

**GROUND FLOOR FINANCE INC.
AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2020 and 2019

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

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December 31, 2020 and 2019

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To the Board of Directors
Groundfloor Finance, Inc. and Subsidiaries
Atlanta, Georgia

We have audited the accompanying consolidated financial statements of Groundfloor Finance, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2020 and 2019 and the related statements of operations, stockholders' deficit, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Substantial Doubt about the Company's Ability to Continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has incurred losses and cash outflows from operations since its inception which result in substantial doubt about the ability of the Company to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding those matters also are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.



Atlanta, Georgia,
March 15, 2021

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	December 31,	
	2020	2019
Assets		
Current assets:		
Cash	\$ 1,429,172	\$ 1,699,196
Loans to developers, net	63,215,374	73,851,996
Interest receivable on loans to developers	3,545,454	2,867,914
Other current assets	2,631,801	937,645
Total current assets	70,821,801	79,356,751
Property, equipment, software, website, and intangible assets, net	1,056,577	971,607
Other assets	71,302	42,603
Total assets	\$ 71,949,680	\$ 80,370,961
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,189,807	\$ 4,602,116
Accrued interest on limited recourse obligations	2,831,984	2,251,926
Limited recourse obligations, net	45,926,226	53,124,759
Revolving credit facility	-	10,460,752
Convertible notes, net of discount of \$126,352 and \$368,526	2,661,774	3,238,474
Short-term notes payable	19,806,920	8,085,257
Total current liabilities	73,416,711	81,763,284
Other liabilities	138,680	136,819
Total liabilities	73,555,391	81,900,103
Commitments and contingencies (See Note 12)		
Stockholders' deficit:		
Common stock, no par, 5,000,000 shares authorized, 2,165,923 and 2,102,720 issued and outstanding	11,596,087	10,564,771
Series A convertible preferred stock, no par, 747,385 shares designated, 747,373 shares issued and outstanding (liquidation preference of \$4,999,925)	4,962,435	4,962,435
Series Seed convertible preferred stock, no par, 575,000 shares designated, 568,796 shares issued and outstanding (liquidation preference of \$2,721,091)	2,609,091	2,609,091
Series B convertible preferred stock, no par, 548,546 shares designated, 188,036 and 0 shares issued and outstanding (liquidation preference of \$3,427,896 and \$0)	3,145,092	-
Additional paid-in capital	2,336,551	1,802,895
Accumulated deficit	(26,254,407)	(21,467,774)
Stock subscription receivable	(560)	(560)
Total stockholders' deficit	(1,605,711)	(1,529,142)
Total liabilities and stockholders' deficit	\$ 71,949,680	\$ 80,370,961

See accompanying notes to consolidated financial statements

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	Year Ended December 31,	
	2020	2019
Non-interest revenue:		
Origination fees	\$ 2,548,305	\$ 2,748,150
Loan servicing revenue	1,348,332	1,964,284
Total non-interest revenue	3,896,637	4,712,434
Net interest income:		
Interest income	7,597,436	6,323,801
Interest expense	(6,042,535)	(4,633,122)
Net interest income	1,554,901	1,690,679
Revenue	5,451,538	6,403,113
Cost of revenue	(611,436)	(779,756)
Gross profit	4,840,102	5,623,357
Operating expenses:		
General and administrative	3,006,854	2,514,202
Sales and customer support	2,457,720	2,939,149
Development	1,205,399	1,125,071
Regulatory	353,103	208,874
Marketing and promotions	1,453,840	1,515,558
Total operating expenses	8,476,916	8,302,854
Loss from operations	(3,636,814)	(2,679,497)
Interest expense on corporate debt instruments	1,149,819	1,157,769
Net loss	\$ (4,786,633)	\$ (3,837,266)

See accompanying notes to consolidated financial statements

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Consolidated Statements of Stockholder's Deficit

	Series A Convertible Preferred Stock		Series Seed Convertible Preferred Stock		Series B Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Stock Subscription Receivable	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
	Stockholders' equity as of December 31, 2018	747,373	4,962,435	568,796	2,609,091	-	-	1,732,585				
2019 Crowdfunded equity raise, net of offering costs	-	-	-	-	-	-	207,735	3,073,307	-	-	-	3,073,307
Issuance of bonus shares	-	-	-	-	-	-	6,800	-	-	-	-	-
Exercise of stock options	-	-	-	-	-	-	7,937	17,379	-	-	-	17,379
Conversion of convertible note	-	-	-	-	-	-	147,663	1,348,821	-	-	-	1,348,821
Share-based compensation expense	-	-	-	-	-	-	-	-	318,545	-	-	318,545
Beneficial conversion feature	-	-	-	-	-	-	-	-	400,778	-	-	400,778
Net loss	-	-	-	-	-	-	-	-	-	(3,837,266)	-	(3,837,266)
Stockholders' equity as of December 31, 2019	747,373	4,962,435	568,796	2,609,091	-	-	2,102,720	10,564,771	1,802,895	(21,467,774)	(560)	(1,529,142)
2020 Crowdfunded equity raise, net of offering costs	-	-	-	-	-	-	30,794	538,720	-	-	-	538,720
Issuance of Series B preferred shares, net of offering costs	-	-	-	-	159,748	2,679,234	-	-	-	-	-	2,679,234
Conversion of convertible notes	-	-	-	-	28,288	465,858	30,841	488,707	-	-	-	954,565
Exercise of stock options	-	-	-	-	-	-	1,568	3,889	-	-	-	3,889
Share-based compensation expense	-	-	-	-	-	-	-	-	533,656	-	-	533,656
Net loss	-	-	-	-	-	-	-	-	-	(4,786,633)	-	(4,786,633)
Stockholders' equity as of December 31, 2020	747,373	4,962,435	568,796	2,609,091	188,036	3,145,092	2,165,923	11,596,087	2,336,551	(26,254,407)	(560)	(1,605,711)

See accompanying notes to consolidated financial statements

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2020	2019
Cash flows from operating activities		
Net loss	\$ (4,786,633)	\$ (3,837,266)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	527,862	481,533
Share-based compensation	533,656	401,930
Noncash interest expense	274,674	85,089
Loss on sale of real estate owned	16,816	-
Origination of loans held for sale	(1,060,410)	(13,659,207)
Proceeds from sales of loans held for sale	1,968,800	15,320,281
Debt conversion inducement expense	41,633	-
Changes in operating assets and liabilities:		
Other assets	8,406	(133,042)
Interest receivable on loans to developers	(677,540)	(1,085,699)
Accounts payable and accrued expenses	(2,316,392)	2,308,919
Accrued interest on limited recourse obligations	580,059	887,310
Net cash flows from operating activities	(4,889,069)	769,848
Cash flows from investing activities		
Loan payments to developers	(66,314,737)	(87,710,983)
Repayments of loans from developers	69,503,979	46,214,398
Proceeds from sale of properties held for sale	1,715,352	2,018,836
Purchases of computer equipment and furniture and fixtures	(53,499)	(50,373)
Payments of software and website development costs	(559,332)	(569,749)
Other investing activities	(80,000)	-
Net cash flows from investing activities	4,211,763	(40,097,871)
Cash flows from financing activities		
Proceeds from limited recourse obligations	62,279,248	72,042,001
Repayments of limited recourse obligations	(66,610,220)	(47,889,960)
Borrowings from the revolving credit facility	3,069,028	58,820,632
Repayments on the revolving credit facility	(13,562,280)	(53,827,652)
Proceeds from issuance of short-term notes payable	68,950,380	24,070,230
Repayments of short-term notes payable	(58,057,817)	(17,260,860)
Proceeds from issuance of convertible notes	288,000	3,174,000
Proceeds from loan under Paycheck Protection Program	829,100	-
Proceeds from issuance of Series B convertible preferred stock, net of offering costs	2,679,234	-
Proceeds from issuance of common stock, net of offering costs	538,720	3,073,307
Repayments of convertible notes	-	(450,000)
Repayment of 2017 Note	-	(1,750,000)
Payment of deferred financing costs	-	(61,250)
Exercise of stock options	3,889	17,379
Net cash flows from financing activities	407,282	39,957,827
Net increase (decrease) in cash	(270,024)	629,804
Cash as of beginning of the year	1,699,196	1,069,392
Cash as of end of the year	<u>\$ 1,429,172</u>	<u>\$ 1,699,196</u>
Supplemental cash flow disclosures:		
Cash paid for interest	\$ 1,260,238	\$ 1,218,759

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2020	2019
Supplemental disclosure of noncash investing and financing activities:		
Loans to developers transferred to other real estate owned	\$ 4,911,985	\$ 2,015,376
Write-down of loans to developers, net and limited recourse obligations, net	308,676	484,282
Write-down of interest receivable on loans to developers and accrued interest on limited recourse obligations	3,002,041	224,106
Conversion of convertible notes payable and accrued interest into common stock or Series B convertible preferred stock	912,933	1,348,821
Increase in allowance for loan to developers and limited recourse obligations	640,000	-
Issued warrants in connection with notes payable	-	139,896
Issued advance agreements for convertible notes payable	-	288,000

See accompanying notes to consolidated financial statements

GROUNDFLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

The terms "we," "our," "GROUNDFLOOR," or the "Company" refer to Groundfloor Finance Inc. and its subsidiaries. The Company was originally organized as a North Carolina limited liability company under the name of Fomentum Labs LLC on January 28, 2013. Fomentum Labs LLC changed its name to Groundfloor LLC on April 26, 2013, and converted into a North Carolina corporation on July 26, 2013. In connection with this conversion, all equity interests in Groundfloor LLC were converted into shares of GROUNDFLOOR Inc.'s common stock. In August 2014, GROUNDFLOOR Inc. converted into a Georgia corporation and changed its name to Groundfloor Finance Inc. The accounting effects of these conversions were reflected retrospectively in the Consolidated Financial Statements. Groundfloor Holdings GA, LLC is the holder of the Revolver, as defined in Note 7. Groundfloor Properties GA LLC was created for the purpose of financing real estate in Georgia. Groundfloor Real Estate 1 LLC, Groundfloor Real Estate 2 LLC, and Groundfloor Yield LLC were created for the purpose of financing real estate in any state. Groundfloor Real Estate, LLC is currently inactive and management does not have plans to use this entity in the near future.

The Company has developed an online investment platform designed to crowdsource financing for real estate development projects (the "Projects"). With this online investment platform (the "Platform"), public investors (the "Investors") are able to choose between multiple Projects, and real estate developers (the "Developers") of the Projects are able to obtain financing. GROUNDFLOOR's financing model replaces traditional sources of financing for Projects with the aggregation of capital from Investors using the internet.

Basis of Presentation and Liquidity

The Company's Consolidated Financial Statements include Groundfloor Finance Inc. and its wholly owned subsidiaries, Groundfloor Properties GA LLC; Groundfloor Real Estate, LLC; Groundfloor Holdings GA, LLC; Groundfloor Real Estate 1 LLC; Groundfloor Real Estate 2, LLC; and Groundfloor Yield LLC (collectively the "Company" or "GROUNDFLOOR"). Intercompany transactions and balances have been eliminated upon consolidation.

The Company's Consolidated Financial Statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities and commitments in the normal course of business.

Operations since inception have consisted primarily of organizing the Company, developing the technology, and securing financing. The accompanying Consolidated Financial Statements have been prepared on a basis which assumes that the Company will continue as a going concern. The Company has incurred losses and cash outflows from operations since its inception. The ultimate success of the Company is dependent on management's ability to develop and market its products and services at levels sufficient to generate operating revenues in excess of expenses.

Management evaluated the condition of the Company and has determined that until such sales levels can be achieved, management will need to secure additional capital to continue growing working capital and fund product development and operations.

Management intends to raise additional debt or equity financing to grow working capital and fund operations. Management believes the Company will obtain additional funding from current and new Investors in order to sustain operations. However, there are no assurances that the Company can be successful in obtaining the additional capital or that such financing will be on terms favorable or acceptable to the Company.

There is substantial doubt that the Company will continue as a going concern for at least 12 months following the date these Consolidated Financial Statements are issued, without additional financing based on the Company's limited operating history and recurring operating losses.

The Consolidated Financial Statements do not include any adjustments that might result from the outcome of the uncertainties described in the Consolidated Financial Statements. In addition, the Consolidated Financial Statements

GROUNDLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

do not include any adjustments relating to the recoverability and classification of assets nor the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

Use of Estimates

The preparation of Consolidated 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 Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Revenue primarily results from fees earned on the loans to the Developers (the “Loans”). Fees include “Origination fees” and “Loan servicing revenue” which are paid by the Developers.

Effective for 2019, the Company adopted Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers* (“Topic 606”). Topic 606 supersedes the revenue requirements in ASC Topic 605, Revenue Recognition. The Company has evaluated the impact of this accounting standard on its Consolidated Financial Statements and concluded that the Company’s contracts with customers continue to fall within the scope of existing guidance. Servicing fees, origination fees, net interest income, and gains and losses on sales of loans remain within the scope of ASC topic 310—Receivables or ASC topic 860—Transfers and Servicing. Consequently, there was no transition adjustment required on the accompanying financial statements for adopting Topic 606.

Origination Fees

“Origination fees” are paid by the Developers for the work performed to facilitate the Loans. The amount to be charged is a percentage based upon the terms of the Loan, including grade, rate, term, and other factors. Origination fees range from 1.0% to 5.0% of the principal amount of a Loan. The origination fee is paid when the Loan is issued to the Developer and deducted from the gross proceeds distributed. A Loan is considered issued when formal closing has occurred and funds have transferred to the Developer’s account, which occurs through an Electronic Funds Transfer (“EFT”).

The origination fees are recognized as revenue ratably over the term of the Loan, while direct costs to originate Loans are recorded as expenses as incurred.

Loan Servicing Revenue

Loan servicing revenue is recognized by the Company, upon recovery, for costs incurred in servicing the Developer’s Loan, including managing payments to and from Developers and payments to Investors. The Company records loan servicing revenue as a component of revenue when collected. Direct costs to service Loans are recorded as expenses as incurred.

Whole Loan Sales

Under loan sale agreements, the Company sells all of its rights, title, and interest in certain loans. At the time of such sales, the Company may simultaneously enter into loan servicing agreements under which it acquires the right to service the loans. The Company calculates a gain or loss on a whole loan sale based on the net proceeds from the whole loan sale, less the carrying value of the loans sold. All unamortized origination fees incurred in the origination process are recognized directly to Consolidated Statements of Operations and recorded to “Origination fees”. For sold loans for which the Company retains servicing rights, the Company compares the expected contractual benefits of servicing to the expected costs of servicing to determine whether a servicing asset or servicing liability arises from the transaction. No servicing rights assets or liabilities have been identified for the years ended December 31, 2020 and 2019.

GROUNDLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Interest Income on Loans to Developers and Interest Expense on Limited Recourse Obligations

The Company recognizes “Interest income” on Loans and “Interest expense” on the corresponding Investor Georgia Notes (if issued by Groundfloor GA) or LROs (if issued by Groundfloor Finance Inc.) using the accrual method based on the stated interest rate to the extent the Company believes it to be collectable. For the purposes of these Consolidated Financial Statements, “Limited recourse obligations, net” refers to both Georgia Notes and LROs. Georgia Notes are securities that the Company has issued through its previously registered Georgia-exclusive securities offering, which has since been terminated. LROs are the Company’s currently registered securities. Both Georgia Notes and LROs represent similar obligations of the Company.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The Company had no cash equivalents as of December 31, 2020 and 2019. From time to time, the Company could maintain cash deposits in excess of federally insured limits. The Company believes credit risk related to its cash and cash equivalents to be minimal.

Each investor’s escrow account receives Federal Deposit Insurance Corporation (“FDIC”) insurance coverage on cash balances subject to normal FDIC coverage rules. Investor funds, whether committed through a LRO or held in escrow, are not included as a part of the Company’s cash balance.

Loans to Developers and Limited Recourse Obligations

“Loans to developers, net” are originally recorded at outstanding principal, then subsequently increased as additional draws are disbursed to developers. “Limited recourse obligation, net” are originally recorded at the original principal amount committed by investors, net of funds not yet to be disbursed to developers on the underlying loans, then subsequently increased as those funds are disbursed to developers. Funds committed by investors in LROs but not yet disbursed to developers on the underlying Loans were approximately \$20,868,000 and \$8,218,000, as of December 31, 2020 and 2019, respectively. These funds are netted against gross balances of approximately \$66,794,000 and \$61,343,000 as of December 31, 2020 and 2019, respectively, on the accompanying Consolidated Balance Sheets.

The interest rate associated with a Loan is the same as the interest rate associated with the corresponding Georgia Notes or LROs.

The Company’s obligation to pay principal and interest on a Georgia Note or LRO is equal to the pro rata portion of the total principal and interest payments collected from the corresponding Loan. The Company obtains a lien against the property being financed and attempts reasonable collection efforts upon the default of a Loan. The Company is not responsible for repaying “Limited recourse obligations, net” associated with uncollectable “Loans to developers, net.” Amounts collected related to a defaulted Loan are returned to the Investors based on their pro rata portion of the corresponding Georgia Notes or LROs, if applicable, less collection costs incurred by the Company.

The Investors may remit funds through the Company’s online portal prior to the actual Loan being closed. These funds are held in an escrow account controlled by a major bank and are not recognized as an LRO until the Loan is closed and funds are transferred to the Developer, which occurs through an EFT transaction. Each Investor escrow account receives FDIC insurance coverage on cash balances subject to normal FDIC coverage rules.

The Loan and corresponding LROs are recorded on the Company’s Consolidated Balance Sheets to “Loans to developers, net” and “Limited recourse obligations, net”, respectively, once the Loan has closed and funds have been disbursed to borrowers. Loans are considered closed after the promissory note for that Loan has been signed and the security interest has been perfected.

Nonaccrual and Past Due Loans

Accrual of interest on “Loans to developers, net” and corresponding “Limited recourse obligations, net” is discontinued when, in management’s opinion, the collection of the interest income appears doubtful. “Interest income” and “Interest expense” on the “Loans to developers, net” and the corresponding “Limited recourse obligations, net”

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

are discontinued and placed on nonaccrual status at the time the Loan is 90 days delinquent unless the Loan is well secured and in process of collection. A Loan may also be placed on nonaccrual status when, in management's judgment, the collection of the interest income appears doubtful based on the status of the underlying development project, even if the Loan is not yet 90 days delinquent. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The "Loans to developers, net" and corresponding "Limited recourse obligations, net" are charged off to the extent principal or interest is deemed uncollectible. All interest accrued but later charged off for "Loans to developers, net" and "Limited recourse obligations, net" is reversed against "Interest income" and the corresponding LROs recorded "Interest expense".

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreements. Impaired loans include Loans on nonaccrual status. When determining if the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement, the Company considers the borrower's capacity to pay, which includes such factors as the borrower's current financial position, an analysis of global cash flow sufficient to pay all debt obligations and an evaluation of secondary sources of repayment, such as collateral value and guarantor support. The Company individually assesses for impairment all nonaccrual Loans and all Loans in fundamental default. If a Loan is deemed impaired, a specific valuation allowance is allocated, if necessary, so that the Loan is reported net, at the present value of estimated future cash flows using the Loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis.

Allowance for Uncollectable Loans and Undeliverable Limited Recourse Obligations

Payments to holders of Georgia Notes or LROs, as applicable, depend on the payments received on the corresponding Loans; a reduction or increase of the expected future payments on Loans will decrease or increase the reserve for the associated Georgia Notes or LROs. The Company recognizes a reserve for uncollectable Loans and corresponding reserve for undeliverable Georgia Notes or LROs in an amount equal to the estimated probable losses net of recoveries. The allowance is based on management's estimates and analysis of historical bad debt experience, existing economic conditions, current loan aging schedules, and expected future write-offs, as well as an assessment of specific, identifiable Developer accounts considered at risk or uncollectible. Expected losses and actual charge-offs on Loans are offset to the extent that the Loans are financed by Georgia Notes or LROs, as applicable, that effectively absorb the related Loan losses.

"Loans to developers, net" are presented net of a reserve for doubtful accounts of approximately \$3,360,000 and \$2,720,000 as of December 31, 2020 and 2019, respectively. "Limited recourse obligations, net" are presented net of a reserve for doubtful accounts of approximately \$4,304,000 and \$2,720,000 as of December 31, 2020 and 2019, respectively.

Other Real Estate Owned

Foreclosed assets acquired through or in lieu of loan foreclosure are held for sale and are initially recorded at fair value less estimated selling costs. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Costs of improvements are capitalized up to the fair value of the property, whereas costs relating to holding foreclosed assets and subsequent adjustments to the value are charged to operations.

Software Development Costs

Software development costs primarily include internal and external labor expenses incurred to develop the software that powers the Company's website. Certain costs incurred during the application development stage are capitalized

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Notes to Consolidated Financial Statements

based on specific activities tracked, while costs incurred during the preliminary project stage and post-implementation and operation stages are expensed as incurred. Capitalized software development costs are amortized over the estimated useful life of the related software. The Company recognized approximately \$448,000 and \$415,000 in expense related to amortization of software development costs for the years ended December 31, 2020 and 2019, respectively.

Property and Equipment

Property and equipment consists of computer equipment, furniture and fixtures, leasehold improvements, and office equipment. Property and equipment is stated at historical cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the life of the lease or the useful life of the improvements. Upon retirement or sale, the cost of assets disposed of and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is credited or charged to income. Repairs and maintenance costs are expensed as incurred.

Depreciation is computed using the following estimated useful lives:

Computer equipment	3 years
Software and website development costs	3 years
Office equipment	5 years
Furniture and fixtures	5 years
Leasehold improvements	5 years

Impairment of Long-Lived Assets

Long-lived assets, such as computer equipment, office equipment, furniture and fixtures, intangible assets, and software and website development costs, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment charge is recognized for an amount by which the carrying amount of the asset exceeds the fair value of the asset.

Intangible Assets

Intangible assets consist of Company's domain names. Intangible assets are being amortized over a 15-year period, their estimated useful lives, on a straight-line basis. The Company recognized approximately \$2,000 in amortization expense during the years ended December 31, 2020 and 2019.

Equity Offering Costs

The Company accounts for offering costs in accordance with Accounting Standard Codification ("ASC"), ASC 340, *Other Assets and Deferred Costs*. Prior to the completion of an offering, offering costs will be capitalized as deferred offering costs on the balance sheet. The deferred offering costs will be charged to stockholders' equity upon the completion of an offering or to expense if the offering is not completed.

For the year ended December 31, 2019, offering costs of approximately \$41,000 incurred in connection with the 2019 Common Stock Offering were deferred and charged against the gross proceeds of the offering in stockholders' equity.

For the year ended December 31, 2020, offering costs of approximately \$233,000 incurred in connection with the issuance of Series B preferred stock were deferred and charged against the gross proceeds of the offering in stockholders' equity. Offering costs incurred in connection with the 2020 Common Stock Offering were not material and were expensed as incurred.

Deferred Revenue

Deferred revenue consists of origination fee payments received in advance of revenue recognized.

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Notes to Consolidated Financial Statements

Advertising Costs

The cost of advertising is expensed as incurred and presented within “Marketing and promotions” expenses in the Consolidated Statements of Operations. The Company incurred approximately \$607,000 and \$274,000 in advertising costs during the years ended December 31, 2020 and 2019, respectively.

Rent Expense

The Company recognizes rent expense on a straight-line basis over the term of the lease. The difference between rent expense and rent paid is recorded as deferred rent in the Consolidated Balance Sheets as a component of “Other liabilities”. Rent expense is presented within “General and administrative” expenses in the Consolidated Statements of Operations. The Company incurred approximately \$309,000 and \$248,000 in rent expense for office facilities during the years ended December 31, 2020 and 2019, respectively.

Share-Based Compensation

The Company recognizes as expense non-cash compensation for all stock-based awards for which vesting is considered probable. Such stock-based awards include stock options and warrants issued as compensation to employees and nonemployees. Non-cash compensation is measured at fair value on the grant date and expensed ratably over the vesting term. The fair value of each stock option and warrant is estimated using the Black-Scholes option pricing model.

Income Taxes

Deferred tax assets and liabilities are determined based on the temporary differences between the Consolidated Financial Statements carrying amounts and the tax basis of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse. In estimating future tax consequences, all expected future events are considered other than enactment of changes in the tax law or rates.

The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized in the Consolidated Financial Statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

The determination of recording or releasing income tax valuation allowance is made, in part, pursuant to an assessment performed by management regarding the likelihood that the Company will generate future taxable income against which benefits of its deferred tax assets may or may not be realized. This assessment requires management to exercise significant judgment and make estimates with respect to its ability to generate taxable income in future periods.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which requires lessees to recognize most leases on the balance sheet as a lease liability and corresponding right-of-use asset. Further clarification of this guidance was subsequently provided by FASB through the issuance of ASU 2018-10, *Codification Improvements to Topic 842, Leases* (“ASU 2018-10”), in July 2018 and the issuance of ASU 2018-11, *Leases (Topic 842): Targeted Improvements* (“ASU 2018-11”), in July 2018. While the guidance in these pronouncements was originally scheduled to take effect for the Company for the year ending December 31, 2020, the FASB subsequently issued ASU 2020-05 in June 2020 deferring the effective date. The guidance in these pronouncements will therefore be effective for the Company for the year ending December 31, 2022. The Company is currently evaluating the effect of this guidance on the Company’s Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”). The FASB subsequently issued a number of pronouncements amending or clarifying ASU 2016-13, including the following: in November 2018, Accounting Standards Update 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses* (“ASU 2018-19”); in May 2019, Accounting Standards Update 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief* (“ASU 2019-05”); in November 2019, *Financial Instruments—Credit Losses (Topic 326)*,

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Notes to Consolidated Financial Statements

Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates (“ASU 2019-10”); and in November 2019, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses* (“ASU 2019-11”). ASU 2016-13 and the subsequent related pronouncements significantly change how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The standard will replace the current incurred loss approach with an expected loss model, referred to as the current expected credit loss (“CECL”) model. The new standard will apply to financial assets subject to credit losses and measured at amortized cost and certain off-balance-sheet credit exposures, which include, but are not limited to, loans, leases, held-to-maturity securities, loan commitments and financial guarantees. ASU 2016-13 simplifies the accounting for purchased credit-impaired debt securities and loans and expands the disclosure requirements regarding an entity’s assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. For public business entities that meet the definition of an SEC filer, ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019; for all other public business entities, the guidance is effective for fiscal years beginning after December 15, 2020; for all other entities (private companies, not-for-profit organizations, and employee benefit plans), the guidance is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. Upon adoption, ASU 2016-13 provides for a modified retrospective transition by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is effective. The Company is currently evaluating the impact this standard will have on the Company’s Consolidated Financial Statements.

In December 2019, the FASB issued Accounting Standards Update 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes* (“ASU 2019-12”). The amendments in this update simplify the accounting for income taxes by removing certain exceptions in Topic 740 and introducing other changes intended to clarify and improve existing guidance. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020; for all other entities, the amendments are effective for fiscal years beginning after December 15, 2021. The Company is currently evaluating the impact that the implementation of this standard will have on the Company’s Consolidated Financial Statements.

In August 2020, the FASB issued Accounting Standards Update 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40)* (“ASU 2020-06”). The amendments in this update simplify the accounting for convertible interest by removing the requirement to separately account for an embedded conversion feature from the host contract in certain instances. The guidance are effective for fiscal years beginning after December 15, 2023, with early adoption permitted. The Company is evaluating the impact that the implementation of this standard will have on the Company’s Consolidated Financial Statements.

NOTE 3: LOANS TO DEVELOPERS, NET

The Company provides financing to borrowers for real estate-related loans. Real estate loans include loans for unoccupied single family or multifamily renovations and new constructions costing between \$30,000 and \$2,000,000 over six months to a year.

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The following table presents the carrying amount of “Loans to developers, net” by letter grade and performance state as of December 31, 2020 and 2019, respectively:

	Current	Workout	Fundamental Default	Total
Loan grades:				
A	\$ 2,553,516	\$ 87,500	\$ 612,546	\$ 3,253,562
B	6,340,810	1,344,234	5,103,005	12,788,049
C	23,559,735	6,183,234	7,548,514	37,291,483
D	9,226,680	1,656,123	1,403,046	12,285,849
E	77,895	686,525	192,011	956,431
F	-	-	-	-
G	-	-	-	-
Gross amount as of December 31, 2020	\$ 41,758,636	\$ 9,957,616	\$ 14,859,122	\$ 66,575,374
Less: Allowance for loan losses				(3,360,000)
Carrying amount as of December 31, 2020				<u>\$ 63,215,374</u>

	Current	Workout	Fundamental Default	Total
Loan grades:				
A	\$ 5,356,177	\$ 115,256	\$ 350,000	\$ 5,821,433
B	15,610,763	1,992,394	528,367	18,131,524
C	33,204,844	2,147,561	3,879,901	39,232,306
D	10,624,400	314,319	1,717,097	12,655,816
E	640,916	-	90,000	730,916
F	-	-	-	-
G	-	-	-	-
Gross amount as of December 31, 2019	\$ 65,437,100	\$ 4,569,530	\$ 6,565,365	\$ 76,571,996
Less: Allowance for loan losses				(2,720,000)
Carrying amount as of December 31, 2019				<u>\$ 73,851,996</u>

Nonaccrual and Past Due Loans

A Loan is placed on nonaccrual status when, in management’s judgment, the collection of the interest income appears doubtful. Loans placed in nonaccrual status stop accruing interest and, if collectability of interest is sufficiently doubtful, “Interest receivable on loans to developers” that has been accrued and is subsequently determined to have doubtful collectability is charged to “Interest income” and the corresponding “Accrued interest on limited recourse obligations” that has been accrued and is subsequently determined to have doubtful collectability is charged to “Interest expense.” Interest income on Loans that are classified as nonaccrual is subsequently applied to principal until the Loans are returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. As of December 31, 2020, the Company placed Loans of approximately \$14,859,122 recorded to “Loans to developers, net” on nonaccrual status.

The following table presents an analysis of past due Loans as of December 31, 2020 and 2019:

	Carrying Amount	Allowance for Loan Losses	Loans to Developers, net
Aging schedule:			
Current	\$ 35,134,514	350,000	34,784,514
Less than 90 days past due	10,994,226	270,000	10,724,226
More than 90 days past due	20,446,634	2,740,000	17,706,634
Total as of December 31, 2020	<u>\$ 66,575,374</u>	<u>3,360,000</u>	<u>63,215,374</u>

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

	Carrying Amount	Allowance for Loan Losses	Loans to Developers, net
Aging schedule:			
Current	\$ 65,884,046	\$ 730,000	\$ 65,154,046
Less than 90 days past due	5,792,759	240,000	5,552,759
More than 90 days past due	4,895,191	1,750,000	3,145,996
Total as of December 31, 2019	<u>\$ 76,571,996</u>	<u>\$ 2,720,000</u>	<u>\$ 73,851,996</u>

Impaired Loans

The following is a summary of information pertaining to impaired loans as of December 31, 2020:

	Balance
Nonaccrual loans	\$ 14,859,122
Fundamental default not included above	-
Total impaired loans	<u>14,859,122</u>
Interest income recognized on impaired loans	<u>\$ 1,251,441</u>

The following table presents an analysis of information pertaining to impaired loans as of December 31, 2020:

	Balance
Principal loan balance	<u>\$22,328,583</u>
Related allowance	\$ 2,908,000
Average recorded investment	\$ 174,000

The following is a summary of information pertaining to impaired loans as of December 31, 2019:

	Balance
Nonaccrual loans	\$ 6,565,365
Fundamental default not included above	-
Total impaired loans	<u>6,565,365</u>
Interest income recognized on impaired loans	<u>\$ 173,000</u>

The following table presents an analysis of information pertaining to impaired loans as of December 31, 2019:

	Balance
Principal loan balance	<u>\$ 6,565,365</u>
Related allowance	\$ 2,020,000
Average recorded investment	\$ 205,000

Credit Quality Monitoring

The Company uses three performance states to better monitor the credit quality of outstanding loans. Outstanding loans are characterized as follows:

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Current - This status indicates that no events of default have occurred, all payment obligations have been met or none are yet triggered.

Workout - This status indicates there has been one or more payment defaults on the Loan and the Company has negotiated a modification of the original terms that does not amount to a fundamental default.

Fundamental Default - This status indicates a Loan has defaulted and there is a chance the Company will not be able to collect 100% of the principal amount of the Loan by the extended payment date of the corresponding Georgia Notes or LROs.

The following table presents “Loans to developers, net” by performance state as of December 31, 2020 and 2019:

	Carrying Amount	Allowance for Loan Losses	Loans to Developers, Net
Performance states:			
Current	\$ 41,758,636	420,000	41,338,636
Workout	9,957,616	220,000	9,737,616
Fundamental default	14,859,122	2,720,000	12,139,122
Total as of December 31, 2020	<u>\$ 66,575,374</u>	<u>3,360,000</u>	<u>63,215,374</u>

	Carrying Amount	Allowance for Loan Losses	Loans to Developers, Net
Performance states:			
Current	\$ 65,437,101	\$ 630,000	\$ 64,807,101
Workout	4,569,530	70,000	4,499,530
Fundamental default	6,565,365	2,020,000	4,545,365
Total as of December 31, 2019	<u>\$ 76,571,996</u>	<u>\$ 2,720,000</u>	<u>\$ 73,851,996</u>

Allowance for Loan Losses

The following table details activity in the allowance for loan losses for the years ended December 31, 2020 and 2019:

	Balance
Balance, December 31, 2019	\$ 2,720,000
Allowance for loan loss	948,676
Loans charged off	(308,676)
Outstanding as of December 31, 2020	<u>\$ 3,360,000</u>
Period-end amount allocated to:	
Loans evaluated individually for impairment	\$ 2,240,000
Loans evaluated collectively for impairment	560,000
General population of loans, other than those specifically identified	560,000
Balance, December 31, 2020	<u>\$ 3,360,000</u>
Loans:	
Loans evaluated individually for impairment	\$ 3,814,468
Loans evaluated collectively for impairment	11,205,286
General population of loans, other than those specifically identified	51,555,620
Balance, December 31, 2020	<u>\$ 66,575,374</u>

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

	Balance
Balance, December 31, 2018	\$ 500,000
Allowance for loan loss	2,750,000
Loans charged off	(530,000)
Outstanding as of December 31, 2019	<u>\$ 2,720,000</u>
Period-end amount allocated to:	
Loans evaluated individually for impairment	1,860,000
Loans evaluated collectively for impairment	160,000
General population of loans, other than those specifically identified	700,000
Balance, December 31, 2019	<u>\$ 2,720,000</u>
Loans:	
Loans evaluated individually for impairment	3,456,044
Loans evaluated collectively for impairment	3,109,321
General population of loans, other than those specifically identified	70,006,631
Balance, December 31, 2019	<u>\$ 76,571,996</u>

NOTE 4: OTHER CURRENT ASSETS

“Other current assets” at December 31, 2020 and 2019, consists of the following:

	2020	2019
Other real estate owned (1)	\$ 2,154,477	\$ 210,962
Due from related party (2)	434,784	417,381
Rent deposit, current portion	21,302	21,302
Advance agreements (3)	-	288,000
Other	21,239	-
Other current assets	<u>\$ 2,631,801</u>	<u>\$ 937,645</u>

- (1) During the year ended December 31, 2020 the Company transferred \$4,912,985 from “Loans to developers, net” to “Other current assets”. Other real estate owned met the held for sale criteria and have been recorded at the lower of carrying amount or fair value less cost to sell. There was no impact to the Company’s Consolidated Statements of Operations from this transfer. The Company recorded a decrease of approximately \$944,442 to “Loans to developers, net” and an offsetting decrease to “Limited recourse obligations, net”.
- (2) Loan and accrued interest receivable from related parties. Refer to Note 11 – Related Party Transactions.
- (3) Advance agreements for the purchase of 2019 Subordinated Convertible Notes. Refer to Note 7 – Debt.

NOTE 5: PROPERTY, EQUIPMENT, SOFTWARE, WEBSITE AND INTANGIBLE ASSETS, NET

“Property, equipment, software, website development costs, and intangible assets, net” at December 31, 2020 and 2019, consists of the following:

	2020	2019
Software and website development costs	\$ 2,434,075	\$ 1,874,742
Computer equipment	137,514	118,476
Leasehold improvements	9,838	22,367
Furniture and fixtures	206,290	171,828
Office equipment	46,405	46,405
Domain names	30,000	30,000
Total property, equipment, software, website and intangible assets	<u>2,864,122</u>	<u>2,263,818</u>
Less: accumulated depreciation and amortization	(1,807,545)	(1,292,211)
Property, equipment, software, website and intangible assets, net	<u>\$ 1,056,577</u>	<u>\$ 971,607</u>

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Depreciation and amortization expense on “Property, equipment, intangible assets, software, and website development costs, net” for the years ended December 31, 2020 and 2019 was approximately \$524,000 and \$482,000, respectively. Amortization of software and website development costs is included as a component of “Development” and depreciation of property, equipment, and intangible assets is included as a component of “General and administrative” in the Consolidated Statements of Operations.

NOTE 6: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

“Accounts payable and accrued expenses” at December 31, 2020 and 2019, consists of the following:

	2020	2019
Deferred loan origination fees	\$ 1,115,067	\$ 1,441,471
Trade accounts payable	478,712	509,443
Accrued interest expense (1)	333,900	302,490
Funded loans-in-process (2)	147,100	2,097,512
Accrued employee compensation	104,551	87,949
Other	10,477	163,251
Accounts payable and accrued expenses	<u>\$ 2,189,807</u>	<u>\$ 4,602,116</u>

- (1) “Accrued interest expense” includes interest related to corporate debt instruments as described in Note 7.
- (2) Certain whole loans originated by the Company in 2019 and subsequently sold to institutional buyers were purchased at the contractual loan amount, which comprises both the principal amount disbursed to borrowers prior to the loan sale and any loan-in-process principal yet to be disbursed. “Funded loans in process” represents the obligation of the Company to disburse loan-in-process funds received from institutional buyers to borrowers for the underlying loans as draws are requested and approved.

NOTE 7: DEBT

Revolving Credit Facility

On November 1, 2016, the Company’s wholly owned subsidiary, Groundfloor Holdings GA, LLC, as borrower, entered into a revolving credit facility (the “Revolver”) with Revolver Capital, LLC. The credit agreement initially provided for revolving loans up to a maximum aggregate principal amount of \$1,500,000, proceeds to be used for bridge funding of underlying loans pending approval from the United States Securities and Exchange Commission. Subsequent amendments to the credit agreement in 2016 and 2017 increased the aggregate commitments under the credit facility to \$4,500,000.

On April 4, 2018, the Credit Agreement dated as of November 1, 2016, as amended by the First Amendment as of November 11, 2016, the Second Amendment dated as of February 22, 2017 and the Third Amendment dated as of April 7, 2017, was assigned to ACM Alamosa DA LLC. The Company and the lender agreed to amend and restate the Original Credit Agreement in its entirety. The other terms of the credit facility remain unchanged.

On September 18, 2018, the Company increased the Revolving Credit Commitments thereunder from \$4,500,000 to \$5,500,000. In connection with the increase the Company paid a \$10,000 commitment fee, which was capitalized and amortized over a twelve-month period. The other terms of the credit facility remain unchanged.

On August 8, 2019, the Company increased the Revolving Credit Commitments thereunder from \$5,500,000 to \$8,500,000. In connection with the increase the Company paid a \$30,000 commitment fee, which is capitalized and amortized over a twelve-month period. The other terms of the credit facility remain unchanged.

On October 1, 2019, the Company increased the Revolving Credit Commitments thereunder from \$8,500,000 to \$10,500,000. In connection with the increase the Company paid a \$20,000 commitment fee, which is capitalized and amortized over a twelve-month period. The other terms of the credit facility remain unchanged.

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The Revolver maturity date was November 2, 2020. The Company had the option to request and the lender may, in its sole discretion, elect to extend the maturity date. The base contractual interest rate applicable throughout the years ended December 31, 2020 and 2019, was the greater of 10.0 percent per annum and the weighted average underlying loan rate with respect to all underlying borrower loans funded under the Revolver. In the event that a loan funded using proceeds from the Revolver is not repaid in full on or before the repayment date for that loan, the contractual interest rate increases to the greater of 15.0 percent per annum or the underlying loan rate plus 3.0 percent.

In March 2020, in connection with the novel coronavirus pandemic and the related tightening of credit markets, GROUND FLOOR's creditor informed the Company that it would cease funding of draws on the Revolver for an undefined period of time and replace the lost financing by expanding on other existing sources of lending capital, most importantly the GROUND FLOOR Notes program. In response, the Company developed a plan to repay the outstanding principal and accrued interest on the Revolver. The outstanding principal and accrued interest on the Revolver were repaid in full in June 2020, and no outstanding balance remains as of December 31, 2020.

As of December 31, 2020 and 2019, respectively, the Company had approximately \$0 and \$7,000 of available borrowings, and \$0 and \$10,493,000 outstanding under the Revolver as presented within Revolving credit facility on the Consolidated Balance Sheets. As of December 31, 2020 and 2019, respectively the Company reflected approximately \$0 and \$33,000 of deferred financing costs related to the Revolver as a reduction to the Revolving credit facility in the Consolidated Balance Sheets. Amortization of these costs was approximately \$33,000 and \$24,000 for the years ended December 31, 2020 and 2019, respectively, presented as a component of "Interest expense" in the Consolidated Statements of Operations. Accrued interest on the Revolver, presented within "Accounts payable and accrued expenses" in the Company's Consolidated Balance Sheets, was approximately \$0 and \$112,000 at December 31, 2020 and 2019, respectively.

2019 Subordinated Convertible Notes

From September 2019 to December 2019, the Company issued subordinated convertible notes (the "2019 Subordinated Convertible Notes") to Investors for total proceeds of \$3,607,000. The 2019 Subordinated Convertible Notes bear interest at the rate of 10% per annum. The outstanding principal and all accrued but unpaid interest is due and payable on the earlier of August 30, 2021, or the consummation of a sale of the Company by consolidation, merger, change of majority ownership, or sale or other disposition of all or substantially all of the assets of the Company (the "Maturity Date"). In the event of a closing of a preferred stock financing with gross proceeds of at least \$8,000,000 ("Qualified Preferred Financing") prior to the Maturity Date, the outstanding principal and all accrued but unpaid interest may be converted into shares of preferred stock issued in the financing at a price per share equal to 90% of the offering price per share in the Qualified Preferred Financing. At any time after six months after the issuance of a 2019 Subordinated Convertible Note, the investor may convert all or a portion of the outstanding principal and accrued interest into shares of common stock at 90% of the per share price of common stock at the time of conversion, as reasonably determined by the Board. The indebtedness represented by the 2019 Subordinated Convertible Notes is subordinated in all respects to the principal of (and premium, if any), unpaid interest on and amounts reimbursable, fees, expenses, costs of enforcement, and other amounts due in connection with the Revolver.

Because of the contractual right of noteholders to convert their holdings to common stock at a discount to fair value, the Company determined that the 2019 Subordinated Convertible Notes contain a beneficial conversion feature. The Company recognized this beneficial conversion feature as a debt discount and component of additional paid-in capital at the in-the-money amount of approximately \$401,000 at the time of issuance. The discount is being amortized to interest expense until the earlier of maturity or exercise of the conversion option. For the years ended December 31, 2020 and 2019, respectively, approximately \$242,000 and \$32,000 was amortized to interest expense in the Consolidated Statements of Operations.

Certain investors in 2019 Subordinated Convertible Notes purchased their shares through the issuance of advance agreements to the Company ("Advances"). The Advances accrue interest at a rate of 10% per annum and are payable to the Company within an initial term of 30 days, with an investor option to extend the term by 30 days, after which the Advances begin accruing interest at a rate of 14% per annum. The funds advanced to the investors are subject to recourse by the Company against the investors. The Advances, with principal sum of \$288,000 as of December 31, 2019, are recorded as a component of "Other current assets" in the Company's Consolidated Balance Sheets. The Advances were paid in full during the year ended December 31, 2020.

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

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In 2020, certain holders of 2019 Subordinated Convertible Notes converted their holdings into common stock or Series B preferred stock, at the discretion of the Noteholders. Additionally, as an incentive to convert, the Company granted all Noteholders a time-limited option to convert their holdings on more favorable terms than those specified in the contractual agreement. Pursuant to these terms, Noteholders converted \$408,000 in principal and approximately \$48,000 in accrued interest into 30,841 shares of common stock at a conversion price of \$14.88, a 15% discount to the per share price of common stock at the time of conversion. Noteholders also converted \$411,000 in principal and approximately \$47,000 in accrued interest into 22,760 shares of Series B preferred stock at a conversion price of \$16.41, a 10% discount to the offering price in the 2020 Series B Preferred Stock Offering, and into 5,528 shares of Series B preferred stock at a conversion price of \$14.58, a 20% discount to the offering price in the 2020 Series B Preferred Stock Offering. Because these Noteholders converted their debt instruments to equity securities of the Company pursuant to an inducement offer, the Company also recognized an expense equal to the fair value of the securities transferred in the conversion in excess of the fair value of the securities issuable pursuant to the original conversion terms. Conversion inducement expense of approximately \$42,000 is recognized in the Consolidated Statements of Operations as a component of “General and administrative”.

Principal of \$2,788,000 and \$3,607,000 on the 2019 Subordinated Convertible Notes, net of an unamortized discount of approximately \$126,000 and \$369,000, was outstanding as of December 31, 2020 and December 31, 2019, respectively. Accrued interest on the 2019 Subordinated Convertible Notes, presented within “Accounts payable and accrued expenses” in the Company’s Consolidated Balance Sheets, was approximately \$334,000 and \$69,000 as of December 31, 2020 and December 31, 2019.

GROUND FLOOR Notes

During the years ended December 31, 2020 and 2019, the Company entered into various secured promissory notes, (the “GROUND FLOOR Notes”), with accredited Investors. The GROUND FLOOR Notes are used for the purpose of the Company to originate, buy, and service loans for the purpose of building, buying, or rehabilitating single family and multifamily structures, or buying land, for commercial purposes. The GROUND FLOOR Notes are issued and secured by the assets of Groundfloor Real Estate 1 LLC, a wholly owned subsidiary of Groundfloor Finance, Inc. As collateral security for GROUND FLOOR Notes, the Company granted first priority security interest in all the loan assets of its wholly owned subsidiary, Groundfloor Real Estate 1 LLC, subject to certain exceptions.

During the year ended December 31, 2019, there were 105 notes entered into with stated interest rates ranging from 3.0% to 8.0% and with terms ranging from 30 days to 12 months. During the year ended December 31, 2020, there were 116 notes entered into with stated interest rates ranging from 2.0% to 10.0% and with terms ranging from 30 days to 12 months. The principal sum of \$18,978,000 and \$6,840,000 remains outstanding as of December 31, 2020 and 2019, respectively, and is presented in “Short-term notes payable” on the Company’s Consolidated Balance Sheets.

Accrued interest on the GROUND FLOOR Notes, presented within “Accounts payable and accrued expenses” in the Company’s Consolidated Balance Sheets, was approximately \$326,000 and \$114,000 at December 31, 2020 and 2019, respectively.

Other Short-term Notes Payable

On November 8, 2019, the Company entered into a short-term note agreement with an investor for a principal sum of \$500,000. The note bears simple interest at a stated rate of 6.0% per annum. The outstanding principal and accrued interest were due and payable on February 6, 2020, 90 days from the date of issuance. As part of the issuance, the investor also received 500 detachable warrants for the purchase of common stock. The Company has allocated the proceeds of the note issuance between the debt instrument and the detachable warrants based on their relative fair values. The amount allocated to the warrants was classified as a component of stockholders’ equity and recorded as a debt discount in the Consolidated Balance Sheets, which will be amortized to interest expense over the term of the note. As of December 31, 2019, the outstanding principal of \$500,000, net of an unamortized discount of approximately \$2,000, are presented in “Short-term notes payable” on the Company’s Consolidated Balance Sheets. Accrued interest on the note, approximately \$5,000 as of December 31, 2019, is presented in “Accounts payable and

GROUND FLOOR FINANCE INC. AND SUBSIDIARIES

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accrued expenses” in the Consolidated Balance Sheets. This note and accrued interest thereon was repaid in full in the year ended December 31, 2020.

On December 19, 2019, the Company entered into a short-term note agreement with an investor for a principal sum of \$500,000. The note bears simple interest at a stated rate of 13.5% per annum. The outstanding principal and accrued interest were due and payable on March 18, 2020, 90 days from the date of issuance. As of December 31, 2019, the outstanding principal of \$500,000, net of an unamortized discount of approximately \$1,000 related to debt issuance costs, are presented in “Short-term notes payable” on the Company’s Consolidated Balance Sheets. Accrued interest on the note, \$2,000 as of December 31, 2019, is presented in “Accounts payable and accrued expenses” in the Consolidated Balance Sheets. This note and accrued interest thereon was repaid in full in the year ended December 31, 2020.

On December 20, 2019, the Company entered into a short-term note agreement with an investor for a principal sum of \$250,000. The note bears simple interest at a stated annual rate of 6.0% per annum. The outstanding principal and accrued interest are due and payable on March 19, 2020, 90 days from the date of issuance. As part of the issuance, the investor also received 250 detachable warrants for the purchase of common stock. The Company has allocated the proceeds of the note issuance between the debt instrument and the detachable warrants based on their relative fair values. The amount allocated to the warrants was classified as a component of stockholders’ equity and recorded as a debt discount in the Consolidated Balance Sheets, which will be amortized to interest expense over the term of the note. As of December 31, 2019, the outstanding principal of \$250,000, net of an unamortized discount of approximately \$2,000, are presented in “Short-term notes payable” on the Company’s Consolidated Balance Sheets. Accrued interest on the note, approximately \$500 as of December 31, 2019, is presented in “Accounts payable and accrued expenses” in the Consolidated Balance Sheets. This note and accrued interest thereon was repaid in full in the year ended December 31, 2020.

Paycheck Protection Program

In April 2020, the Company received a loan from Suntrust Bank in the amount of \$829,100 under the Paycheck Protection Program (“PPP”), established by the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”). The PPP is sponsored by the U.S. Small Business Administration (“SBA”), and is providing small businesses – sole proprietors, independent contractors, and, with certain industry exceptions, businesses with fewer than 500 employees – the opportunity to apply for a loan of up to \$10 million to cover up to eight weeks of payroll costs, including benefits. Funds may also be used to cover interest on mortgage obligations, leases, and utilities incurred or in place before February 15, 2020. Based on current SBA guidance, PPP loans can be forgiven as long as (i) loan proceeds are used for covered expenses, (ii) full-time employee headcount is maintained during the eight-week period covered by the PPP loan, (iii) compensation for employees who earned less than \$100,000 on an annualized basis in 2019 is not reduced by more than 25% during the covered period and (iv) not more than 40% of the amount forgiven may be for non-payroll costs. The Company has used the PPP Loan proceeds to cover payroll costs, rent and utilities in accordance with the relevant terms and conditions of the CARES Act.

NOTE 8: STOCKHOLDERS’ DEFICIT

Capital Structure

Authorized Shares - As of December 31, 2020, the Company is authorized to issue 5,000,000 shares of no par value common stock and 1,316,181 shares of no par value preferred stock. The preferred stock has been designated as Series A Preferred Stock (the “Series A”), consisting of 747,385 shares, and Series Seed Preferred Stock (the “Series Seed”), consisting of 568,796 shares (collectively, “Preferred Stock”).

Common Stock Transactions

In February 2018, the Company launched an offering of its common stock under Tier 2 of Regulation A pursuant to an offering statement on Form 1-A qualified by the SEC (the “2018 Common Stock Offering”). The Company offered up to 500,000 shares of common stock at \$10 per share, with a minimum investment of \$100, or ten shares of common stock. The aggregate initial offering price of the common stock will not exceed \$5,000,000 in any 12-month period, and there is no minimum offering amount. The Company may issue up to 30,000 additional bonus shares. The 2018 Common Stock Offering closed on July 31, 2018. During the 2018 Common Stock Offering, the Company issued

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437,917 shares of common stock for gross proceeds of \$4,228,700. The Company incurred offering costs of approximately \$125,000 related to the 2018 Common Stock Offering.

In conjunction with the 2018 Common Stock Offering, certain holders of Restated Subordinated Convertible Notes converted their outstanding principal and accrued interest into common stock at a contractually agreed upon 10% discount to the offered price. In 2018, approximately \$278,000 in notes principal and accrued interest were converted into 30,847 shares of common stock. In 2019, approximately \$1,289,000 in notes principal and accrued interest were converted into 143,223 shares of common stock.

In October 2018, the Company entered into a common stock purchase agreement for private placement of 125,000 shares of the Company's common stock for gross proceeds of \$1,500,000.

In January 2019, the Company launched an offering of its common stock under Tier 2 of Regulation A pursuant to an offering statement on Form 1-A qualified by the SEC (the "2019 Common Stock Offering"). The Company offered up to 900,000 shares of common stock at \$15.00 per share, with a minimum investment of \$150, or 10 shares of common stock. According to the terms of the offering statement, the aggregate initial offering price of the common stock will not exceed \$13,500,000 in any 12-month period, and there is no minimum offering amount. The Company may issue up to 30,000 additional bonus shares through an incentive program available to investors who had provided a previous indication of interest in investing in the Company.

The 2019 Common Stock Offering closed on a rolling basis from January 2019 to July 2019. As a result of the offering, the Company received gross proceeds of approximately \$3,115,000 in exchange for the issuance of 214,535 shares of common stock, including 6,800 bonus shares issued through the incentive program described above. The proceeds are presented in the Consolidated Balance Sheets as a component of stockholders' equity, net of direct offering costs of approximately \$42,000 incurred.

In conjunction with the 2019 Common Stock Offering, certain holders of Restated Subordinated Convertible Notes converted their outstanding principal and accrued interest into common stock at a contractually agreed upon 10% discount to the offered price. In 2019, approximately \$60,000 in notes principal and accrued interest were converted into 4,440 shares of common stock.

In February 2020, the Company launched an offering of its common stock under Tier 2 of Regulation A pursuant to an offering statement on Form 1-A qualified by the SEC (the "2020 Common Stock Offering"). Participation in the 2020 Common Stock Offering was limited to existing shareholders. The Company offered shares of common stock at \$17.50 per share, with a minimum investment of \$175, or 10 shares of common stock. According to the terms of the offering statement, the aggregate initial offering price of the common stock will not exceed \$5,000,000 in any 12-month period, and there is no minimum offering amount. As a result of the offering, the Company received gross proceeds of approximately \$539,000 in exchange for the issuance of 30,794 shares of common stock.

Preferred Stock Transactions

Series A

During 2015, the Company issued 709,812 shares of Series A to Investors for total proceeds of \$4,748,705. In conjunction with the equity issuance, the Company converted all outstanding promissory notes payable and accrued interest totaling \$251,295 into 37,561 shares of Series A.

Series Seed

During 2015 and 2014, the Company issued 201,146 and 91,259 shares, respectively, to Investors for total proceeds of \$1,047,000 and \$475,000. In conjunction with the equity issuance in 2014, the Company converted all outstanding convertible notes payable and accrued interest totaling \$1,098,388 into 276,391 shares of Series Seed.

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Series B

In July 2020, the Company launched an offering of 548,546 shares of Series B Preferred Stock at \$18.23 per share (“Series B Preferred Stock Offering”). According to the terms of the offering statement, the aggregate initial offering price of the Series B Stock will not exceed \$10,000,000 in any 12-month period, and the Company will not execute sales of any securities under Regulation A that aggregate more than \$50,000,000 in any twelve-month period.

Since the launch of the offering, the Company has offered its Series B Stock on a continuous basis directly through the Company website, and also on the online platform utilized by SI Securities, LLC located at www.seedinvest.com, to both accredited and non-accredited investors.

As a result of the offering, the Company has as of December 31, 2020 received gross proceeds of approximately \$2,912,000 in exchange for the issuance of 159,748 shares of Series B preferred stock, presented net of offering costs of \$233,000 in the Consolidated Balance Sheets as a component of stockholders’ equity. Pursuant to the offering, certain holders of 2019 Subordinated Convertible Notes converted their holdings into Series B Preferred Stock as discussed in Note 7.

Voting - The holders of Preferred Stock are entitled to one vote for each share of common stock into which the preferred shares are convertible.

Liquidation - Upon any liquidation, dissolution, or winding up of the Company, the holders of Series A shall be entitled to be paid out of the assets of the Company available for distribution to its stockholders before any payment shall be made to the holders of common stock or Series Seed, an amount per share equal to the greater of: i) the Series A original issue price of \$6.69 per share, plus any dividends declared but unpaid, and ii) such amount per share as would have been payable had all shares of Series A been converted into common stock immediately prior to such liquidation, dissolution, or winding up. If the available assets are insufficient to pay the holders of shares of Series A the full amount to which they shall be entitled, then all of the available assets shall be distributed to the holders of the Series A pro rata in accordance with their ownership thereof.

After payment in full of the Series A preference amount, the Series Seed stockholders are entitled to a liquidation preference equal to the greater of: i) the Series Seed original issue price of \$5.205 per share, plus any dividends declared but unpaid, or ii) such amount per share as would have been payable had all shares of Series Seed been converted into common stock immediately prior to such liquidation, dissolution, or winding up. If the available assets are insufficient to pay the holders of shares of Series Seed the full amount to which they shall be entitled, then all of the available assets shall be distributed to the holders of the Series Seed pro rata in accordance with their ownership thereof. Any assets remaining after such preferential distribution shall be distributed to holders of the common stock.

After payment in full of the Series Seed preference amount, the Series B stockholders are entitled to a liquidation preference equal to the greater of: i) the Series B original issue price of \$18.23 per share, plus any dividends declared but unpaid, or ii) such amount per share as would have been payable had all shares of Series Seed been converted into common stock immediately prior to such liquidation, dissolution, or winding up. If the available assets are insufficient to pay the holders of shares of Series Seed the full amount to which they shall be entitled, then all of the available assets shall be distributed to the holders of the Series Seed pro rata in accordance with their ownership thereof.

Any assets remaining after such preferential distribution shall be distributed to holders of the common stock.

Conversion - Shares of Preferred Stock are convertible into shares of common stock at the option of the holder at any time. The number of common stock shares for Preferred Stock can be determined by dividing the original issue price by the then-effective conversion price.

Mandatory Conversion - All outstanding shares of Preferred Stock shall automatically be converted into shares of common stock upon the closing of the sales of shares of common stock to the public, with gross proceeds to the Company of at least \$20,000,000. All outstanding shares of Series A, Series Seed, and Series B Stock shall automatically be converted into shares of common stock by the date and time, or the occurrence of an event, specified

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by vote or written consent of the holders of at least a majority of the then outstanding shares of Series A, Series Seed, and Series B Stock, respectively, each voting as a single class.

Dividends - All dividends shall be declared pro rata on the common stock and Preferred Stock on a pari passu basis according to the numbers of common stock held by such holders on an as converted basis.

NOTE 9: STOCK OPTIONS AND WARRANTS

Stock Options

In August 2013, the Company adopted the 2013 Stock Option Plan (the “Plan”). The Plan provides incentives to eligible employees, officers, and directors in the form of incentive stock options, non-qualified stock options, and restricted stock awards. The Company has reserved a total of Plan of 400,000 shares of common stock for issuance under the Plan. Of these shares, 29,821 shares are available for future stock option grants as of December 31, 2020.

The Board of Directors has the authority to administer the Plan and determine, among other things, the interpretation of any provisions of the Plan, the eligible employees who are granted options, the number of options that may be granted, vesting schedules, and option exercise prices. The Company’s stock options have a contractual life not to exceed ten years. The Company issues new shares of common stock upon exercise of stock options.

Due to limited historical data, the Company estimates stock price volatility based on the actual volatility of comparable publicly traded companies over the expected life of the option. The expected term represents the average time that options that vest are expected to be outstanding. The expected term for options granted to non-employees is the contractual life. The risk-free rate is based on the United States Treasury yield curve for the expected life of the option.

Management used the Black-Scholes-Merton option pricing model to determine the fair value of options issued during the years ended December 31, 2020 and 2019.

The assumptions used to calculate the fair value of stock options granted are as follows:

For the Year Ended December 31, 2020	Non- Employees	Employees
Estimated dividend yield	- %	- %
Expected stock price volatility	55.0	50.0%
Risk-free interest rate	1.52%	0.34 - 1.40%
Expected life of options (in years)	10.0	6.25
Weighted-average fair value per share	\$ 11.28	\$ 8.35

For the Year Ended December 31, 2019	Non- Employees	Employees
Estimated dividend yield	-%	-%
Expected stock price volatility	55.0%	50.0%
Risk-free interest rate	1.9%	2.1%
Expected life of options (in years)	10.0	6.25
Weighted-average fair value per share	\$ 9.77	\$ 7.54

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The following summarizes the stock option activity for the years ended December 31, 2020 and 2019:

	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding as of December 31, 2018	319,925	\$ 4.40		
Exercised	(7,937)	2.19		
Terminated	(50,030)	5.52		
Granted	62,250	15.00		
Outstanding as of December 31, 2019	<u>324,208</u>	<u>\$ 6.25</u>		
Exercised	(1,568)	2.48		
Terminated	(53,608)	11.70		
Granted	101,147	17.50		
Outstanding as of December 31, 2020	<u>370,179</u>	<u>8.55</u>	<u>6.9</u>	<u>3,312,000</u>
Exercisable as of December 31, 2020	237,811	5.26	5.8	2,910,000
Expected to vest after December 31, 2020	132,368	14.46	8.8	402,000

The following table summarizes certain information about all stock options outstanding as of December 31, 2020:

<u>Exercise Price</u>	<u>Number of Options Outstanding</u>	<u>Weighted-Average Remaining Contractual Life (In Years)</u>	<u>Number of Options Exercisable</u>
\$ 0.67	64,000	3.0	64,000
1.87	36,000	4.6	36,000
2.40	69,692	6.3	64,487
3.99	10,000	3.8	10,000
10.00	28,725	7.5	13,420
12.00	33,501	8.0	9,695
15.00	34,073	8.6	2,983
17.50	94,188	9.8	37,226
	<u>370,179</u>		<u>237,811</u>

As of December 31, 2020, there was approximately \$723,000 of total unrecognized compensation cost related to stock option arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.9 years. The total intrinsic value of stock option awards exercised was approximately \$24,000 during the fiscal year ended December 31, 2020.

The Company recorded approximately \$59,000 and \$3,000 in non-employee and \$475,000 and \$176,000 in employee share-based compensation expense during 2020 and 2019, respectively.

Warrants

The Company issued 10,550 warrants during the year ended December 31, 2019, for the purchase of common stock. The warrants are exercisable immediately at \$2.40 or \$15.00 with a contractual term of ten years. The estimated fair value of the warrants was approximately \$140,000 when issued. The fair value was calculated using the Black-Scholes-Merton pricing model with the following weighted-average assumptions: risk-free interest rate of 2.5%, expected life of ten years, dividend yields of 0%, and volatility factor of 55.0%. These assumptions yielded a weighted average fair value of \$13.27 per warrant.

During the years ended December 31, 2020 and 2019, respectively, 0 and 9,800 warrants were issued in connection with the 2017 Note. These warrants were measured at fair value and recorded as a discount to "Long-term notes

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payable,” with a corresponding increase to “Additional paid-in capital.” The discount will be amortized to expense over the remaining term of the 2017 Note. Upon full repayment and retirement of the 2017 Note in 2019, any unamortized discount at the time of repayment was amortized. The Company recognized expense of approximately \$223,000 related to amortization of the 2017 Note warrant discount for the year ended December 31, 2019, as a component of “General and administrative” in the Consolidated Statements of Operations.

The remaining 750 warrants issued in 2019 were issued in conjunction with the issuance of short-term notes payable in November and December 2019. These warrants have been measured at fair value and recorded as a discount to “Short-term notes payable,” with a corresponding increase to “Additional paid-in capital.” The discount will be amortized to interest expense over the remaining term of the corresponding notes. The Company recognized expense of approximately \$4,000 related to amortization of these warrant discounts for the year ended December 31, 2020.

None of the outstanding warrants have been exercised as of December 31, 2020.

NOTE 10: INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the Company’s deferred income tax assets and liabilities as of December 31, 2020 and 2019, are as follows:

	<u>2020</u>	<u>2019</u>
Deferred income tax assets and liabilities:		
Net operating loss carryforwards	\$ 6,156,000	\$ 5,141,000
Accrued expenses	27,000	23,000
Share-based compensation	142,000	141,000
Accrued interest	130,000	203,000
Research and development credit	152,000	25,000
Depreciation and amortization	31,000	(37,000)
Valuation allowance	(6,638,000)	(5,496,000)
	<u>\$ -</u>	<u>\$ -</u>

The Company has established a valuation allowance against its deferred tax assets due to the uncertainty surrounding the realization of such asset. The valuation allowance increased by approximately \$1,142,000 and \$832,000, respectively, during the years ended December 31, 2020 and 2019.

As of December 31, 2020, the Company has federal and state net operating loss carryforwards of approximately \$24,480,000 available to offset future federal and state taxable income, which begin to expire in 2033 and 2028. In general, a corporation’s ability to utilize its NOL and research and development credit carryforwards may be substantially limited due to the ownership change limitations as required by Section 382 and 383 of the Internal Revenue Code of 1986, as amended (Code), as well as similar state provisions. The federal and state Section 382 and 383 limitations may limit the use of a portion of the Company’s domestic NOL and tax credit carryforwards. Further, a portion of the carryforwards may expire before being applied to reduce future income tax liabilities.

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Notes to Consolidated Financial Statements

Income taxes computed at the statutory federal income tax rate are reconciled to the provision for income tax expense for 2020 and 2019 as follows:

	2020		2019	
	Amount	% of Pre-Tax Earnings	Amount	% of Pre-Tax Earnings
Income tax expense (benefit) at statutory rate	\$(1,005,000)	(21.0)%	\$ (806,000)	(21.0)%
State taxes (net of federal benefit)	(222,000)	(4.6)%	(161,000)	(4.6)%
Non-deductible expenses	497,000	10.4%	135,000	(0.6)%
True-up adjustment for deferred items	(412,000)	(6.6)%	-	-
Change in valuation allowance	958,000	21.8%	832,000	26.2%
Provision for income tax expense	\$ -	0.0%	\$ -	0.0%

The Company recognizes interest and penalties related to uncertain tax positions in the provision for income taxes. As of December 31, 2020 and 2019, the Company had no accrual related to uncertain tax positions.

NOTE 11: RELATED PARTY TRANSACTIONS

ISB Development Corp.

The Company issued a short-term note in November 2019 to ISB Development Corp., an entity owned and operated by a director of the Company, for a principal sum of \$500,000. The short-term note and accrued interest thereon were repaid in full in 2020. See Note 7, under the heading “Other short-term notes payable,” for further discussion and disclosure related to the related party note.

Moma Walnut, LLC

In June 2019, the Company extended a fully collateralized loan to Moma Walnut, LLC, an entity that is owned and operated by a director of the Company. The loan has a principal amount of \$400,000, bears interest at a stated rate of 5% per annum, and was initially due within 30 days. Terms were subsequently modified in August 2019 to increase the interest rate to 13% per annum and extend the maturity date to August 11, 2020. In September 2020, the terms were again amended to retroactively change the interest rate to 10% per annum and to require monthly interest payments. As of December 31, 2020 and 2019, the related party loan receivable and accrued interest thereon are presented in the Consolidated Balance Sheets as a component of “Other current assets” in the amount of \$404,000 and \$417,000, respectively.

Employee Loan

In November 2020, an employee of the Company was extended a loan in the amount of \$30,000, bearing interest at a rate of 1% per annum. The loan matures on October 31, 2021. As of December 31, 2020, the related party loan receivable and accrued interest thereon are presented in the Consolidated Balance Sheets as a component of “Other current assets” in the amount of approximately \$30,000.

NOTE 12: COMMITMENTS AND CONTINGENCIES

The Company has a noncancelable operating lease agreement for office space. The lease contains a renewal option within 67 months of the commencement date of September 2018. Additionally, the company amended the lease to acquire approximately 4,000 sq ft of new office space within the current building. Rent expense for operating leases, which has escalating rents over the term of the lease, is recorded on a straight-line basis over the minimum lease terms. Rent expense under the operating lease was approximately \$309,000 and \$248,000 as a component of “General and administrative” in the Consolidated Statements of Operations for the years ended December 31, 2020 and 2019, respectively.

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As of December 31, 2020, the approximate amounts of the annual future minimum lease payments under noncancelable operating leases obligations are as follows:

	Balance
Years ending December 31,	
2021	\$ 387,505
2022	432,710
2023	445,679
2024	151,754
2025	-
	<u>\$ 1,417,648</u>

The Company is subject to legal proceedings which arise in the ordinary course of business. In the opinion of the Company, the resolution of these matters will not have a material adverse impact on the Company's consolidated financial position or results of operations.

NOTE 13: SUBSEQUENT EVENTS

In January 2021, the Company submitted an application for 100% loan forgiveness related to the loan received in 2020 through the Paycheck Protection Program. The application is pending as of the date of issuance of these financial statements.

As discussed in Note 7, in July 2020 the Company commenced an offering of Series B Stock on an online platform utilized by SI Securities, LLC, located at www.secdinvest.com, to both accredited and non-accredited investors. That offering extended into 2021 and continues to accept new investments as of the issuance date of these financial statements. Pursuant to that offering, from January 1, 2021 through the issuance date of these financial statements, the Company has received gross proceeds of approximately \$701,000, net of issuance costs of approximately \$56,000, in exchange for the issuance of 38,429 shares of Series B Stock.