qualify for recognition as a completed sale, within one year; and 5) Actions required to complete the plan indicate it is unlikely that significant changes to the plan will be made or the plan will be withdrawn.

If circumstances arise that previously were considered unlikely, and, as a result, the Company decides not to sell a real estate property classified as held for sale, the property is reclassified to held for investment. The property is then measured individually at the lower of its carrying amount, adjusted for depreciation or amortization expense that would have been recognized had the property been continuously classified as held for investment or its fair value at the date of the subsequent decision not to sell.

Environmental Remediation Liability

Liabilities related to future environmental remediation costs are recorded when remediation or monitoring or both are probable and the costs can be reasonably estimated. The Company’s environmental remediation liability related to the property located in Santa Clara, California (held within 1850 De La Cruz, LLC – see Notes 4 and 12) was recorded based on a third party consultant’s estimate of the costs required to remediate and monitor the contamination.

Earnings per Share

The Company calculates basic earnings (loss) per share by dividing net income (loss) allocable to common stockholders for the period by the weighted-average shares of common stock outstanding for that period. Diluted earnings (loss) per share takes into effect any dilutive instruments, except when doing so would be anti-dilutive. At the present time, the Company has not issued any restricted stock or restricted stock units.

Income Taxes

The Company intends to elect and qualify for taxation as a REIT. As a result of the Company’s expected REIT qualification and its distribution policy, the Company does not generally expect to pay U.S. federal corporate level income taxes. Many of the REIT requirements, however, are highly technical and complex. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that the Company distribute annually at least 90% of the Company’s REIT taxable income to the Company’s stockholders. If the Company has previously qualified as a REIT and fails to qualify as a REIT in any subsequent taxable year and does not qualify for certain statutory relief provisions, the Company will be subject to U.S. federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may be precluded from qualifying as a REIT for the Company’s four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain U.S. federal, state, local and foreign taxes on the Company’s income and property and to U.S. federal income and excise taxes on the Company’s undistributed REIT taxable income.

ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has analyzed its various federal and state filing positions and believes that its income tax filing positions and deductions are well documented and supported.

As of September 30, 2013 and December 31, 2012, the Company has not recorded a reserve for any uncertain income tax positions. There has been no interest or penalties incurred to date.

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table shows the allocation of the allowance for loan losses as of and for the three and nine months ended September 30, 2013 by portfolio segment and by impairment methodology:

2013	Commercial	Residential	Land	Total
Allowance for loan losses:				
Three Months Ended September 30, 2013				
Beginning balance	$ 1,216,857	$ 4,378,847	$ 9,012	$ 5,604,716
Charge-offs	—	—	—	—
(Reversal) Provision	(420,085)	222	3	(419,860)
Ending Balance	$ 796,772	$ 4,379,069	$ 9,015	$ 5,184,856
Nine Months Ended September 30, 2013				
Beginning balance	$ 1,606,925	$ 4,288,108	$ 18,522,864	$ 24,417,897
Charge-offs	—	—	(11,856,697)	(11,856,697)
(Reversal) Provision	(810,153)	90,961	(6,657,152)	(7,376,344)
Ending balance	$ 796,772	$ 4,379,069	$ 9,015	$ 5,184,856
As of September 30, 2013				
Ending balance: individually evaluated for impairment	$ 446,711	$ 3,644,145	$ —	$ 4,090,856
	350,061	$ 734,924	$ 9,015	$ 1,094,000

Ending balance: collectively evaluated for impairment	$			
Ending balance	$ 796,772	$ 4,379,069	$ 9,015	$ 5,184,856
Loans:				
Ending balance	$ 19,318,878	$ 29,124,575	$ 5,175,503	$ 53,618,956
Ending balance: individually evaluated for impairment	$ 14,066,878	$ 10,304,575	$ 4,975,503	$ 29,346,956
Ending balance: collectively evaluated for impairment	$ 5,252,000	$ 18,820,000	$ 200,000	$ 24,272,000

OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

The following table shows the allocation of the allowance for loan losses for the three and nine months ended September 30, 2012 and as of December 31, 2012 by portfolio segment and by impairment methodology:

2012	Commercial	Residential	Land	Total
Allowance for loan losses:				
Three Months Ended September 30, 2012				
Beginning balance	$ 2,369,287	$ 3,855,281	$ 18,164,938	$ 24,389,506
(Reversal) Provision	(167,073)	(211,200)	929,843	551,570
Ending Balance	$ 2,202,214	$ 3,644,081	$ 19,094,781	$ 24,941,076
Nine Months Ended September 30, 2012				
Beginning balance	$ 2,951,543	$ 3,855,281	$ 17,735,073	$ 24,541,897
(Reversal) Provision	(749,329)	(211,200)	1,359,708	399,179
Ending balance	$ 2,202,214	$ 3,644,081	$ 19,094,781	$ 24,941,076
As of December 31, 2012				
Ending balance: individually evaluated for impairment	$ 446,904	$ 3,644,129	$ 18,522,864	$ 22,613,897
Ending balance: collectively evaluated for impairment	$ 1,046,681	$ 757,319	$ —	$ 1,804,000

Ending balance	$ 1,493,585	$4,401,448	$ 18,522,864	$24,417,897
Loans:				
Ending balance	$ 21,884,292	$ 19,199,631	$ 29,178,339	$70,262,262
Ending balance: individually evaluated for impairment	$ 9,694,292	$ 10,379,631	$ 29,178,339	$49,252,262
Ending balance: collectively evaluated for impairment	$ 12,190,000	$8,820,000	$ —	$21,010,000

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OWENS REALTY MORTGAGE, INC.

Notes to Consolidated Financial Statements (Unaudited)

The following tables show an aging analysis of the loan portfolio by the time past due as of September 30, 2013 and December 31, 2012:

	Loans 30-59 Days Past Due	Loans 60-89 Days Past Due	Loans 90 or More Days Past Due