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# **SECURITY NATIONAL FINANCIAL CORP**

## **FORM 10-Q**

(Quarterly Report)

Filed 11/14/17 for the Period Ending 09/30/17

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarter ended **September 30, 2017**, 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: **000-09341**

**SECURITY NATIONAL FINANCIAL CORPORATION**

*(Exact name of registrant as specified in its charter)*

**UTAH**

*(State or other jurisdiction of incorporation or organization)*

**87-0345941**

*(I.R.S. Employer Identification No.)*

**5300 South 360 West, Suite 250, Salt Lake City, Utah**

*(Address of principal executive offices)*

**84123**

*(Zip Code)*

**(801) 264-1060**

*(Registrant's telephone number, including area code)*

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

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

Class A Common Stock, \$2.00 par value  
Title of Class

13,820,079  
Number of Shares Outstanding as of November 14, 2017

Class C Common Stock, \$2.00 par value  
Title of Class

2,005,026  
Number of Shares Outstanding as of November 14, 2017

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2017

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SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

**Part I - Financial Information**

**Item 1. Financial Statements.**

|   | September 30<br>2017<br>(Unaudited) | December 31<br>2016<br>(As Restated) |
|---|-------------------------------------|--------------------------------------|
| <b>Assets</b>   |                                     |                                      |
| Investments:  |                                     |                                      |
| Fixed maturity securities, held to maturity, at amortized cost  | \$ 230,811,272                      | \$ 184,979,644                       |
| Equity securities, available for sale, at estimated fair value  | 5,957,488                           | 9,911,256                            |
| Mortgage loans held for investment (net of allowances for loan losses of \$2,051,818 and \$1,748,783 for 2017 and 2016)       | 147,300,691                         | 148,990,732                          |
| Real estate held for investment (net of accumulated depreciation of \$17,919,427 and \$16,138,439 for 2017 and 2016)          | 150,568,998                         | 145,165,921                          |
| Policy loans and other investments (net of allowances for doubtful accounts of \$1,142,257 and \$1,119,630 for 2017 and 2016) | 42,489,149                          | 41,599,246                           |
| Short-term investments  | 17,830,990                          | 27,560,040                           |
| Accrued investment income   | 3,391,688                           | 2,972,596                            |
| <b>Total investments</b>  | <b>598,350,276</b>                  | <b>561,179,435</b>                   |
| Cash and cash equivalents   | 38,593,462                          | 38,987,430                           |
| Loans held for sale (including \$166,990,187 for 2017 and \$-0- for 2016 at estimated fair value)                             | 201,895,906                         | 189,139,832                          |
| Receivables (net of allowances for doubtful accounts of \$2,758,394 and \$2,355,482 for 2017 and 2016)                        | 8,613,364                           | 8,410,546                            |
| Restricted assets   | 10,815,726                          | 10,391,394                           |
| Cemetery perpetual care trust investments   | 4,438,788                           | 4,131,885                            |
| Receivable from reinsurers  | 13,394,586                          | 13,079,668                           |
| Cemetery land and improvements  | 10,581,368                          | 10,672,836                           |
| Deferred policy and pre-need contract acquisition costs   | 78,049,594                          | 69,118,745                           |
| Mortgage servicing rights, net  | 20,396,568                          | 18,872,362                           |
| Property and equipment, net   | 7,560,662                           | 8,791,522                            |
| Value of business acquired  | 6,831,777                           | 7,570,300                            |
| Goodwill  | 2,765,570                           | 2,765,570                            |
| Other   | 5,616,664                           | 9,310,040                            |
| <b>Total Assets</b>   | <b>\$ 1,007,904,311</b>             | <b>\$ 952,421,565</b>                |

See accompanying notes to condensed consolidated financial statements (unaudited).

SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

|   | September 30<br>2017<br>(Unaudited) | December 31<br>2016<br>(As Restated) |
|---|-------------------------------------|--------------------------------------|
| <b>Liabilities and Stockholders' Equity</b>   |                                     |                                      |
| <b>Liabilities</b>  |                                     |                                      |
| Future policy benefits and unpaid claims  | \$ 600,643,308                      | \$ 584,067,692                       |
| Unearned premium reserve  | 4,290,164                           | 4,469,771                            |
| Bank and other loans payable  | 182,769,669                         | 152,140,679                          |
| Deferred pre-need cemetery and mortuary contract revenues   | 12,716,761                          | 12,360,249                           |
| Cemetery perpetual care obligation  | 3,679,925                           | 3,598,580                            |
| Accounts payable  | 3,279,790                           | 4,213,109                            |
| Other liabilities and accrued expenses  | 33,448,055                          | 34,693,485                           |
| Income taxes  | 27,732,758                          | 24,318,869                           |
| <b>Total liabilities</b>  | <b>868,560,430</b>                  | <b>819,862,434</b>                   |
| <b>Stockholders' Equity</b>   |                                     |                                      |
| Preferred Stock - non-voting - \$1.00 par value; 5,000,000 shares authorized; none issued or outstanding  | -                                   | -                                    |
| Class A: common stock - \$2.00 par value; 20,000,000 shares authorized; issued 13,820,079 shares in 2017 and 13,819,006 shares in 2016          | 27,640,158                          | 27,638,012                           |
| Class B: non-voting common stock - \$1.00 par value; 5,000,000 shares authorized; none issued or outstanding                                    | -                                   | -                                    |
| Class C: convertible common stock - \$2.00 par value; 3,000,000 shares authorized; issued 2,005,026 shares in 2017 and 1,902,229 shares in 2016 | 4,010,052                           | 3,804,458                            |
| Additional paid-in capital  | 35,490,027                          | 34,813,246                           |
| Accumulated other comprehensive income, net of taxes  | 336,631                             | 264,822                              |
| Retained earnings   | 72,848,622                          | 67,409,204                           |
| Treasury stock at cost - 559,605 Class A shares in 2017 and 704,122 Class A shares in 2016  | (981,609)                           | (1,370,611)                          |
| <b>Total stockholders' equity</b>   | <b>139,343,881</b>                  | <b>132,559,131</b>                   |
| <b>Total Liabilities and Stockholders' Equity</b>   | <b>\$ 1,007,904,311</b>             | <b>\$ 952,421,565</b>                |

See accompanying notes to condensed consolidated financial statements (unaudited).

SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

|   | Three Months Ended<br>September 30 |                     | Nine Months Ended<br>September 30 |                      |
|---|------------------------------------|---------------------|-----------------------------------|----------------------|
|   | 2017                               | 2016                | 2017                              | 2016                 |
| <b>Revenues:</b>  |                                    |                     |                                   |                      |
| Insurance premiums and other considerations   | \$ 17,489,560                      | \$ 17,157,319       | \$ 52,345,184                     | \$ 47,508,420        |
| Net investment income   | 8,361,466                          | 8,089,857           | 25,559,113                        | 23,484,280           |
| Net mortuary and cemetery sales   | 2,717,311                          | 2,776,023           | 9,356,659                         | 9,541,950            |
| Realized gains (losses) on investments and other assets                                       | (319,666)                          | (39,169)            | 713,066                           | 179,296              |
| Other than temporary impairments on investments   | (163,375)                          | (30,000)            | (481,741)                         | (133,630)            |
| Mortgage fee income   | 41,597,573                         | 53,195,763          | 122,086,734                       | 146,967,246          |
| Other   | 2,288,982                          | 1,798,864           | 6,393,691                         | 4,944,670            |
| <b>Total revenues</b>   | <b>71,971,851</b>                  | <b>82,948,657</b>   | <b>215,972,706</b>                | <b>232,492,232</b>   |
| <b>Benefits and expenses:</b>   |                                    |                     |                                   |                      |
| Death benefits  | 8,772,153                          | 7,250,100           | 26,113,770                        | 22,410,230           |
| Surrenders and other policy benefits  | 547,648                            | 630,735             | 2,085,296                         | 1,709,915            |
| Increase in future policy benefits  | 6,735,141                          | 6,382,949           | 17,669,279                        | 15,777,008           |
| Amortization of deferred policy and pre-need acquisition costs and value of business acquired | 2,238,955                          | 2,301,107           | 6,271,763                         | 6,221,495            |
| Selling, general and administrative expenses:   |                                    |                     |                                   |                      |
| Commissions   | 18,999,583                         | 24,395,173          | 53,877,389                        | 68,214,894           |
| Personnel   | 17,200,315                         | 17,755,070          | 53,754,920                        | 52,535,277           |
| Advertising   | 1,611,599                          | 2,006,013           | 4,407,877                         | 5,053,968            |
| Rent and rent related   | 2,257,259                          | 2,122,708           | 6,693,292                         | 6,235,430            |
| Depreciation on property and equipment  | 517,041                            | 528,051             | 1,723,879                         | 1,585,995            |
| Provision for loan loss reserve   | -                                  | 600,000             | -                                 | 600,000              |
| Costs related to funding mortgage loans   | 2,809,471                          | 2,365,395           | 7,315,227                         | 6,956,774            |
| Other   | 7,035,570                          | 8,075,906           | 22,227,370                        | 21,388,693           |
| Interest expense  | 1,655,870                          | 1,476,137           | 4,295,263                         | 3,775,483            |
| Cost of goods and services sold-mortuaries and cemeteries                                     | 453,229                            | 485,783             | 1,507,295                         | 1,396,574            |
| <b>Total benefits and expenses</b>  | <b>70,833,834</b>                  | <b>76,375,127</b>   | <b>207,942,620</b>                | <b>213,861,736</b>   |
| <b>Earnings before income taxes</b>   | <b>1,138,017</b>                   | <b>6,573,530</b>    | <b>8,030,086</b>                  | <b>18,630,496</b>    |
| Income tax expense  | (41,179)                           | (2,390,525)         | (2,587,384)                       | (6,892,544)          |
| <b>Net earnings</b>   | <b>\$ 1,096,838</b>                | <b>\$ 4,183,005</b> | <b>\$ 5,442,702</b>               | <b>\$ 11,737,952</b> |
| <b>Net earnings per Class A Equivalent common share (1)</b>                                   | <b>\$ 0.07</b>                     | <b>\$ 0.28</b>      | <b>\$ 0.36</b>                    | <b>\$ 0.80</b>       |
| <b>Net earnings per Class A Equivalent common share-assuming dilution (1)</b>                 | <b>\$ 0.07</b>                     | <b>\$ 0.27</b>      | <b>\$ 0.35</b>                    | <b>\$ 0.77</b>       |
| Weighted-average Class A equivalent common share outstanding (1)                              | 15,256,857                         | 14,830,078          | 15,159,569                        | 14,744,779           |
| Weighted-average Class A equivalent common shares outstanding-assuming dilution (1)           | 15,542,660                         | 15,269,613          | 15,474,826                        | 15,166,045           |

(1) Net earnings per share amounts have been adjusted retroactively for the effect of annual stock dividends.

See accompanying notes to condensed consolidated financial statements (unaudited).

SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

|   | Three Months Ended<br>September 30 |              | Nine Months Ended<br>September 30 |               |
|---|------------------------------------|--------------|-----------------------------------|---------------|
|   | 2017                               | 2016         | 2017                              | 2016          |
| Net earnings                                      | \$ 1,096,838                       | \$ 4,183,005 | \$ 5,442,702                      | \$ 11,737,952 |
| Other comprehensive income:                       |                                    |              |                                   |               |
| Unrealized gains on available for sale securities | 144,381                            | 212,413      | 106,543                           | 684,002       |
| Unrealized gains on derivative instruments        | 554                                | -            | 3,170                             | 5,541         |
| Other comprehensive income, before income tax     | 144,935                            | 212,413      | 109,713                           | 689,543       |
| Income tax expense                                | (50,517)                           | (74,383)     | (37,904)                          | (239,339)     |
| Other comprehensive income, net of income tax     | 94,418                             | 138,030      | 71,809                            | 450,204       |
| Comprehensive income                              | \$ 1,191,256                       | \$ 4,321,035 | \$ 5,514,511                      | \$ 12,188,156 |

See accompanying notes to condensed consolidated financial statements (unaudited).

SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(Unaudited)

|                                      | <b>Class A<br/>Common<br/>Stock</b> | <b>Class C<br/>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Total</b>          |
|--------------------------------------|-------------------------------------|-------------------------------------|---|---|------------------------------|---------------------------|-----------------------|
| <b>Balance at December 31, 2015</b>  | \$ 26,218,200                       | \$ 3,419,280                        | \$ 30,232,582                             | \$ (499,358)  | \$ 60,525,404                | \$ (2,179,429)            | \$ 117,716,679        |
| Net earnings                         | -                                   | -                                   | -   | -   | 11,737,952                   | -                         | 11,737,952            |
| Other comprehensive income           | -                                   | -                                   | -   | 450,204   | -                            | -                         | 450,204               |
| Grant of stock options               | -                                   | -                                   | 253,427                                   | -   | -                            | -                         | 253,427               |
| Exercise of stock options            | 64,834                              | -                                   | 12,374                                    | -   | -                            | -                         | 77,208                |
| Sale of treasury stock               | -                                   | -                                   | 440,420                                   | -   | -                            | 634,268                   | 1,074,688             |
| Stock dividends                      | 274                                 | 12,768                              | 30,779                                    | -   | (43,821)                     | -                         | -                     |
| Conversion Class C to Class A        | 17,016                              | (17,016)                            | -   | -   | -                            | -                         | -                     |
| <b>Balance at September 30, 2016</b> | <u>\$ 26,300,324</u>                | <u>\$ 3,415,032</u>                 | <u>\$ 30,969,582</u>                      | <u>\$ (49,154)</u>  | <u>\$ 72,219,535</u>         | <u>\$ (1,545,161)</u>     | <u>\$ 131,310,158</u> |
| <b>Balance at December 31, 2016</b>  | \$ 27,638,012                       | \$ 3,804,458                        | \$ 34,813,246                             | \$ 264,822  | \$ 67,409,204                | \$ (1,370,611)            | \$ 132,559,131        |
| Net earnings                         | -                                   | -                                   | -   | -   | 5,442,702                    | -                         | 5,442,702             |
| Other comprehensive income           | -                                   | -                                   | -   | 71,809  | -                            | -                         | 71,809                |
| Grant of stock options               | -                                   | -                                   | 305,741                                   | -   | -                            | -                         | 305,741               |
| Exercise of stock options            | 2                                   | 206,804                             | (206,806)                                 | -   | -                            | -                         | -                     |
| Sale of treasury stock               | -                                   | -                                   | 575,496                                   | -   | -                            | 574,472                   | 1,149,968             |
| Purchase of treasury stock           | -                                   | -                                   | -   | -   | -                            | (185,470)                 | (185,470)             |
| Stock dividends                      | 930                                 | 4                                   | 2,350                                     | -   | (3,284)                      | -                         | -                     |
| Conversion Class C to Class A        | 1,214                               | (1,214)                             | -   | -   | -                            | -                         | -                     |
| <b>Balance at September 30, 2017</b> | <u>\$ 27,640,158</u>                | <u>\$ 4,010,052</u>                 | <u>\$ 35,490,027</u>                      | <u>\$ 336,631</u>   | <u>\$ 72,848,622</u>         | <u>\$ (981,609)</u>       | <u>\$ 139,343,881</u> |

See accompanying notes to condensed consolidated financial statements (unaudited).

SECURITY NATIONAL FINANCIAL CORPORATION  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|  | Nine Months Ended<br>September 30 |                      |
|--|-----------------------------------|----------------------|
|  | 2017                              | 2016                 |
| <b>Cash flows from operating activities:</b>                             |                                   |                      |
| Net cash provided by operating activities                                | \$ 6,030,453                      | \$ 17,639,672        |
| <b>Cash flows from investing activities:</b>                             |                                   |                      |
| Securities held to maturity:   |                                   |                      |
| Purchase-fixed maturity securities                                       | (59,325,291)                      | (6,519,416)          |
| Calls and maturities - fixed maturity securities                         | 11,933,573                        | 10,032,336           |
| Securities available for sale:   |                                   |                      |
| Purchase - equity securities   | (5,126,062)                       | (3,726,194)          |
| Sales - equity securities  | 9,153,786                         | 3,349,728            |
| Purchases of short-term investments                                      | (27,483,124)                      | (13,379,112)         |
| Sales of short-term investments  | 37,212,174                        | 7,185,582            |
| Net changes in restricted assets   | (409,625)                         | (438,204)            |
| Net changes in perpetual care trusts                                     | (231,415)                         | (966,367)            |
| Mortgage loans, policy loans, and other investments made                 | (340,424,956)                     | (338,457,602)        |
| Payments received for mortgage loans, policy loans and other investments | 344,278,996                       | 330,303,396          |
| Purchase of property and equipment                                       | (508,846)                         | (1,303,979)          |
| Sale of property and equipment   | 9,977                             | 34,000               |
| Purchase of real estate  | (12,474,490)                      | (19,448,152)         |
| Sale of real estate  | 8,612,307                         | 5,672,484            |
| Cash paid for purchase of subsidiaries, net of cash acquired             | -                                 | (4,328,520)          |
| Net cash used in investing activities                                    | (34,782,996)                      | (31,990,020)         |
| <b>Cash flows from financing activities:</b>                             |                                   |                      |
| Investment contract receipts   | 9,457,285                         | 8,401,542            |
| Investment contract withdrawals  | (11,522,652)                      | (9,957,964)          |
| Proceeds from stock options exercised                                    | -                                 | 77,208               |
| Purchase of treasury stock   | (185,470)                         | -                    |
| Repayment of bank loans  | (2,142,382)                       | (1,169,233)          |
| Proceeds from borrowing on bank loans                                    | 16,729,056                        | 2,523,670            |
| Net change in warehouse line borrowings                                  | 16,022,738                        | 23,893,122           |
| Net change in line of credit borrowings                                  | -                                 | 1,439,650            |
| Net cash provided by financing activities                                | 28,358,575                        | 25,207,995           |
| <b>Net change in cash and cash equivalents</b>                           | <b>(393,968)</b>                  | <b>10,857,647</b>    |
| Cash and cash equivalents at beginning of period                         | 38,987,430                        | 40,053,242           |
| <b>Cash and cash equivalents at end of period</b>                        | <b>\$ 38,593,462</b>              | <b>\$ 50,910,889</b> |
| <b>Supplemental Disclosure of Cash Flow Information:</b>                 |                                   |                      |
| Cash paid (received) during the year for:                                |                                   |                      |
| Interest (net of amount capitalized)                                     | \$ 4,188,579                      | \$ 3,781,423         |
| Income taxes (net of refunds)  | (788,601)                         | 2,538,097            |
| <b>Non Cash Operating, Investing and Financing Activities:</b>           |                                   |                      |
| Transfer of loans held for sale to mortgage loans held for investment    | \$ 5,032,147                      | \$ 7,386,432         |
| Accrued real estate construction costs and retainage                     | 1,932,790                         | -                    |
| Mortgage loans foreclosed into real estate                               | 1,576,196                         | 1,703,476            |
| Benefit plans funded with treasury stock                                 | 1,149,968                         | 1,074,688            |

See accompanying notes to condensed consolidated financial statements (unaudited).

1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Articles 8 and 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements of the Company and notes thereto for the year ended December 31, 2016, included in the Company's Annual Report on Form 10-K/A (file number 000-09341). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The presentation of certain amounts in the prior year have been reclassified to conform to the 2017 presentation. The Company reclassified certain amounts from other assets to receivables, from receivables to other liabilities, from other assets to other liabilities, from equity securities to other investments, from other liabilities to mortgage loans held for investment, from net investment income to mortgage fee income, and from mortgage fee income to net investment income. These reclassifications had no impact on net earnings or stockholders' equity. Additionally, see the discussion regarding correction of errors in Notes 21 and 22 included in the Company's Form 10-K/A for the year ended December 31, 2016.

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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant changes in the near term are those used in determining the value of derivative assets and liabilities; those used in determining deferred acquisition costs and the value of business acquired; those used in determining the value of mortgage loans foreclosed to real estate held for investment; those used in determining the liability for future policy benefits and unearned revenue; those used in determining the estimated future costs for pre-need sales; those used in determining the value of mortgage servicing rights; those used in determining allowances for loan losses for mortgage loans held for investment; those used in determining loan loss reserve; and those used in determining deferred tax assets and liabilities. Although some variability is inherent in these estimates, management believes the amounts provided are fairly stated in all material respects.

2) Recent Accounting Pronouncements

ASU No. 2017-01: "Business Combinations (Topic 805): Clarifying the Definition of a Business" - Issued in January 2017, ASU 2017-01 intends to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business: inputs, processes, and outputs. While an integrated set of assets and activities, collectively referred to as a "set," that is a business usually has outputs, outputs are not required to be present. ASU 2017-01 provides a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. ASU 2017-01 will be effective for the Company on January 1, 2018. While the Company's acquisitions have historically been classified as either business combinations or asset acquisitions, certain acquisitions that were classified as business combinations by the Company likely would have been considered asset acquisitions under the new standard. As a result, transaction costs are more likely to be capitalized since the Company expects some of its future acquisitions to be classified as asset acquisitions under this new standard. In addition, goodwill that was previously allocated to businesses that were sold or held for sale will no longer be allocated and written off upon sale if future sales were deemed to be sales of assets and not businesses.

ASU No. 2016-13: "Financial Instruments - Credit Losses (Topic 326)" - Issued in June 2016, ASU 2016-13 amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current generally accepted accounting principles ("GAAP") and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however Topic 326 will require that credit losses be presented as an allowance rather than as a write-down. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2019. The Company is in the process of evaluating the potential impact of this standard.

2) Recent Accounting Pronouncements (Continued)

ASU No. 2016-02: "Leases (Topic 842)" - Issued in February 2016, ASU 2016-02 supersedes the requirements in ASC Topic 840, "Leases", and was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018. The Company is in the process of evaluating the potential impact of this standard, which is not expected to be material to the Company's results of operations but will have an effect on the balance sheet presentation for leased assets and obligations.

ASU No. 2016-01: "Financial Instruments - Overall (Topic 825-10)" - Issued in January 2016, ASU 2016-01 changes the accounting for non-consolidated equity investments that are not accounted for under the equity method of accounting by requiring changes in fair value to be recognized in income. Under current guidance, changes in fair value for investments of this nature are recognized in accumulated other comprehensive income as a component of stockholders' equity. Additionally, ASU 2016-01 simplifies the impairment assessment of equity investments without readily determinable fair values; requires entities to use the exit price when estimating the fair value of financial instruments; and modifies various presentation disclosure requirements for financial instruments. The Company holds equity securities classified as available for sale securities that are currently measured at fair value with changes in fair value recognized through other comprehensive income. Upon adoption of ASU 2016-01 the Company will be required to recognize changes in the fair value of these equity securities through earnings, thus increasing the volatility of the Company's earnings. However, adoption of this standard will not significantly affect the Company's comprehensive income or stockholders' equity. This new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017, with the cumulative effect of the adoption made to the balance sheet as of the date of adoption. Thus, the adoption will result in a reclassification of the related accumulated net unrealized gains (losses) currently included in accumulated other comprehensive income to retained earnings. See Note 3 for details regarding the Company's equity securities currently classified as available for sale. The Company will adopt this standard beginning January 1, 2018.

ASU No. 2014-09: "Revenue from Contracts with Customers (Topic 606)" - Issued in May 2014, ASU 2014-09 supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition". ASU 2014-09 clarifies the principles for recognizing revenue in order to improve comparability of revenue recognition practices across entities and industries. ASU 2014-09 provides guidance intended to assist in the identification of contracts with customers and separate performance obligations within those contracts, the determination and allocation of the transaction price to those identified performance obligations and the recognition of revenue when a performance obligation has been satisfied. ASU 2014-09 also requires disclosures regarding the nature, amount, timing, and uncertainty of revenues and cash flows from contracts with customers. Insurance contracts are excluded from the scope of this new guidance.

Upon adoption, ASU 2014-09 provides for transition through either a full retrospective approach requiring the restatement of all presented prior periods or a modified retrospective approach, which allows the new recognition standard to be applied to only those contracts that are not completed at the date of transition. If the modified retrospective approach is adopted, a cumulative effect adjustment to retained earnings is performed with additional disclosures required including the amount by which each line item is affected by the transition as compared to the guidance in effect before adoption and an explanation of the reasons for significant changes in these amounts. The Company intends to adopt ASU 2014-09 using the modified retrospective method. The Company does not expect to record a cumulative effect adjustment to its beginning retained earnings as a result of adoption of ASU 2014-09.

The Company's revenues from contracts with customers that are subject to ASU 2014-09 include revenues on mortuary and cemetery contracts. The recognition and measurement of these items is not expected to change as a result of the Company's adoption of ASU 2014-09 and thus the Company does not expect that the adoption of ASU 2014-09 will significantly impact the Company's results of operations or financial position but is still in the process of evaluating the final impact, including the potential impact on disclosures of contracts with customers. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017. The Company will adopt this standard beginning January 1, 2018.

The Company has reviewed other recent accounting pronouncements and has determined that they will not significantly impact the Company's results of operations or financial position.

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3) Investments

The Company's investments as of September 30, 2017 are summarized as follows:

|   | <u>Cost</u>          | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Estimated<br/>Fair<br/>Value</u> |
|---|----------------------|---------------------------------------|--|-------------------------------------|
| <u>September 30, 2017</u>   |                      |                                       |  |                                     |
| Fixed maturity securities held to maturity carried at amortized cost: |                      |                                       |  |                                     |
| Bonds:  |                      |                                       |  |                                     |
| U.S. Treasury securities and obligations of U.S. Government agencies  | \$ 54,279,156        | \$ 237,071                            | \$ (226,543)                           | \$ 54,289,684                       |
| Obligations of states and political subdivisions                      | 5,865,790            | 124,685                               | (77,272)                               | 5,913,203                           |
| Corporate securities including public utilities                       | 160,278,125          | 14,088,157                            | (1,285,361)                            | 173,080,921                         |
| Mortgage-backed securities  | 9,764,566            | 253,573                               | (171,423)                              | 9,846,716                           |
| Redeemable preferred stock  | 623,635              | 53,403                                | -                                      | 677,038                             |
| Total fixed maturity securities held to maturity                      | <u>\$230,811,272</u> | <u>\$14,756,889</u>                   | <u>\$ (1,760,599)</u>                  | <u>\$243,807,562</u>                |
| Equity securities available for sale at estimated fair value:         |                      |                                       |  |                                     |
| Common stock:   |                      |                                       |  |                                     |
| Industrial, miscellaneous and all other                               | \$ 6,310,307         | \$ 467,132                            | \$ (819,951)                           | \$ 5,957,488                        |
| Total equity securities available for sale at estimated fair value    | <u>\$ 6,310,307</u>  | <u>\$ 467,132</u>                     | <u>\$ (819,951)</u>                    | <u>\$ 5,957,488</u>                 |
| Mortgage loans held for investment at amortized cost:                 |                      |                                       |  |                                     |
| Residential   | \$ 65,759,761        |                                       |  |                                     |
| Residential construction  | 41,306,722           |                                       |  |                                     |
| Commercial  | 42,923,761           |                                       |  |                                     |
| Less: Unamortized deferred loan fees, net                             | (637,735)            |                                       |  |                                     |
| Less: Allowance for loan losses                                       | (2,051,818)          |                                       |  |                                     |
| Total mortgage loans held for investment                              | <u>\$147,300,691</u> |                                       |  |                                     |
| Real estate held for investment net of accumulated depreciation:      |                      |                                       |  |                                     |
| Residential   | \$ 69,469,220        |                                       |  |                                     |
| Commercial  | 81,099,778           |                                       |  |                                     |
| Total real estate held for investment                                 | <u>\$150,568,998</u> |                                       |  |                                     |
| Policy loans and other investments at amortized cost:                 |                      |                                       |  |                                     |
| Policy loans  | \$ 6,677,924         |                                       |  |                                     |
| Insurance assignments   | 33,340,431           |                                       |  |                                     |
| Federal Home Loan Bank stock  | 689,400              |                                       |  |                                     |
| Other investments   | 2,923,681            |                                       |  |                                     |
| Less: Allowance for doubtful accounts                                 | (1,142,287)          |                                       |  |                                     |
| Total policy loans and other investments                              | <u>\$ 42,489,149</u> |                                       |  |                                     |
| Short-term investments at amortized cost                              | <u>\$ 17,830,990</u> |                                       |  |                                     |
| Accrued investment income   | <u>\$ 3,391,688</u>  |                                       |  |                                     |

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
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September 30, 2017 (Unaudited)

3) Investments (Continued)

The Company's investments as of December 31, 2016 are summarized as follows:

|   | <u>Cost</u>          | <u>Gross<br/>Unrealized<br/>Gains</u> | <u>Gross<br/>Unrealized<br/>Losses</u> | <u>Estimated<br/>Fair<br/>Value</u> |
|---|----------------------|---------------------------------------|--|-------------------------------------|
| <b><u>December 31, 2016:</u></b>                                      |                      |                                       |  |                                     |
| Fixed maturity securities held to maturity carried at amortized cost: |                      |                                       |  |                                     |
| Bonds:  |                      |                                       |  |                                     |
| U.S. Treasury securities and obligations of U.S. Government agencies  | \$ 4,475,065         | \$ 249,028                            | \$ (66,111)                            | \$ 4,657,982                        |
| Obligations of states and political subdivisions                      | 6,017,225            | 153,514                               | (133,249)                              | 6,037,490                           |
| Corporate securities including public utilities                       | 164,375,636          | 10,440,989                            | (3,727,013)                            | 171,089,612                         |
| Mortgage-backed securities  | 9,488,083            | 221,400                               | (280,871)                              | 9,428,612                           |
| Redeemable preferred stock  | 623,635              | 13,418                                | -                                      | 637,053                             |
| Total fixed maturity securities held to maturity                      | <u>\$184,979,644</u> | <u>\$11,078,349</u>                   | <u>\$ (4,207,244)</u>                  | <u>\$191,850,749</u>                |
| Equity securities available for sale at estimated fair value:         |                      |                                       |  |                                     |
| Common stock:   |                      |                                       |  |                                     |
| Industrial, miscellaneous and all other                               | \$ 10,323,238        | \$ 447,110                            | \$ (859,092)                           | \$ 9,911,256                        |
| Total securities available for sale carried at estimated fair value   | <u>\$ 10,323,238</u> | <u>\$ 447,110</u>                     | <u>\$ (859,092)</u>                    | <u>\$ 9,911,256</u>                 |
| Mortgage loans held for investment at amortized cost:                 |                      |                                       |  |                                     |
| Residential   | \$ 58,593,622        |                                       |  |                                     |
| Residential construction  | 40,800,117           |                                       |  |                                     |
| Commercial  | 51,536,622           |                                       |  |                                     |
| Less: Unamortized deferred loan fees, net                             | (190,846)            |                                       |  |                                     |
| Less: Allowance for loan losses                                       | <u>(1,748,783)</u>   |                                       |  |                                     |
| Total mortgage loans held for investment                              | <u>\$148,990,732</u> |                                       |  |                                     |
| Real estate held for investment net of accumulated depreciation:      |                      |                                       |  |                                     |
| Residential   | \$ 76,191,985        |                                       |  |                                     |
| Commercial  | 68,973,936           |                                       |  |                                     |
| Total real estate held for investment                                 | <u>\$145,165,921</u> |                                       |  |                                     |
| Policy loans and other investments at amortized cost:                 |                      |                                       |  |                                     |
| Policy loans  | \$ 6,694,148         |                                       |  |                                     |
| Insurance assignments   | 33,548,079           |                                       |  |                                     |
| Promissory notes  | 48,797               |                                       |  |                                     |
| Federal Home Loan Bank stock  | 662,100              |                                       |  |                                     |
| Other investments   | 1,765,752            |                                       |  |                                     |
| Less: Allowance for doubtful accounts                                 | <u>(1,119,630)</u>   |                                       |  |                                     |
| Total policy loans and other investments                              | <u>\$ 41,599,246</u> |                                       |  |                                     |
| Short-term investments at amortized cost                              | <u>\$ 27,560,040</u> |                                       |  |                                     |
| Accrued investment income   | <u>\$ 2,972,596</u>  |                                       |  |                                     |

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3) Investments (Continued)

**Fixed Maturity Securities**

The following tables summarize unrealized losses on fixed maturity securities held to maturity, which are carried at amortized cost, at September 30, 2017 and December 31, 2016. The unrealized losses were primarily related to interest rate fluctuations. The tables set forth unrealized losses by duration with the fair value of the related fixed maturity securities:

|  | Unrealized<br>Losses for<br>Less than<br>Twelve<br>Months | Fair Value           | Unrealized<br>Losses for<br>More than<br>Twelve<br>Months | Fair Value           | Total<br>Unrealized<br>Loss | Fair Value           |
|--|---|----------------------|---|----------------------|-----------------------------|----------------------|
| <b>At September 30, 2017</b>   |   |                      |   |                      |                             |                      |
| U.S. Treasury Securities and<br>Obligations of U.S. Government<br>Agencies | \$ 182,493  | \$ 51,456,444        | \$ 44,050   | \$ 851,779           | \$ 226,543                  | \$ 52,308,223        |
| Obligations of states and political<br>subdivisions                        | 18,357  | 2,486,400            | 58,915  | 1,651,253            | 77,272                      | 4,137,653            |
| Corporate securities   | 286,166   | 16,526,010           | 999,195   | 10,820,005           | 1,285,361                   | 27,346,015           |
| Mortgage-backed securities   | 68,972  | 2,026,033            | 102,451   | 1,156,803            | 171,423                     | 3,182,836            |
| Total unrealized losses  | <u>\$ 555,988</u>   | <u>\$ 72,494,887</u> | <u>\$ 1,204,611</u>                                       | <u>\$ 14,479,840</u> | <u>\$ 1,760,599</u>         | <u>\$ 86,974,727</u> |
| <b>At December 31, 2016</b>  |   |                      |   |                      |                             |                      |
| U.S. Treasury Securities and<br>Obligations of U.S. Government<br>Agencies | \$ 66,111   | \$ 1,342,088         | \$ -  | \$ -                 | \$ 66,111                   | \$ 1,342,088         |
| Obligations of states and political<br>subdivisions                        | 133,249   | 3,686,856            | -   | -                    | 133,249                     | 3,686,856            |
| Corporate securities   | 1,728,312   | 41,796,016           | 1,998,701   | 12,969,135           | 3,727,013                   | 54,765,151           |
| Mortgage-backed securities   | 176,715   | 4,176,089            | 104,156   | 940,278              | 280,871                     | 5,116,367            |
| Total unrealized losses  | <u>\$ 2,104,387</u>                                       | <u>\$ 51,001,049</u> | <u>\$ 2,102,857</u>                                       | <u>\$ 13,909,413</u> | <u>\$ 4,207,244</u>         | <u>\$ 64,910,462</u> |

There were 143 securities with an average fair value of 98.3% of amortized cost at September 30, 2017. There were 250 securities with an average fair value of 93.9% of amortized cost at December 31, 2016. During the three months ended September 30, 2017 and 2016 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of \$100,000 and \$30,000, respectively, and for the nine months ended September 30, 2017 and 2016 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of \$418,366 and \$90,000, respectively.

On a quarterly basis, the Company evaluates its fixed maturity securities held to maturity. This evaluation includes a review of current ratings by the National Association of Insurance Commissions ("NAIC"). Securities with a rating of 1 or 2 are considered investment grade and are not reviewed for impairment. Securities with ratings of 3 to 5 are evaluated for impairment. Securities with a rating of 6 are automatically determined to be impaired and are written down. The evaluation involves an analysis of the securities in relation to historical values, interest payment history, projected earnings and revenue growth rates as well as a review of the reason for a downgrade in the NAIC rating. Based on the analysis of a security that is rated 3 to 5, a determination is made whether the security will likely make interest and principal payments in accordance with the terms of the financial instrument. If it is unlikely that the security will meet contractual obligations, the loss is considered to be other than temporary, the security is written down to the new anticipated market value and an impairment loss is recognized. Impairment losses are treated as credit losses as the Company holds fixed maturity securities to maturity unless the underlying conditions have changed in the financial instrument to require an impairment.

The fair values of fixed maturity securities are based on quoted market prices, when available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting expected future cash flows using a current market value applicable to the coupon rate, credit and maturity of the investments.

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3) Investments (Continued)

The amortized cost and estimated fair value of fixed maturity securities held to maturity, at September 30, 2017, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                            | Amortized<br>Cost    | Estimated<br>Fair<br>Value |
|----------------------------|----------------------|----------------------------|
| Held to Maturity:          |                      |                            |
| Due in 2017                | \$ 1,205,533         | \$ 1,208,929               |
| Due in 2018 through 2021   | 77,063,707           | 78,846,158                 |
| Due in 2022 through 2026   | 54,265,268           | 56,731,089                 |
| Due after 2026             | 87,888,563           | 96,497,632                 |
| Mortgage-backed securities | 9,764,566            | 9,846,716                  |
| Redeemable preferred stock | 623,635              | 677,038                    |
| Total held to maturity     | <u>\$230,811,272</u> | <u>\$243,807,562</u>       |

The Company is a member of the Federal Home Loan Bank of Des Moines ("FHLB"). In June through August of 2017, the Company purchased a total of \$50,000,000, par value, of United States Treasury fixed maturity securities that it deposited with the FHLB. These securities will generate interest income for the Company and will be available to use as collateral on any cash borrowings from the FHLB. As of September 30, 2017, the Company did not have any outstanding amounts owed to FHLB.

**Equity Securities**

The following tables summarize unrealized losses on equity securities available for sale, that were carried at estimated fair value based on quoted trading prices at September 30, 2017 and December 31, 2016. The unrealized losses were primarily the result of decreases in fair value in the retail, industrial and energy sectors. The tables set forth unrealized losses by duration and number of investment positions, together with the fair value of the related equity securities available for sale in a loss position:

|   | Unrealized<br>Losses for<br>Less than<br>Twelve<br>Months | No. of<br>Investment<br>Positions | Unrealized<br>Losses for<br>More than<br>Twelve<br>Months | No. of<br>Investment<br>Positions | Total<br>Unrealized<br>Losses |
|---|---|-----------------------------------|---|-----------------------------------|-------------------------------|
| <u>At September 30, 2017</u>            |   |                                   |   |                                   |                               |
| Industrial, miscellaneous and all other | \$ 150,581  | 108                               | \$ 669,370  | 92                                | \$ 819,951                    |
| Total unrealized losses                 | <u>\$ 150,581</u>   | <u>108</u>                        | <u>\$ 669,370</u>   | <u>92</u>                         | <u>\$ 819,951</u>             |
| Fair Value                              | <u>\$ 988,159</u>   |                                   | <u>\$ 1,444,994</u>                                       |                                   | <u>\$ 2,433,153</u>           |
| <u>At December 31, 2016</u>             |   |                                   |   |                                   |                               |
| Industrial, miscellaneous and all other | \$ 215,563  | 124                               | \$ 643,529  | 104                               | \$ 859,092                    |
| Total unrealized losses                 | <u>\$ 215,563</u>   | <u>124</u>                        | <u>\$ 643,529</u>   | <u>104</u>                        | <u>\$ 859,092</u>             |
| Fair Value                              | <u>\$ 2,063,144</u>                                       |                                   | <u>\$ 1,685,874</u>                                       |                                   | <u>\$ 3,749,018</u>           |

The average fair value of the equity securities available for sale was 74.8% and 81.4% of the original investment as of September 30, 2017 and December 31, 2016, respectively. The intent of the Company is to retain equity securities for a period of time sufficient to allow for the recovery in fair value. However, the Company may sell equity securities during a period in which the fair value has declined below the amount of the original investment. In certain situations, new factors, including changes in the business environment, can change the Company's previous intent to continue holding a security. During the three months ended September 30, 2017 and 2016, an other than temporary decline in the fair value resulted in the recognition of an impairment loss on equity securities of \$63,375 and \$0-, respectively, and for the nine months ended September 30, 2017 and 2016, an other than temporary decline in the fair value resulted in the recognition of an impairment loss on equity securities of \$63,375 and \$43,630, respectively.

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3) Investments (Continued)

On a quarterly basis, the Company reviews its investment in equity securities that are in a loss position. The first step is to identify securities by lots which are currently carried on the books at a value greater than the 52-week high. These securities are further evaluated by reviewing current market value in relation to historical value, price earnings ratios, projected earnings, revenue growth rates, negative company related events, market sector comparisons and analyst reports to determine if a security has a reasonable expectation to return to the current cost basis. Based on the analysis, a determination is made whether a security will likely recover from the loss position within a reasonable period of time. If it is unlikely that the security will recover from the loss position, the loss is considered to be other than temporary, the security is written down to a restated value and an impairment loss is recognized.

The fair values for equity securities are based on quoted market prices.

There were no investments, aggregated by issuer, in excess of 10% of shareholders' equity (before net unrealized gains and losses on equity securities available for sale) at September 30, 2017, other than investments issued or guaranteed by the United States Government.

The Company's net realized gains and losses from sales, calls, and maturities, and other than temporary impairments from investments and other assets are summarized as follows:

|  | Three Months Ended<br>September 30 |                           | Nine Months Ended<br>September 30 |                         |
|--|------------------------------------|---------------------------|-----------------------------------|-------------------------|
|  | 2017                               | 2016                      | 2017                              | 2016                    |
| <b>Fixed maturity securities held to maturity:</b> |                                    |                           |                                   |                         |
| Gross realized gains                               | \$ 110,529                         | \$ 65,179                 | \$ 163,950                        | \$ 259,635              |
| Gross realized losses                              | (651,754)                          | (4,527)                   | (686,819)                         | (7,405)                 |
| Other than temporary impairments                   | (100,000)                          | (30,000)                  | (418,366)                         | (90,000)                |
| <b>Equity securities available for sale:</b>       |                                    |                           |                                   |                         |
| Gross realized gains                               | 25,898                             | 36,751                    | 132,350                           | 176,331                 |
| Gross realized losses                              | (26)                               | (4,544)                   | (58,464)                          | (37,146)                |
| Other than temporary impairments                   | (63,375)                           | -                         | (63,375)                          | (43,630)                |
| <b>Other assets:</b>                               |                                    |                           |                                   |                         |
| Gross realized gains                               | 225,022                            | 191,992                   | 2,006,721                         | 468,675                 |
| Gross realized losses                              | (29,335)                           | (324,020)                 | (844,672)                         | (680,794)               |
| <b>Total</b>                                       | <b><u>\$ (483,041)</u></b>         | <b><u>\$ (69,169)</u></b> | <b><u>\$ 231,325</u></b>          | <b><u>\$ 45,666</u></b> |

The net realized gains and losses on the sale of securities are recorded on the trade date, and the cost of the securities sold is determined using the specific identification method.

The carrying amount of held to maturity securities sold was \$2,240,249 and \$1,989,159 for the nine months ended September 30, 2017 and 2016, respectively. The net realized loss related to these sales was \$385,484 for the nine months ended September 30, 2017 and the net realized gain related to these sales was \$156,154 for the nine months ended September 30, 2016. Although the intent is to buy and hold a fixed maturity security to maturity, the Company will sell a security prior to maturity if conditions have changed within the entity that issued the security to increase the risk of default to an unacceptable level.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
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3) Investments (Continued)

Major categories of net investment income are as follows:

|                                    | Three Months Ended<br>September 30 |                     | Nine Months Ended<br>September 30 |                      |
|------------------------------------|------------------------------------|---------------------|-----------------------------------|----------------------|
|                                    | 2017                               | 2016                | 2017                              | 2016                 |
| Fixed maturity securities          | \$ 2,692,586                       | \$ 2,410,641        | \$ 7,475,156                      | \$ 6,472,847         |
| Equity securities                  | 66,320                             | 78,402              | 209,517                           | 208,696              |
| Mortgage loans held for investment | 2,973,349                          | 2,830,853           | 8,803,257                         | 8,238,249            |
| Real estate held for investment    | 2,818,672                          | 2,736,301           | 8,540,756                         | 8,162,574            |
| Policy loans                       | 195,098                            | 205,537             | 621,854                           | 558,778              |
| Insurance assignments              | 3,234,520                          | 2,952,170           | 9,943,561                         | 8,915,654            |
| Other investments                  | 16,051                             | -                   | 36,041                            | 13,962               |
| Short-term investments             | 109,939                            | 20,978              | 311,989                           | 66,480               |
| Gross investment income            | 12,106,535                         | 11,234,882          | 35,942,131                        | 32,637,240           |
| Investment expenses                | (3,745,069)                        | (3,145,025)         | (10,383,018)                      | (9,152,960)          |
| Net investment income              | <u>\$ 8,361,466</u>                | <u>\$ 8,089,857</u> | <u>\$ 25,559,113</u>              | <u>\$ 23,484,280</u> |

Net investment income includes income earned by the restricted assets of the cemeteries and mortuaries of \$129,235 and \$133,289 for the three months ended September 30, 2017 and 2016, respectively, and \$369,721 and \$295,630 for the nine months ended September 30, 2017 and 2016, respectively.

Net investment income on real estate consists primarily of rental revenue.

Investment expenses consist primarily of depreciation, property taxes, operating expenses of real estate and an estimated portion of administrative expenses relating to investment activities.

Securities on deposit with regulatory authorities as required by law amounted to \$9,166,082 at September 30, 2017 and \$9,269,121 at December 31, 2016. The pledged securities are included in various assets under investments on the accompanying condensed consolidated balance sheets.

**Real Estate Held for Investment**

The Company continues to strategically deploy resources into real estate to match the income and yield durations of its primary obligations. The sources for these real estate assets come through its various business units in the form of acquisition, development and foreclosures on mortgage loans.

Commercial Real Estate Held for Investment

The Company owns and manages commercial real estate assets as a means of generating investment income. These assets are acquired in accordance with the Company's goals and objectives for risk-adjusted returns. Due diligence is conducted on each asset using internal and third-party reports. Geographic locations and asset classes of the investment activity is determined by senior management under the direction of the Board of Directors.

The Company employs full-time employees to attend to the day-to-day operations of those assets within the greater Salt Lake area and close surrounding markets. The Company utilizes third party property managers when the geographic boundary does not warrant full-time staff or through strategic lease-up periods. The Company generally looks to acquire assets in regions that are high growth regions for employment and population and in assets that provide operational efficiencies.

The Company currently owns and operates 12 commercial properties in 7 states. These properties include industrial warehouses, office buildings, retail centers, undeveloped land and includes the redevelopment and expansion of its corporate campus in Salt Lake City, Utah. The Company does use debt in strategic cases to leverage established yields or to acquire a higher quality or different class of asset.

The aggregated net ending balance of commercial real estate that serves as collateral for bank borrowings was approximately \$65,907,000 and \$51,507,000 as of September 30, 2017 and December 31, 2016, respectively. The associated bank loan carrying values totaled approximately \$38,161,000 and \$21,831,000 as of September 30, 2017 and December 31, 2016, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the Company's commercial real estate held for investment for the periods presented:

|             | Net Ending Balance      |                      | Total Square Footage    |                        |
|-------------|-------------------------|----------------------|-------------------------|------------------------|
|             | September<br>30<br>2017 | December 31<br>2016  | September<br>30<br>2017 | December<br>31<br>2016 |
| Arizona     | \$ 4,000(1)             | \$ 450,538(1)        | -                       | 16,270                 |
| Arkansas    | 97,219                  | 100,369              | 3,200                   | 3,200                  |
| Kansas      | 11,993,029              | 12,450,297           | 222,679                 | 222,679                |
| Louisiana   | 499,573                 | 518,700              | 7,063                   | 7,063                  |
| Mississippi | 3,748,324               | 3,818,985            | 33,821                  | 33,821                 |
| New Mexico  | 7,000(1)                | 7,000(1)             | -                       | -                      |
| Texas       | 3,728,960               | 3,734,974            | 23,470                  | 23,470                 |
| Utah        | 61,021,673(2)           | 47,893,073(2)        | 433,244                 | 433,244                |
|             | <u>\$ 81,099,778</u>    | <u>\$ 68,973,936</u> | <u>723,477</u>          | <u>739,747</u>         |

(1) Includes undeveloped land

(2) Includes 53rd Center completed in July 2017

Residential Real Estate Held for Investment

The Company owns a portfolio of residential homes primarily as a result of loan foreclosures. The strategy has been to lease these homes to produce cash flow, and allow time for the economic fundamentals to return to the various markets. As an orderly and active market for these homes returns, the Company has the option to dispose or to continue and hold them for cash flow and acceptable returns.

The Company established Security National Real Estate Services ("SNRE") to manage the residential portfolio. SNRE cultivates and maintains the preferred vendor relationships necessary to manage costs and quality of work performed on the portfolio of homes across the country.

As of September 30, 2017, SNRE manages 107 residential properties in 9 states across the United States which includes a newly constructed apartment complex, Dry Creek at East Village, in Sandy, Utah.

The net ending balance of residential real estate that serves as collateral for a bank borrowing was approximately \$34,772,000 and \$35,798,000, as of September 30, 2017 and December 31, 2016, respectively. The associated bank loan carrying value was approximately \$26,893,000 and \$27,377,000 as of September 30, 2017 and December 31, 2016, respectively.

The net ending balance of foreclosed residential real estate included in residential real estate held for investment is \$34,167,065 and \$39,856,434 as of September 30, 2017 and December 31, 2016, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the Company's residential real estate held for investment for the periods presented:

|            | Net Ending Balance      |                        |
|------------|-------------------------|------------------------|
|            | September<br>30<br>2017 | December<br>31<br>2016 |
| Arizona    | \$ 217,516              | \$ 742,259             |
| California | 5,663,871               | 5,848,389              |
| Colorado   | -                       | 364,489                |
| Florida    | 7,311,913               | 8,327,355              |
| Hawaii     | 712,286                 | -                      |
| Ohio       | 46,658                  | 46,658                 |
| Oklahoma   | 17,500                  | -                      |
| Texas      | 511,486                 | 1,091,188              |
| Utah       | 54,701,809              | 59,485,466             |
| Washington | 286,181                 | 286,181                |
|            | <u>\$ 69,469,220</u>    | <u>\$ 76,191,985</u>   |

Real Estate Owned and Occupied by the Company

The primary business units of the Company occupy a portion of the real estate owned by the Company. Currently, the Company occupies nearly 80,000 square feet, or approximately 10% of the overall commercial real estate holdings.

As of September 30, 2017, real estate owned and occupied by the Company is summarized as follows:

| Location                                    | Business Segment  | Approximate<br>Square<br>Footage | Square<br>Footage<br>Occupied<br>by the<br>Company |
|---|---|----------------------------------|--|
| 5300 South 360 West, Salt Lake City, UT (1) | Corporate Offices, Life Insurance<br>and Cemetery/Mortuary Operations | 36,000                           | 100%   |
| 5201 Green Street, Salt Lake City, UT       | Mortgage Operations   | 36,899                           | 34%  |
| 1044 River Oaks Dr., Flowood, MS            | Life Insurance Operations   | 5,522                            | 27%  |

(1) This asset is included in property and equipment on the condensed consolidated balance sheet

3) Investments (Continued)

**Mortgage Loans Held for Investment**

Mortgage loans held for investment consist of first and second mortgages. The mortgage loans bear interest at rates ranging from 2.0% to 10.5%, maturity dates range from three months to 30 years and are secured by real estate. Concentrations of credit risk arise when a number of mortgage loan debtors have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company has a diversified mortgage loan portfolio consisting of residential mortgages, commercial loans and residential construction loans and requires collateral on all real estate exposures, a substantial portion of its debtors' ability to honor obligations is reliant on the economic stability of the geographic region in which the debtors do business. At September 30, 2017, the Company had 45%, 11%, 11%, 7%, 5%, 5% and 4% of its mortgage loans from borrowers located in the states of Utah, California, Texas, Florida, Arizona, Nevada, and Tennessee, respectively.

Mortgage loans held for investment are carried at their unpaid principal balances adjusted for net deferred fees, charge-offs and the related allowance for loan losses. Interest income is included in net investment income on the condensed consolidated statements of earnings and is recognized when earned. The Company defers related material loan origination fees, net of related direct loan origination costs, and amortizes the net fees over the term of the loans. Origination fees are included in net investment income on the condensed consolidated statements of earnings.

Mortgage loans are secured by the underlying property and require an appraisal at the time of underwriting and funding. Generally, the Company will fund a loan not to exceed 80% of the loan's collateral fair market value. Amounts over 80% will require additional collateral or mortgage insurance by an approved third-party insurer.

The Company provides for losses on its mortgage loans held for investment through an allowance for loan losses (a contra-asset account). The allowance is comprised of two components. The first component is an allowance for collectively evaluated impairment that is based upon the Company's historical experience in collecting similar receivables. The second component is based upon individual evaluation of loans that are determined to be impaired. Upon determining impairment, the Company establishes an individual impairment allowance based upon an assessment of the fair value of the underlying collateral. When a loan becomes delinquent, the Company proceeds to foreclose on the real estate and all expenses for foreclosure are expensed as incurred. Once foreclosed, an adjustment for the lower of cost or fair value is made, if necessary, and the amount is classified as real estate held for investment. The Company will rent the properties until it is deemed desirable to sell them.

The allowance for losses on mortgage loans held for investment could change based on changes in the value of the underlying collateral, the performance status of the loans, or the Company's actual collection experience. The actual losses could change, in the near term, from the established allowance, based upon the occurrence or non-occurrence of these events.

For purposes of determining the allowance for losses, the Company has segmented its mortgage loans held for investment by loan type. The Company's loan types are commercial, residential, and residential construction. The inherent risks within the portfolio vary depending upon the loan type as follows:

Commercial - Underwritten in accordance with the Company's policies to determine the borrower's ability to repay the obligation as agreed. Commercial loans are made primarily based on the underlying collateral supporting the loan. Accordingly, the repayment of a commercial loan depends primarily on the collateral and its ability to generate income and secondary on the borrower's (or guarantors) ability to repay.

Residential - Secured by family dwelling units. These loans are secured by first mortgages on the unit, which are generally the primary residence of the borrower, generally at a loan-to-value ratio ("LTV") of 80% or less.

Residential construction (including land acquisition and development) - Underwritten in accordance with the Company's underwriting policies which include a financial analysis of the builders, borrowers (guarantors), construction cost estimates, and independent appraisal valuations. These loans will rely on the value associated with the project upon completion. These cost and valuation estimates may be inaccurate. Construction loans generally involve the disbursement of substantial funds over a short period of time with repayment substantially dependent upon the success of the completed project and the ability of the borrower to secure long-term financing. Additionally, land is underwritten according to the Company's policies, which include independent appraisal valuations as well as the estimated value associated with the land upon completion of development into finished lots. These cost and valuation estimates may be inaccurate. These loans are considered to be of a higher risk than other mortgage loans due to their ultimate repayment being sensitive to general economic conditions, availability of long-term or construction financing, and interest rate sensitivity.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the allowance for loan losses as a contra-asset account for the periods presented:

**Allowance for Credit Losses and Recorded Investment in Mortgage Loans**

|   | <u>Commercial</u>    | <u>Residential</u>   | <u>Residential<br/>Construction</u> | <u>Total</u>          |
|---|----------------------|----------------------|-------------------------------------|-----------------------|
| <b>September 30, 2017</b>                             |                      |                      |                                     |                       |
| Allowance for credit losses:                          |                      |                      |                                     |                       |
| Beginning balance - January 1, 2017                   | \$ 187,129           | \$ 1,461,540         | \$ 100,114                          | \$ 1,748,783          |
| Charge-offs   | -                    | (49,775)             | (64,894)                            | (114,669)             |
| Provision   | -                    | 417,704              | -                                   | 417,704               |
| Ending balance - September 30, 2017                   | <u>\$ 187,129</u>    | <u>\$ 1,829,469</u>  | <u>\$ 35,220</u>                    | <u>\$ 2,051,818</u>   |
| Ending balance: individually evaluated for impairment | <u>\$ -</u>          | <u>\$ 411,172</u>    | <u>\$ -</u>                         | <u>\$ 411,172</u>     |
| Ending balance: collectively evaluated for impairment | <u>\$ 187,129</u>    | <u>\$ 1,418,297</u>  | <u>\$ 35,220</u>                    | <u>\$ 1,640,646</u>   |
| Mortgage loans:                                       |                      |                      |                                     |                       |
| Ending balance  | <u>\$ 42,923,761</u> | <u>\$ 65,759,761</u> | <u>\$ 41,306,722</u>                | <u>\$ 149,990,244</u> |
| Ending balance: individually evaluated for impairment | <u>\$ 203,806</u>    | <u>\$ 5,425,757</u>  | <u>\$ -</u>                         | <u>\$ 5,629,563</u>   |
| Ending balance: collectively evaluated for impairment | <u>\$ 42,719,955</u> | <u>\$ 60,334,004</u> | <u>\$ 41,306,722</u>                | <u>\$ 144,360,681</u> |
| <b>December 31, 2016</b>                              |                      |                      |                                     |                       |
| Allowance for credit losses:                          |                      |                      |                                     |                       |
| Beginning balance - January 1, 2016                   | \$ 187,129           | \$ 1,560,877         | \$ 100,114                          | \$ 1,848,120          |
| Charge-offs   | -                    | (420,135)            | -                                   | (420,135)             |
| Provision   | -                    | 320,798              | -                                   | 320,798               |
| Ending balance - December 31, 2016                    | <u>\$ 187,129</u>    | <u>\$ 1,461,540</u>  | <u>\$ 100,114</u>                   | <u>\$ 1,748,783</u>   |
| Ending balance: individually evaluated for impairment | <u>\$ -</u>          | <u>\$ 374,501</u>    | <u>\$ -</u>                         | <u>\$ 374,501</u>     |
| Ending balance: collectively evaluated for impairment | <u>\$ 187,129</u>    | <u>\$ 1,087,039</u>  | <u>\$ 100,114</u>                   | <u>\$ 1,374,282</u>   |
| Mortgage loans:                                       |                      |                      |                                     |                       |
| Ending balance  | <u>\$ 51,536,622</u> | <u>\$ 58,593,622</u> | <u>\$ 40,800,117</u>                | <u>\$ 150,930,361</u> |
| Ending balance: individually evaluated for impairment | <u>\$ 202,992</u>    | <u>\$ 2,916,538</u>  | <u>\$ 64,895</u>                    | <u>\$ 3,184,425</u>   |
| Ending balance: collectively evaluated for impairment | <u>\$ 51,333,630</u> | <u>\$ 55,677,084</u> | <u>\$ 40,735,222</u>                | <u>\$ 147,745,936</u> |

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the aging of mortgage loans held for investment for the periods presented:

**Age Analysis of Mortgage Loans Held for Investment**

|                           | <b>30-59<br/>Days<br/>Past<br/>Due</b> | <b>60-89<br/>Days<br/>Past<br/>Due</b> | <b>Greater<br/>Than<br/>90 Days<br/>(1)</b> | <b>In Process<br/>of<br/>Foreclosure<br/>(1)</b> | <b>Total<br/>Past Due</b> | <b>Current</b>       | <b>Total<br/>Mortgage<br/>Loans</b> | <b>Allowance<br/>for<br/>Loan<br/>Losses</b> | <b>Unamortized<br/>deferred<br/>loan fees,<br/>net</b> | <b>Net<br/>Mortgage<br/>Loans</b> |
|---------------------------|--|--|---|--|---------------------------|----------------------|-------------------------------------|--|--|-----------------------------------|
| <b>September 30, 2017</b> |  |  |   |  |                           |                      |                                     |  |  |                                   |
| Commercial                | \$513,218                              | \$ -                                   | \$ -  | \$ 203,806                                       | \$ 717,024                | \$ 42,206,737        | \$ 42,923,761                       | \$ (187,129)                                 | \$ (229,603)   | \$ 42,507,029                     |
| Residential               | 22,277                                 | 1,236,721                              | 2,200,206                                   | 3,225,551  | 6,684,755                 | 59,075,006           | 65,759,761                          | (1,829,469)                                  | (21,578)   | 63,908,714                        |
| Residential Construction  | -                                      | -                                      | -   | -  | -                         | 41,306,722           | 41,306,722                          | (35,220)                                     | (386,554)  | 40,884,948                        |
| <b>Total</b>              | <b>\$535,495</b>                       | <b>\$1,236,721</b>                     | <b>\$2,200,206</b>                          | <b>\$ 3,429,357</b>                              | <b>\$7,401,779</b>        | <b>\$142,588,465</b> | <b>\$149,990,244</b>                | <b>\$(2,051,818)</b>                         | <b>\$( 637,735)</b>                                    | <b>\$147,300,691</b>              |
| <b>December 31, 2016</b>  |  |  |   |  |                           |                      |                                     |  |  |                                   |
| Commercial                | \$ -                                   | \$ -                                   | \$ -  | \$ 202,992                                       | \$ 202,992                | \$ 51,333,630        | \$ 51,536,622                       | \$ (187,129)                                 | \$ (155,725)   | \$ 51,193,768                     |
| Residential               | 964,960                                | 996,779                                | 1,290,355                                   | 1,626,183  | 4,878,277                 | 53,715,345           | 58,593,622                          | (1,461,540)                                  | (35,121)   | 57,096,961                        |
| Residential Construction  | -                                      | -                                      | 64,895                                      | -  | 64,895                    | 40,735,222           | 40,800,117                          | (100,114)                                    | -  | 40,700,003                        |
| <b>Total</b>              | <b>\$964,960</b>                       | <b>\$ 996,779</b>                      | <b>\$1,355,250</b>                          | <b>\$ 1,829,175</b>                              | <b>\$5,146,164</b>        | <b>\$145,784,197</b> | <b>\$150,930,361</b>                | <b>\$(1,748,783)</b>                         | <b>\$( 190,846)</b>                                    | <b>\$148,990,732</b>              |

(1) Interest income is not recognized on loans past due greater than 90 days or in foreclosure.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
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3) Investments (Continued)

Impaired Mortgage Loans Held for Investment

Impaired mortgage loans held for investment include loans with a related specific valuation allowance or loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary. The recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, for each reporting period and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

|                                     | <u>Recorded<br/>Investment</u> | <u>Unpaid<br/>Principal<br/>Balance</u> | <u>Related<br/>Allowance</u> | <u>Average<br/>Recorded<br/>Investment</u> | <u>Interest<br/>Income<br/>Recognized</u> |
|-------------------------------------|--------------------------------|---|------------------------------|--|---|
| <b>September 30, 2017</b>           |                                |   |                              |  |   |
| With no related allowance recorded: |                                |   |                              |  |   |
| Commercial                          | \$ 203,806                     | \$ 203,806                              | \$ -                         | \$ 456,524                                 | \$ -                                      |
| Residential                         | 3,872,587                      | 3,872,587                               | -                            | 3,281,980                                  | -   |
| Residential construction            | -                              | -                                       | -                            | -  | -   |
| With an allowance recorded:         |                                |   |                              |  |   |
| Commercial                          | \$ -                           | \$ -                                    | \$ -                         | \$ -                                       | \$ -                                      |
| Residential                         | 1,553,170                      | 1,553,170                               | 411,172                      | 1,287,394                                  | -   |
| Residential construction            | -                              | -                                       | -                            | -  | -   |
| Total:                              |                                |   |                              |  |   |
| Commercial                          | \$ 203,806                     | \$ 203,806                              | \$ -                         | \$ 456,524                                 | \$ -                                      |
| Residential                         | 5,425,757                      | 5,425,757                               | 411,172                      | 4,569,374                                  | -   |
| Residential construction            | -                              | -                                       | -                            | -  | -   |
| <b>December 31, 2016</b>            |                                |   |                              |  |   |
| With no related allowance recorded: |                                |   |                              |  |   |
| Commercial                          | \$ 202,992                     | \$ 202,992                              | \$ -                         | \$ 202,992                                 | \$ -                                      |
| Residential                         | -                              | -                                       | -                            | -  | -   |
| Residential construction            | 64,895                         | 64,895                                  | -                            | 79,082                                     | -   |
| With an allowance recorded:         |                                |   |                              |  |   |
| Commercial                          | \$ -                           | \$ -                                    | \$ -                         | \$ -                                       | \$ -                                      |
| Residential                         | 2,916,538                      | 2,916,538                               | 374,501                      | 3,001,850                                  | -   |
| Residential construction            | -                              | -                                       | -                            | -  | -   |
| Total:                              |                                |   |                              |  |   |
| Commercial                          | \$ 202,992                     | \$ 202,992                              | \$ -                         | \$ 202,992                                 | \$ -                                      |
| Residential                         | 2,916,538                      | 2,916,538                               | 374,501                      | 3,001,850                                  | -   |
| Residential construction            | 64,895                         | 64,895                                  | -                            | 79,082                                     | -   |

Credit Risk Profile Based on Performance Status

The Company's mortgage loan held for investment portfolio is monitored based on performance of the loans. Monitoring a mortgage loan increases when the loan is delinquent or earlier if there is an indication of impairment. The Company defines non-performing mortgage loans as loans 90 days or greater delinquent or on non-accrual status.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

3) Investments (Continued)

The Company's performing and non-performing mortgage loans held for investment were as follows:

**Mortgage Loans Held for Investment Credit Exposure  
Credit Risk Profile Based on Payment Activity**

|                | <u>Commercial</u>           |                             | <u>Residential</u>          |                             | <u>Residential Construction</u> |                             | <u>Total</u>                 |                              |
|----------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|---------------------------------|-----------------------------|------------------------------|------------------------------|
|                | <u>September 30, 2017</u>   | <u>December 31, 2016</u>    | <u>September 30, 2017</u>   | <u>December 31, 2016</u>    | <u>September 30, 2017</u>       | <u>December 31, 2016</u>    | <u>September 30, 2017</u>    | <u>December 31, 2016</u>     |
| Performing     | \$ 42,719,955               | \$ 51,333,630               | \$ 60,334,004               | \$ 55,677,084               | \$ 41,306,722                   | \$ 40,735,222               | \$ 144,360,681               | \$ 147,745,936               |
| Non-performing | 203,806                     | 202,992                     | 5,425,757                   | 2,916,538                   | -                               | 64,895                      | 5,629,563                    | 3,184,425                    |
| <b>Total</b>   | <b><u>\$ 42,923,761</u></b> | <b><u>\$ 51,536,622</u></b> | <b><u>\$ 65,759,761</u></b> | <b><u>\$ 58,593,622</u></b> | <b><u>\$ 41,306,722</u></b>     | <b><u>\$ 40,800,117</u></b> | <b><u>\$ 149,990,244</u></b> | <b><u>\$ 150,930,361</u></b> |

Non-Accrual Mortgage Loans Held for Investment

Once a loan is past due 90 days, it is the policy of the Company to end the accrual of interest income on the loan and write off any interest income that had been accrued. Payments received for loans on a non-accrual status are recognized on a cash basis. Interest income recognized from any payments received for loans on a non-accrual status was immaterial. Accrual of interest resumes if a loan is brought current. Interest not accrued on these loans totals approximately \$185,000 and \$172,000 as of September 30, 2017 and December 31, 2016, respectively.

The following is a summary of mortgage loans held for investment on a non-accrual status for the periods presented.

|                          | <b>Mortgage Loans on Non-Accrual Status</b> |                                 |
|--------------------------|---|---------------------------------|
|                          | As of<br>September<br>30<br>2017            | As of<br>December<br>31<br>2016 |
| Commercial               | \$ 203,806                                  | \$ 202,992                      |
| Residential              | 5,425,757                                   | 2,916,538                       |
| Residential construction | -   | 64,895                          |
| <b>Total</b>             | <b><u>\$ 5,629,563</u></b>                  | <b><u>\$ 3,184,425</u></b>      |

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

4) Loans Held for Sale

Fair Value Option Election

Accounting Standards Codification ("ASC") No. 825, "Financial Instruments", allows for the option to report certain financial assets and liabilities at fair value initially and at subsequent measurement dates with changes in fair value included in earnings. The option may be applied instrument by instrument, but it is irrevocable. The Company elected the fair value option for loans held for sale originated after July 1, 2017. The Company believes the fair value option most closely aligns the timing of the recognition of gains and costs. These loans are intended for sale and the Company believes that the fair value is the best indicator of the resolution of these loans. Electing fair value also reduces certain timing differences and better matches changes in the fair value of these assets with changes in the fair value of the related derivatives used for these assets.

Interest income is recorded based on the contractual terms of the loan and in accordance with the Company's policy on mortgage loans held for investment and is included in mortgage fee income on the condensed consolidated statement of earnings. None of these loans are 90 or more days past due nor on nonaccrual status as of September 30, 2017. See Note 8 to the condensed consolidated financial statements for additional disclosures regarding loans held for sale.

The following is a summary of the aggregate fair value and the aggregate unpaid principal balance ("UPB") of loans held for sale for the periods presented:

|                      | As of<br>September<br>30<br>2017 |
|----------------------|----------------------------------|
| Aggregate fair value | \$166,990,187                    |
| UPB                  | 161,165,793                      |
| Unrealized gain      | 5,824,394                        |

Mortgage Fee Income

Mortgage fee income consists of origination fees, processing fees, interest income and certain other income related to the origination and sale of mortgage loans held for sale.

Major categories of mortgage fee income for loans held for sale are as follows:

|   | Three Months Ended<br>September 30 |                     | Nine Months Ended<br>September 30 |                      |
|---|------------------------------------|---------------------|-----------------------------------|----------------------|
|   | 2017                               | 2016                | 2017                              | 2016                 |
| Loan fees                                   | \$15,203,107                       | \$11,988,959        | \$ 33,291,947                     | \$ 33,071,486        |
| Interest income                             | 2,097,249                          | 2,204,286           | 5,679,868                         | 6,022,796            |
| Secondary gains                             | 28,550,295                         | 41,346,576          | 87,165,736                        | 108,667,085          |
| Change in fair value of loan commitments    | (4,833,268)                        | (1,505,820)         | (3,677,554)                       | 1,459,568            |
| Change in fair value of loans held for sale | 1,061,917                          | -                   | 1,061,917                         | -                    |
| Provision for loan loss reserve             | (481,727)                          | (838,238)           | (1,435,180)                       | (2,253,689)          |
| Mortgage fee income                         | <u>\$41,597,573</u>                | <u>\$53,195,763</u> | <u>\$122,086,734</u>              | <u>\$146,967,246</u> |

Loan Loss Reserve

When a repurchase demand corresponding to a mortgage loan previously held for sale and sold to a third-party investor is received from a third-party investor, the relevant data is reviewed and captured so that an estimated future loss can be calculated. The key factors that are used in the estimated loss calculation are as follows: (i) lien position, (ii) payment status, (iii) claim type, (iv) unpaid principal balance, (v) interest rate, and (vi) validity of the demand. Other data is captured and is useful for management purposes; the actual estimated loss is generally based on these key factors. The Company conducts its own review upon the receipt of a repurchase demand. In many instances, the Company is able to resolve the issues relating to the repurchase demand by the third-party investor without having to make any payments to the investor.

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4) Loans Held for Sale (Continued)

The following is a summary of the loan loss reserve that is included in other liabilities and accrued expenses:

|  | As of<br>September<br>30<br>2017 | As of<br>December<br>31<br>2016 |
|--|----------------------------------|---------------------------------|
| Balance, beginning of period               | \$ 627,733                       | \$ 2,805,900                    |
| Provision on current loan originations (1) | 1,435,180                        | 2,988,754                       |
| Additional provision for loan loss reserve | -                                | 1,700,000                       |
| Charge-offs, net of recaptured amounts     | 108,175                          | (6,866,921)                     |
| Balance, end of period                     | <u>\$ 2,171,088</u>              | <u>\$ 627,733</u>               |

(1) Included in Mortgage fee income

The Company believes the loan loss reserve represents probable loan losses incurred as of the balance sheet date. Actual loan loss experience could change, in the near-term, from the established reserve based upon claims that could be asserted by third-party investors. The Company believes there is potential to resolve any alleged claims by third-party investors on acceptable terms. If the Company is unable to resolve such claims on acceptable terms, legal action may ensue. In the event of legal action by any third-party investor, the Company believes it has significant defenses to any such action and intends to vigorously defend itself against such action.

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5) Stock Compensation Plans

The Company has four fixed option plans (the "2003 Plan", the "2006 Director Plan", the "2013 Plan" and the "2014 Director Plan"). Compensation expense for options issued of \$102,429 and \$84,949 has been recognized for these plans for the three months ended September 30, 2017 and 2016, respectively, and \$305,741 and \$253,427 for the nine months ended September 30, 2017 and 2016, respectively. As of September 30, 2017, the total unrecognized compensation expense related to the options issued was \$69,719, which is expected to be recognized over the vesting period of one year.

The Company generally estimates the expected life of the options based upon the contractual term of the options adjusted for actual experience. Future volatility is estimated based upon the weighted historical volatility of the Company's Class A common stock over a period equal to the estimated life of the options. Common stock issued upon exercise of stock options are generally new share issuances rather than from treasury shares.

A summary of the status of the Company's stock compensation plans as of September 30, 2017, and the changes during the nine months ended September 30, 2017, are presented below:

|   | Number of<br>Class A<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Number of<br>Class C<br>Shares | Weighted<br>Average<br>Exercise<br>Price |
|---|--------------------------------|--|--------------------------------|--|
| Outstanding at December 31, 2016  | 741,973                        | \$ 4.33                                  | 556,298                        | \$ 4.61                                  |
| Granted   | -                              |  | -                              |  |
| Exercised   | -                              |  | (103,402)                      | 1.31                                     |
| Cancelled   | -                              |  | (24,227)                       | 1.31                                     |
| Outstanding at September 30, 2017   | <u>741,973</u>                 | \$ 4.33                                  | <u>428,669</u>                 | \$ 5.59                                  |
| <b>As of September 30, 2017:</b>  |                                |  |                                |  |
| Options exercisable   | <u>706,854</u>                 | \$ 4.21                                  | <u>407,669</u>                 | \$ 5.50                                  |
| <b>As of September 30, 2017:</b>  |                                |  |                                |  |
| Available options for future grant  | <u>525,682</u>                 |  | <u>227,750</u>                 |  |
| <b>Weighted average contractual term of options outstanding at September 30, 2017</b> |                                |  |                                |  |
|   | 6.62 years                     |  | 2.63 years                     |  |
| <b>Weighted average contractual term of options exercisable at September 30, 2017</b> |                                |  |                                |  |
|   | 6.50 years                     |  | 2.55 years                     |  |
| <b>Aggregated intrinsic value of options outstanding at September 30, 2017 (1)</b>    |                                |  |                                |  |
|   | <u>\$ 941,567</u>              |  | <u>\$ 151,012</u>              |  |
| <b>Aggregated intrinsic value of options exercisable at September 30, 2017 (1)</b>    |                                |  |                                |  |
|   | <u>\$ 941,311</u>              |  | <u>\$ 151,012</u>              |  |

(1) The Company used a stock price of \$5.10 as of September 30, 2017 to derive intrinsic value.

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5) Stock Compensation Plans (Continued)

A summary of the status of the Company's stock compensation plans as of September 30, 2016, and the changes during the nine months ended September 30, 2016, are presented below:

|  | Number of<br>Class A<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Number of<br>Class C<br>Shares | Weighted<br>Average<br>Exercise<br>Price |
|--|--------------------------------|--|--------------------------------|--|
| Outstanding at December 31, 2015   | 618,261                        | \$ 3.89                                  | 577,436                        | \$ 3.54                                  |
| Granted  | -                              |  | -                              |  |
| Exercised  | (32,417)                       | 2.38                                     | -                              |  |
| Cancelled  | -                              |  | -                              |  |
| Outstanding at September 30, 2016  | <u>585,844</u>                 | \$ 3.97                                  | <u>577,436</u>                 | \$ 3.54                                  |
| As of September 30, 2016:  |                                |  |                                |  |
| Options exercisable  | <u>550,792</u>                 | \$ 3.82                                  | <u>551,186</u>                 | \$ 3.38                                  |
| As of September 30, 2016:  |                                |  |                                |  |
| Available options for future grant   | <u>397,342</u>                 |  | <u>57,750</u>                  |  |
| Weighted average contractual term of options outstanding at September 30, 2016 | 6.99 years                     |  | 2.00 years                     |  |
| Weighted average contractual term of options exercisable at September 30, 2016 | 6.86 years                     |  | 1.90 years                     |  |
| Aggregated intrinsic value of options outstanding at September 30, 2016 (1)    | <u>\$ 1,179,541</u>            |  | <u>\$ 1,460,167</u>            |  |
| Aggregated intrinsic value of options exercisable at September 30, 2016 (1)    | <u>\$ 1,179,541</u>            |  | <u>\$ 1,460,167</u>            |  |

(1) The Company used a stock price of \$5.86 as of September 30, 2016 to derive intrinsic value.

The total intrinsic value (which is the amount by which the fair value of the underlying stock exceeds the exercise price of an option on the exercise date) of stock options exercised during the nine months ended September 30, 2017 and 2016 was \$578,017 and \$98,663, respectively.

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6) Earnings Per Share

The basic and diluted earnings per share amounts were calculated as follows:

|   | Three Months Ended<br>September 30 |              | Nine Months Ended<br>September 30 |               |
|---|------------------------------------|--------------|-----------------------------------|---------------|
|   | 2017                               | 2016         | 2017                              | 2016          |
| Numerator:                                  |                                    |              |                                   |               |
| Net earnings                                | \$ 1,096,838                       | \$ 4,183,005 | \$ 5,442,702                      | \$ 11,737,952 |
| Denominator:                                |                                    |              |                                   |               |
| Basic weighted-average shares outstanding   | 15,256,857                         | 14,830,078   | 15,159,569                        | 14,744,779    |
| Effect of dilutive securities:              |                                    |              |                                   |               |
| Employee stock options                      | 285,803                            | 439,535      | 315,257                           | 421,266       |
| Diluted weighted-average shares outstanding | 15,542,660                         | 15,269,613   | 15,474,826                        | 15,166,045    |
| Basic net earnings per share                | \$ 0.07                            | \$ 0.28      | \$ 0.36                           | \$ 0.80       |
| Diluted net earnings per share              | \$ 0.07                            | \$ 0.27      | \$ 0.35                           | \$ 0.77       |

Net earnings per share amounts have been retroactively adjusted for the effect of annual stock dividends. For the nine months ended September 30, 2017 and 2016, there were 486,725 and 250,039 of anti-dilutive employee stock option shares, respectively, that were not included in the computation of diluted net earnings per common share as their effect would be anti-dilutive.

7) Business Segment Information

Description of Products and Services by Segment

The Company has three reportable business segments: life insurance, cemetery and mortuary, and mortgage. The Company's life insurance segment consists of life insurance premiums and operating expenses from the sale of insurance products sold by the Company's independent agency force and net investment income derived from investing policyholder and segment surplus funds. The Company's cemetery and mortuary segment consists of revenues and operating expenses from the sale of at-need cemetery and mortuary merchandise and services at its mortuaries and cemeteries, pre-need sales of cemetery spaces after collection of 10% or more of the purchase price and the net investment income from investing segment surplus funds. The Company's mortgage segment consists of fee income and expenses from the originations of residential mortgage loans and interest earned and interest expenses from warehousing loans held for sale.

Measurement of Segment Profit or Loss and Segment Assets

The accounting policies of the reportable segments are the same as those described in the Significant Accounting Principles of the Form 10-K/A for the year ended December 31, 2016. Intersegment revenues are recorded at cost plus an agreed upon intercompany profit, and are eliminated upon consolidation.

Factors Management Used to Identify the Enterprise's Reportable Segments

The Company's reportable segments are business units that are managed separately due to the different products provided and the need to report separately to the various regulatory jurisdictions. The Company regularly reviews the quantitative thresholds and other criteria to determine when other business segments may need to be reported.

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7) Business Segment Information (Continued)

|                                    | <u>Life<br/>Insurance</u> | <u>Cemetery/<br/>Mortuary</u> | <u>Mortgage</u>    | <u>Intercompany<br/>Eliminations</u> | <u>Consolidated</u>  |
|------------------------------------|---------------------------|-------------------------------|--------------------|--------------------------------------|----------------------|
| <b>For the Three Months Ended</b>  |                           |                               |                    |                                      |                      |
| <b>September 30, 2017</b>          |                           |                               |                    |                                      |                      |
| Revenues from external customers   | \$ 25,229,759             | \$ 2,988,137                  | \$ 43,753,955      | \$ -                                 | \$ 71,971,851        |
| Intersegment revenues              | 3,333,593                 | 116,290                       | 86,580             | (3,536,463)                          | -                    |
| Segment profit before income taxes | 522,574                   | 237,108                       | 378,335            | -                                    | 1,138,017            |
| <b>For the Three Months Ended</b>  |                           |                               |                    |                                      |                      |
| <b>September 30, 2016</b>          |                           |                               |                    |                                      |                      |
| Revenues from external customers   | \$ 24,972,397             | \$ 2,900,917                  | \$ 55,075,343      | \$ -                                 | \$ 82,948,657        |
| Intersegment revenues              | 3,318,369                 | 107,745                       | 79,164             | (3,505,278)                          | -                    |
| Segment profit before income taxes | 2,139,702                 | 54,891                        | 4,378,937          | -                                    | 6,573,530            |
| <b>For the Nine Months Ended</b>   |                           |                               |                    |                                      |                      |
| <b>September 30, 2017</b>          |                           |                               |                    |                                      |                      |
| Revenues from external customers   | \$ 77,112,117             | \$ 9,907,037                  | \$128,953,552      | \$ -                                 | \$ 215,972,706       |
| Intersegment revenues              | 9,299,671                 | 338,745                       | 268,764            | (9,907,180)                          | -                    |
| Segment profit before income taxes | 4,824,654                 | 1,331,896                     | 1,873,536          | -                                    | 8,030,086            |
| Identifiable Assets                | 853,298,860               | 94,716,098                    | 190,202,990        | (133,079,207)                        | 1,005,138,741        |
| Goodwill                           | 2,765,570                 | -                             | -                  | -                                    | 2,765,570            |
| Total Assets                       | <u>856,064,430</u>        | <u>94,716,098</u>             | <u>190,202,990</u> | <u>(133,079,207)</u>                 | <u>1,007,904,311</u> |
| <b>For the Nine Months Ended</b>   |                           |                               |                    |                                      |                      |
| <b>September 30, 2016</b>          |                           |                               |                    |                                      |                      |
| Revenues from external customers   | \$ 70,616,968             | \$10,045,384                  | \$151,829,880      | \$ -                                 | \$ 232,492,232       |
| Intersegment revenues              | 9,780,803                 | 616,532                       | 239,503            | (10,636,838)                         | -                    |
| Segment profit before income taxes | 5,785,464                 | 1,283,553                     | 11,561,479         | -                                    | 18,630,496           |
| Identifiable Assets                | 797,486,493               | 95,414,964                    | 194,469,525        | (138,809,339)                        | 948,561,643          |
| Goodwill                           | 2,765,570                 | -                             | -                  | -                                    | 2,765,570            |
| Total Assets                       | <u>800,252,063</u>        | <u>95,414,964</u>             | <u>194,469,525</u> | <u>(138,809,339)</u>                 | <u>951,327,213</u>   |

8) Fair Value of Financial Instruments

Generally accepted accounting principles (GAAP) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. GAAP also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. Fair value measurements are classified under the following hierarchy:

8) Fair Value of Financial Instruments (Continued)

*Level 1:* Financial assets and financial liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

*Level 2:* Financial assets and financial liabilities whose values are based on the following:

- a) Quoted prices for similar assets or liabilities in active markets;
- b) Quoted prices for identical or similar assets or liabilities in non-active markets; or
- c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

*Level 3:* Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs may reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

The Company utilizes a combination of third party valuation service providers, brokers, and internal valuation models to determine fair value.

The following methods and assumptions were used by the Company in estimating the fair value disclosures related to significant financial instruments:

The items shown under Level 1 and Level 2 are valued as follows:

*Equity Securities Available for Sale:* The fair values of investments in equity securities along with methods used to estimate such values are disclosed in Note 3 of the Notes to the condensed consolidated financial statements.

*Restricted Assets:* A portion of these assets include mutual funds and equity securities that have quoted market prices that are used to determine fair value. Also included are cash and cash equivalents and participations in mortgage loans. The carrying amounts reported in the accompanying condensed consolidated balance sheets for these financial instruments approximate their fair values due to their short-term nature.

*Cemetery Endowment Care Trust Investments:* A portion of these assets include equity securities that have quoted market prices that are used to determine fair value. Also included are cash and cash equivalents. The carrying amounts reported in the accompanying condensed consolidated balance sheets for these financial instruments approximate their fair values due to their short-term nature.

*Call and Put Options:* The Company uses quoted market prices to value its call and put options.

Additionally, there were no transfers between Level 1 and Level 2 in the fair value hierarchy.

The items shown under Level 3 are valued as follows:

*Loans Held for Sale, at Fair Value:* The Company elected the fair value option for all loans held for sale originated after July 1, 2017. The fair value is based on quoted market prices, when available. When a quoted market price is not readily available, the Company uses the market price from its last sale of similar assets.

*Loan Commitments and Forward Sale Commitments:* The Company's mortgage segment enters into loan commitments with potential borrowers and forward sale commitments to sell loans to third-party investors. The Company also uses a hedging strategy for these transactions. A loan commitment binds the Company to lend funds to a qualified borrower at a specified interest rate and within a specified period of time, generally up to 30 days after issuance of the loan commitment. Loan commitments are defined to be derivatives under GAAP and are recognized at fair value on the consolidated balance sheets with changes in their fair values recorded in current earnings.

The Company estimates the fair value of a loan commitment based on the change in estimated fair value of the underlying mortgage loan, quoted MBS prices, estimates of the fair value of mortgage servicing rights, and an estimate of the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the loan commitment is issued. Following issuance, the value of a mortgage loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans. Fallout rates and other factors from the Company's recent historical data are used to estimate the quantity and value of mortgage loans that will fund within the terms of the commitments.

8) Fair Value of Financial Instruments (Continued)

Interest Rate Swaps: Management considers the interest rate swap instruments to be an effective cash flow hedge against the variable interest rate on bank borrowings since the interest rate swap mirrors the term of the note payable and expires on the maturity date of the bank loan it hedges. The interest rate swaps are derivative financial instruments carried at their fair value. The fair value of the interest rate swap was derived from a model that factors in current market assumptions about future interest rates.

Impaired Mortgage Loans Held for Investment: The Company believes that the fair value of these nonperforming loans will approximate the unpaid principal balance expected to be recovered based on the fair value of the underlying collateral. For residential and commercial properties, the collateral value is estimated by obtaining an independent appraisal. The appraisal typically considers area comparables and property condition as well as potential rental income that could be generated (particularly for commercial properties). For residential construction loans, the collateral is typically incomplete, so fair value is estimated as the replacement cost using data from Marshall and Swift, a provider of building cost information to the real estate construction.

Real Estate Held for Investment: The Company believes that in an orderly market, fair value will approximate the replacement cost of a home and the rental income provides a cash flow stream for investment analysis. The Company believes the highest and best use of the properties are as income producing assets since it is the Company's intent to hold the properties as rental properties, matching the income from the investment in rental properties with the funds required for future estimated policy claims.

It should be noted that for replacement cost, when determining the fair value of mortgage properties, the Company uses Marshall and Swift, a provider of building cost information to the real estate construction industry. For the investment analysis, the Company used market data based upon its real estate operation experience and projected the present value of the net rental income over seven years. The Company also considers area comparables and property condition when determining fair value.

In addition to this analysis performed by the Company, the Company depreciates Real Estate Held for Investment. This depreciation reduces the book value of these properties and lessens the exposure to the Company from further deterioration in real estate values.

Mortgage Servicing Rights: The Company initially recognizes Mortgage Servicing Rights ("MSRs") at their estimated fair values derived from the net cash flows associated with the servicing contracts, where the Company assumes the obligation to service the loan in the sale transaction. The precise fair value of MSRs cannot be readily determined because MSRs are not actively traded in stand-alone markets. Considerable judgment is required to estimate the fair values of these assets and the exercise of such judgment can significantly affect the Company's earnings.

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8) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at September 30, 2017.

|  | Total                | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|----------------------|--|--|--|
| Assets accounted for at fair value on a recurring basis            |                      |  |  |  |
| Common stock   | \$ 5,957,488         | \$ 5,957,488   | \$ -   | \$ -   |
| Total equity securities available for sale                         | <u>\$ 5,957,488</u>  | <u>\$ 5,957,488</u>  | <u>\$ -</u>                                      | <u>\$ -</u>  |
| Loans held for sale  | \$166,990,187        | \$ -   | \$ -   | \$166,990,187                                      |
| Restricted assets (1)  | 78,421               | 78,421   | -  | -  |
| Cemetery perpetual care trust investments (1)                      | 676,881              | 676,881  | -  | -  |
| Derivatives - loan commitments (2)                                 | 3,140,704            | -  | -  | 3,140,704  |
| Total assets accounted for at fair value on a recurring basis      | <u>\$176,843,681</u> | <u>\$ 6,712,790</u>  | <u>\$ -</u>                                      | <u>\$170,130,891</u>                               |
| Liabilities accounted for at fair value on a recurring basis       |                      |  |  |  |
| Derivatives - bank loan interest rate swaps (3)                    | \$ (138)             | \$ -   | \$ -   | \$ (138)   |
| - call options (4)   | (50,452)             | (50,452)   | -  | -  |
| - put options (4)  | (63,637)             | (63,637)   | -  | -  |
| - loan commitments (4)   | (8,926)              | -  | -  | (8,926)  |
| Total liabilities accounted for at fair value on a recurring basis | <u>\$ (123,153)</u>  | <u>\$ (114,089)</u>  | <u>\$ -</u>                                      | <u>\$ (9,064)</u>                                  |

(1) Excluding cash

(2) Included in other assets on the condensed consolidated balance sheet

(3) Included in bank and other loans payable on the condensed consolidated balance sheet

(4) Included in other liabilities and accrued expenses on the condensed consolidated balance sheet

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

|  | Net<br>Loan<br>Commitments | Bank<br>Loan<br>Interest<br>Rate Swaps | Loans<br>Held<br>for Sale |
|--|----------------------------|--|---------------------------|
| Balance - December 31, 2016                | \$ 6,809,332               | \$ (3,308)                             | \$ -                      |
| Purchases                                  |                            |  | 636,022,818               |
| Sales                                      |                            |  | (473,930,540)             |
| Total gains (losses):                      |                            |  |                           |
| Included in earnings (1)                   | (3,677,554)                | -                                      | 4,897,909                 |
| Included in other comprehensive income (2) | -                          | 3,170                                  | -                         |
| Balance - September 30, 2017               | <u>\$ 3,131,778</u>        | <u>\$ (138)</u>                        | <u>\$ 166,990,187</u>     |

(1) As a component of Mortgage fee income on the condensed consolidated statement of earnings

(2) As a component of Unrealized gains on derivative instruments on the condensed consolidated statement of comprehensive income

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8) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at September 30, 2017.

|   | Total               | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|---------------------|--|--|--|
| Assets accounted for at fair value on a nonrecurring basis              |                     |  |  |  |
| Impaired mortgage loans held for investment                             | \$ 5,218,392        | \$ -   | \$ -   | \$ 5,218,392                                       |
| Mortgage servicing rights additions                                     | 4,057,974           | -  | -  | 4,057,974  |
| <b>Total assets accounted for at fair value on a nonrecurring basis</b> | <b>\$ 9,276,366</b> | <b>\$ -</b>  | <b>\$ -</b>                                      | <b>\$ 9,276,366</b>                                |

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at December 31, 2016.

|   | Total               | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---|---------------------|--|--|--|
| Assets accounted for at fair value on a recurring basis                   |                     |  |  |  |
| Common stock  | \$ 9,911,256        | \$ 9,911,256   | \$ -   | \$ -   |
| Total equity securities available for sale                                | \$ 9,911,256        | \$ 9,911,256   | \$ -   | \$ -   |
| Restricted assets (1)   | \$ 736,603          | \$ 736,603   | \$ -   | \$ -   |
| Cemetery perpetual care trust investments (1)                             | 698,202             | 698,202  | -  | -  |
| Derivatives - loan commitments (2)  | 6,911,544           | -  | -  | 6,911,544  |
| <b>Total assets accounted for at fair value on a recurring basis</b>      | <b>\$18,257,605</b> | <b>\$11,346,061</b>  | <b>\$ -</b>                                      | <b>\$ 6,911,544</b>                                |
| Liabilities accounted for at fair value on a recurring basis              |                     |  |  |  |
| Derivatives - bank loan interest rate swaps (3)                           | \$ (3,308)          | -  | -  | \$ (3,308)   |
| - call options (4)  | (109,474)           | (109,474)  | -  | -  |
| - put options (4)   | (26,494)            | (26,494)   | -  | -  |
| - loan commitments (4)  | (102,212)           | -  | -  | (102,212)  |
| <b>Total liabilities accounted for at fair value on a recurring basis</b> | <b>\$ (241,488)</b> | <b>\$ (135,968)</b>  | <b>\$ -</b>                                      | <b>\$ (105,520)</b>                                |

(1) Excluding cash

(2) Included in other assets on the condensed consolidated balance sheet

(3) Included in bank and other loans payable on the condensed consolidated balance sheet

(4) Included in other liabilities and accrued expenses on the condensed consolidated balance sheet

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8) Fair Value of Financial Instruments (Continued)

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

|  | Net Loan<br>Commitments | Bank<br>Loan<br>Interest<br>Rate<br>Swaps |
|--|-------------------------|---|
| Balance - December 31, 2015                | \$ 7,671,495            | \$ (13,947)                               |
| Total gains (losses):                      |                         |   |
| Included in earnings (1)                   | (862,163)               | -   |
| Included in other comprehensive income (2) | -                       | 10,639                                    |
| Balance - December 31, 2016                | <u>\$ 6,809,332</u>     | <u>\$ (3,308)</u>                         |

(1) As a component of Mortgage fee income on the condensed consolidated statement of earnings

(2) As a component of Unrealized gains on derivative instruments on the condensed consolidated statement of comprehensive income

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at December 31, 2016.

|  | Total               | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|---------------------|---|--|--|
| Assets accounted for at fair value on a nonrecurring basis       |                     |   |  |  |
| Impaired mortgage loans held for investment                      | \$ 2,809,925        | \$ -  | \$ -   | \$ 2,809,925                                       |
| Mortgage servicing rights additions                              | 8,603,154           | -   | -  | 8,603,154  |
| Real estate held for investment                                  | <u>2,347,820</u>    | -   | -  | <u>2,347,820</u>                                   |
| Total assets accounted for at fair value on a nonrecurring basis | <u>\$13,760,899</u> | <u>\$ -</u>   | <u>\$ -</u>                                      | <u>\$ 13,760,899</u>                               |

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8) Fair Value of Financial Instruments (Continued)

**Fair Value of Financial Instruments Carried at Other Than Fair Value**

ASC 825, Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent limitations in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at September 30, 2017 and December 31, 2016.

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of September 30, 2017:

|  | <u>Carrying Value</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u>    | <u>Total<br/>Estimated<br/>Fair Value</u> |
|--|-----------------------|----------------|----------------|-------------------|---|
| <b>Assets</b>                              |                       |                |                |                   |   |
| Fixed maturity securities held to maturity | \$ 230,811,272        | \$ -           | \$243,807,562  | \$ -              | \$ 243,807,562                            |
| Mortgage loans held for investment:        |                       |                |                |                   |   |
| Residential                                | 63,908,714            | -              | -              | 68,139,551        | 68,139,551                                |
| Residential construction                   | 40,884,948            | -              | -              | 40,884,948        | 40,884,948                                |
| Commercial                                 | <u>42,507,029</u>     | <u>-</u>       | <u>-</u>       | <u>44,223,823</u> | <u>44,223,823</u>                         |
| Mortgage loans held for investment, net    | \$ 147,300,691        | \$ -           | \$ -           | \$ 153,248,322    | \$ 153,248,322                            |
| Loans held for sale (at amortized costs)   | 34,905,719            | -              | -              | 35,131,853        | 35,131,853                                |
| Policy loans                               | 6,677,924             | -              | -              | 6,677,924         | 6,677,924                                 |
| Insurance assignments, net (1)             | 32,198,144            | -              | -              | 32,198,144        | 32,198,144                                |
| Short-term investments                     | 17,830,990            | -              | 17,830,990     | -                 | 17,830,990                                |
| Mortgage servicing rights, net             | 20,396,568            | -              | -              | 26,785,380        | 26,785,380                                |
| <b>Liabilities</b>                         |                       |                |                |                   |   |
| Bank and other loans payable               | \$(182,769,531)       | \$ -           | \$ -           | \$(182,769,531)   | \$(182,769,531)                           |
| Policyholder account balances (2)          | (48,200,442)          | -              | -              | (37,564,692)      | (37,564,692)                              |
| Future policy benefits - annuities (2)     | (99,519,758)          | -              | -              | (100,851,101)     | (100,851,101)                             |

(1) Included in policy loans and other investments on the condensed consolidated balance sheet.

(2) Included in future policy benefits and unpaid claims on the condensed consolidated balance sheet.

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8) Fair Value of Financial Instruments (Continued)

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of December 31, 2016:

|  | Carrying Value  | Level 1 | Level 2        | Level 3         | Total<br>Estimated<br>Fair Value |
|--|-----------------|---------|----------------|-----------------|----------------------------------|
| <b>Assets</b>                              |                 |         |                |                 |                                  |
| Fixed maturity securities held to maturity | \$ 184,979,644  | \$ -    | \$ 191,850,749 | \$ -            | \$ 191,850,749                   |
| Mortgage loans held for investment:        |                 |         |                |                 |                                  |
| Residential                                | 57,096,961      | -       | -              | 61,357,393      | 61,357,393                       |
| Residential construction                   | 40,700,003      | -       | -              | 40,700,003      | 40,700,003                       |
| Commercial                                 | 51,193,768      | -       | -              | 53,299,800      | 53,299,800                       |
| Mortgage loans held for investment, net    | \$ 148,990,732  | \$ -    | \$ -           | \$ 155,357,196  | \$ 155,357,196                   |
| Loans held for sale                        | 189,578,243     | -       | -              | 192,289,854     | 192,289,854                      |
| Policy loans                               | 6,694,148       | -       | -              | 6,694,148       | 6,694,148                        |
| Insurance assignments, net (1)             | 32,477,246      | -       | -              | 32,477,246      | 32,477,246                       |
| Short-term investments                     | 27,560,040      | -       | 27,560,040     | -               | 27,560,040                       |
| Mortgage servicing rights, net             | 18,872,362      | -       | -              | 25,496,832      | 25,496,832                       |
| <b>Liabilities</b>                         |                 |         |                |                 |                                  |
| Bank and other loans payable               | \$(152,137,371) | \$ -    | \$ -           | \$(152,137,371) | \$(152,137,371)                  |
| Policyholder account balances (2)          | (49,421,125)    | -       | -              | (38,530,031)    | (38,530,031)                     |
| Future policy benefits - annuities (2)     | (99,388,662)    | -       | -              | (100,253,261)   | (100,253,261)                    |

(1) Included in policy loans and other investments on the condensed consolidated balance sheet.

(2) Included in future policy benefits and unpaid claims on the condensed consolidated balance sheet.

The methods, assumptions and significant valuation techniques and inputs used to estimate the fair value of these financial instruments are summarized as follows:

Fixed Maturity Securities Held to Maturity: The fair values of fixed maturity securities are based on quoted market prices, when available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting expected future cash flows using a current market value applicable to the coupon rate, credit and maturity of the investments.

Mortgage Loans Held for Investment: The estimated fair value of the Company's mortgage loans held for investment is determined using various methods. The Company's mortgage loans are grouped into three categories: Residential, Residential Construction and Commercial. When estimating the expected future cash flows, it is assumed that all loans will be held to maturity, and any loans that are non-performing are evaluated individually for impairment.

Residential - The estimated fair value of mortgage loans is determined through a combination of discounted cash flows (estimating expected future cash flows of interest payments and discounting them using current interest rates from single family mortgages) and considering pricing of similar loans that were sold recently.

Residential Construction - These loans are primarily short in maturity accordingly, the estimated fair value is determined to be the carrying value.

Commercial - The estimated fair value is determined by estimating expected future cash flows of interest payments and discounting them using current interest rates for commercial mortgages.

Loans Held for Sale, at Amortized Cost: The fair value is based on quoted market prices, when available. When a quoted market price is not readily available, the Company uses the market price from its last sale of similar assets.

Policy Loans: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values because they are fully collateralized by the cash surrender value of the underlying insurance policies.

8) Fair Value of Financial Instruments (Continued)

Insurance Assignments, Net: These investments are primarily short in maturity, accordingly, the carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

Short-Term Investments: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values due to their short-term nature.

Mortgage Servicing Rights, Net: The methods used to determine fair value of mortgage servicing rights were previously disclosed in this Note 8.

Bank and Other Loans Payable: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values due to their relatively short-term maturities and variable interest rates.

Policyholder Account Balances and Future Policy Benefits-Annuities: Future policy benefit reserves for interest-sensitive insurance products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. Policy benefits and claims that are charged to expense include benefit claims incurred in the period in excess of related policy account balances. Interest crediting rates for interest-sensitive insurance products ranged from 1.5% to 6.5%. The fair values for these investment-type insurance contracts are estimated based on the present value of liability cash flows.

The fair values for the Company's insurance contracts other than investment-type contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

9) Allowance for Doubtful Accounts

The Company records an allowance and recognizes an expense for potential losses from other investments and receivables in accordance with generally accepted accounting principles.

Receivables are the result of cemetery and mortuary operations, mortgage loan operations and life insurance operations. The allowance is based upon the Company's historical experience for collectively evaluated impairment. Other allowances are based upon receivables individually evaluated for impairment. Collectability of the cemetery and mortuary receivables is significantly influenced by current economic conditions. The critical issues that impact recovery of mortgage loan operations are interest rate risk, loan underwriting, new regulations and the overall economy.

10) Derivative Instruments

**Mortgage Banking Derivatives**

Loan Commitments

The Company is exposed to price risk due to the potential impact of changes in interest rates on the values of loan commitments from the time a loan commitment is made to an applicant to the time the loan that would result from the exercise of that loan commitment is funded. Managing price risk is complicated by the fact that the ultimate percentage of loan commitments that will be exercised (i.e., the number of loans that will be funded) fluctuates. The probability that a loan will not be funded or the loan application is denied or withdrawn within the terms of the commitment is driven by a number of factors, particularly the change, if any, in mortgage rates following the issuance of the loan commitment.

In general, the probability of funding increases if mortgage rates rise and decreases if mortgage rates fall. This is due primarily to the relative attractiveness of current mortgage rates compared to the applicant's committed rate. The probability that a loan will not be funded within the terms of the mortgage loan commitment also is influenced by the source of the applications (retail, broker or correspondent channels), proximity to rate lock expiration, purpose for the loan (purchase or refinance) product type and the application approval status. The Company has developed fallout estimates using historical data that take into account all of the variables, as well as renegotiations of rate and point commitments that tend to occur when mortgage rates fall. These fallout estimates are used to estimate the number of loans that the Company expects to be funded within the terms of the loan commitments and are updated periodically to reflect the most current data.

The Company estimates the fair value of a loan commitment based on the change in estimated fair value of the underlying mortgage loan, quoted MBS prices, estimates of the fair value of mortgage servicing rights, and an estimate of the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the loan commitment is issued and is shown net of expenses. Following issuance, the value of a loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans.

Forward Sale Commitments

The Company utilizes forward commitments to economically hedge the price risk associated with its outstanding mortgage loan commitments. A forward commitment protects the Company from losses on sales of the loans arising from exercise of the loan commitments. Management expects these types of commitments will experience changes in fair value opposite to changes in fair value of the loan commitments, thereby reducing earnings volatility related to the recognition in earnings of changes in the values of the commitments.

The net changes in fair value of all loan commitments and forward sale commitments are shown in current earnings as a component of mortgage fee income.

**Call and Put Options**

The Company uses a strategy of selling "out of the money" call options on its available for sale equity securities as a source of revenue. The options give the purchaser the right to buy from the Company specified equity securities at a set price up to a pre-determined date in the future. The Company uses the strategy of selling put options as a means of generating cash or purchasing equity securities at lower than current market prices. The Company receives an immediate payment of cash for the value of the option and establishes a liability for the fair value of the option. The liability for options is adjusted to fair value at each reporting date. In the event a call option is exercised, the Company recognizes a gain on the sale of the equity security enhanced by the value of the option that was sold. If the option expires unexercised, the Company recognizes a gain from the sale of the option. In the event a put option is exercised, the Company acquires an equity security at the strike price of the option reduced by the value received from the sale of the put option. The equity security is then traded as a normal equity security in the Company's portfolio.

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10) Derivative Instruments (Continued)

The following table shows the notional amount and fair value of derivatives as of September 30, 2017 and December 31, 2016.

| Balance Sheet Location                                    | Fair Values and Notional Values of Derivative Instruments |                       |                      |                   |                       |                      |                   |
|---|---|-----------------------|----------------------|-------------------|-----------------------|----------------------|-------------------|
|   | September 30, 2017  |                       |                      | December 31, 2016 |                       |                      |                   |
|   | Notional Amount   | Asset Fair Value      | Liability Fair Value | Notional Amount   | Asset Fair Value      | Liability Fair Value |                   |
| Derivatives not designated as hedging instruments:        |   |                       |                      |                   |                       |                      |                   |
| Loan commitments  | Other assets and Other liabilities                        | \$ 147,086,043        | \$ 3,140,704         | \$ 8,926          | \$ 191,757,193        | \$ 6,911,544         | \$ 102,212        |
| Call options  | Other liabilities   | 1,473,050             | --                   | 50,452            | 2,169,850             | --                   | 109,474           |
| Put options   | Other liabilities   | 2,593,300             | --                   | 63,637            | 1,336,750             | --                   | 26,494            |
| Derivatives designated as fair value hedging instruments: |   |                       |                      |                   |                       |                      |                   |
| Interest rate swaps                                       | Bank and other loans payable                              | 43,940                | --                   | 138               | 175,762               | --                   | 3,308             |
| Total   |   | <u>\$ 151,196,333</u> | <u>\$ 3,140,704</u>  | <u>\$ 123,153</u> | <u>\$ 195,439,555</u> | <u>\$ 6,911,544</u>  | <u>\$ 241,488</u> |

The following table shows the gains and losses on derivatives for the periods presented. There were no gains or losses reclassified from accumulated other comprehensive income (OCI) into income or gains or losses recognized in income on derivatives ineffective portion or any amounts excluded from effective testing.

| Derivative           | Classification                                 | Net Amount Gain (Loss)          |                | Net Amount Gain (Loss)         |              |
|----------------------|--|---------------------------------|----------------|--------------------------------|--------------|
|                      |  | Three Months Ended September 30 |                | Nine Months Ended September 30 |              |
|                      |  | 2017                            | 2016           | 2017                           | 2016         |
| Interest Rate Swaps  | Other comprehensive income                     | \$ 554                          | \$ -           | \$ 3,170                       | \$ 5,541     |
| Loan commitments     | Mortgage fee income                            | \$ (4,833,268)                  | \$ (1,505,820) | \$ (3,677,554)                 | \$ 1,459,568 |
| Call and put options | Realized gains on investments and other assets | \$ 27,734                       | \$ 73,250      | \$ 216,561                     | \$ 210,522   |

11) Reinsurance, Commitments and Contingencies

**Reinsurance**

The Company follows the procedure of reinsuring risks in excess of a specified limit, which ranges from \$25,000 to \$100,000. The Company is liable for these amounts in the event such reinsurers are unable to pay their portion of the claims. The Company has also assumed insurance from other companies.

**Mortgage Loan Loss Settlements**

Future loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on loans sold. The estimated liability for indemnification losses is included in other liabilities and accrued expenses and, as of September 30, 2017 and December 31, 2016, the balances were \$2,171,000 and \$628,000, respectively.

**Mortgage Loan Loss Litigation**

**Lehman Brothers Holdings Litigation - Delaware and New York**

In January 2014, Lehman Brothers Holdings, Inc. ("Lehman Holdings") entered into a settlement with the Federal National Mortgage Association (Fannie Mae) concerning the mortgage loan claims that Fannie Mae had asserted against Lehman Holdings, which were based on alleged breaches of certain representations and warranties by Lehman Holdings in the mortgage loans it had sold to Fannie Mae. Lehman Holdings acquired these loans from Aurora Bank, FSB, formerly known as Lehman Brothers Bank, FSB, which in turn purchased the loans from certain residential mortgage loan originators, including SecurityNational Mortgage. A settlement based on similar circumstances was entered into between Lehman Holdings and the Federal Home Loan Mortgage Corporation (Freddie Mac) in February 2014.

11) Reinsurance, Commitments and Contingencies (Continued)

Lehman Holdings filed a motion in May 2014 with the U.S. Bankruptcy Court of the Southern District of New York to require the mortgage loan originators, including SecurityNational Mortgage, to engage in non-binding mediations of their alleged indemnification claims against the mortgage loan originators relative to the Fannie Mae and Freddie Mac settlements with Lehman Holdings. The mediation was not successful in resolving any issues between SecurityNational Mortgage and Lehman Holdings.

On January 26, 2016, SecurityNational Mortgage filed a declaratory judgment action against Lehman Holdings in the Superior Court for the State of Delaware. In the Delaware action, SecurityNational Mortgage asserted its right to obtain a declaration of rights in that there are allegedly millions of dollars in dispute with Lehman Holdings pertaining to approximately 136 loans. SecurityNational Mortgage sought a declaratory judgment as to its rights as it contends that it has no liability to Lehman Holdings as a result of Lehman Holdings' settlements with Fannie Mae and Freddie Mac. Lehman Holdings filed a motion in the Delaware court seeking to stay or dismiss the declaratory judgment action. On August 24, 2016, the Court ruled that it would exercise its discretion to decline jurisdiction over the action and granted Lehman Holdings' motion to dismiss.

On February 3, 2016, Lehman Holdings filed an adversary proceeding against approximately 150 mortgage loan originators, including SecurityNational Mortgage, in the U.S. Bankruptcy Court of the Southern District of New York seeking a declaration of rights similar in nature to the declaratory judgment that SecurityNational Mortgage sought in its Delaware lawsuit, and for damages relating to the alleged obligations of the defendants under the indemnification provisions of the alleged agreements, in amounts to be determined at trial, including interest, attorneys' fees and costs incurred by Lehman Holdings in enforcing the obligations of the defendants. No response was required to be filed relative to the Complaint or the Amended Complaint dated March 7, 2016. A Case Management Order was entered on November 1, 2016.

On December 27, 2016, pursuant to the Case Management Order, Lehman Holdings filed a Second Amended Complaint against SecurityNational Mortgage, which eliminates the declaratory judgment claim but retains a similar claim for damages as in the Complaint. The case is presently in a motion period. Many of the defendants, including SecurityNational Mortgage, filed a joint motion in the case asserting that the Bankruptcy Court does not have subject matter jurisdiction concerning the matter and that venue is improper. Lehman Holdings' response memorandum was filed on May 31, 2017 and a reply memorandum of the defendants filing the motion was filed on July 14, 2017. A hearing date for the motion has not been set. No Answer to the Second Amended Complaint is required to be filed by SecurityNational Mortgage pending further order of the Court. SecurityNational Mortgage denies that it has any liability to Lehman Holdings and intends to vigorously protect and defend its position.

**Other Contingencies and Commitments**

The Company has entered into commitments to fund construction and land development loans and has also provided financing for land acquisition and development. As of September 30, 2017, the Company's commitments were approximately \$69,601,000 for these loans, of which \$41,307,000 had been funded. The Company will advance funds once the work has been completed and an independent inspection is made. The maximum loan commitment ranges between 50% and 80% of appraised value. The Company receives fees and interest for these loans and the interest rate is generally fixed 5.50% to 8.00% per annum. Maturities range between six and eighteen months.

The Company belongs to a captive insurance group for certain casualty insurance, worker compensation and liability programs. Insurance reserves are maintained relative to these programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the insurance liabilities and related reserves, the captive insurance management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. If actual claims or adverse development of loss reserves occurs and exceed these estimates, additional reserves may be required. The estimation process contains uncertainty since captive insurance management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date.

The Company is a defendant in various other legal actions arising from the normal conduct of business. Management believes that none of the actions will have a material effect on the Company's financial position or results of operations. Based on management's assessment and legal counsel's representations concerning the likelihood of unfavorable outcomes, no amounts have been accrued for the above claims in the consolidated financial statements.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations.

#### 12) Mortgage Servicing Rights

The Company initially records these Mortgage Servicing Rights ("MSRs") at fair value as discussed in Note 8.

The Company's subsequent accounting for MSRs is based on the class of MSRs. The Company has identified two classes of MSRs: MSRs backed by mortgage loans with initial term of 30 years and MSRs backed by mortgage loans with initial term of 15 years. The Company distinguishes between these classes of MSRs due to their differing sensitivities to change in value as the result of changes in market. After being initially recorded at fair value, MSRs backed by mortgage loans are accounted for using the amortization method. MSR amortization is determined by amortizing the balance straight-line over an estimated seven and nine-year life which estimates the proportion to, and over the period of the estimated future net servicing income of the underlying financial assets.

The Company periodically assesses MSRs for impairment. Impairment occurs when the current fair value of the MSR falls below the asset's carrying value (carrying value is the amortized cost reduced by any related valuation allowance). If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance.

Management periodically reviews the various loan strata to determine whether the value of the MSRs in a given stratum is impaired and likely to recover. When management deems recovery of the value to be unlikely in the foreseeable future, a write-down of the cost of the MSRs for that stratum to its estimated recoverable value is charged to the valuation allowance.

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12) Mortgage Servicing Rights (Continued)

The following is a summary of the MSR activity for the periods presented.

|  | As of<br>September<br>30<br>2017 | As of<br>December<br>31<br>2016 |
|--|----------------------------------|---------------------------------|
| Amortized cost:  |                                  |                                 |
| Balance before valuation allowance at beginning of year                                    | \$ 18,872,362                    | \$ 12,679,755                   |
| MSR additions resulting from loan sales  | 4,057,974                        | 8,603,154                       |
| Amortization (1)   | (2,533,768)                      | (2,410,547)                     |
| Application of valuation allowance to write down MSRs with other than temporary impairment | -                                | -                               |
| Balance before valuation allowance at end of period  | <u>\$ 20,396,568</u>             | <u>\$ 18,872,362</u>            |
| Valuation allowance for impairment of MSRs:  |                                  |                                 |
| Balance at beginning of year   | \$ -                             | \$ -                            |
| Additions  | -                                | -                               |
| Application of valuation allowance to write down MSRs with other than temporary impairment | -                                | -                               |
| Balance at end of period   | <u>\$ -</u>                      | <u>\$ -</u>                     |
| <b>Mortgage servicing rights, net</b>  | <b><u>\$ 20,396,568</u></b>      | <b><u>\$ 18,872,362</u></b>     |
| <b>Estimated fair value of MSRs at end of period</b>                                       | <b><u>\$ 26,785,380</u></b>      | <b><u>\$ 25,496,832</u></b>     |

(1) Included in other expenses on the condensed consolidated statements of earnings

The following table summarizes the Company's estimate of future amortization of its existing MSRs carried at amortized cost:

|              | Estimated<br>MSR<br>Amortization |
|--------------|----------------------------------|
| 2017         | \$ 162,284                       |
| 2018         | 3,372,381                        |
| 2019         | 3,372,381                        |
| 2020         | 3,372,381                        |
| 2021         | 3,372,381                        |
| Thereafter   | 6,744,760                        |
| <b>Total</b> | <b><u>\$ 20,396,568</u></b>      |

The Company collected the following contractual servicing fee income and late fee income as reported in other revenues on the condensed consolidated statement of earnings:

|                            | Three Months Ended<br>September 30 |                            | Nine Months Ended<br>September 30 |                            |
|----------------------------|------------------------------------|----------------------------|-----------------------------------|----------------------------|
|                            | 2017                               | 2016                       | 2017                              | 2016                       |
| Contractual servicing fees | \$ 1,848,831                       | \$ 1,496,365               | \$ 5,359,425                      | \$ 4,024,720               |
| Late fees                  | 99,077                             | 67,032                     | 266,218                           | 189,237                    |
| <b>Total</b>               | <b><u>\$ 1,947,908</u></b>         | <b><u>\$ 1,563,397</u></b> | <b><u>\$ 5,625,643</u></b>        | <b><u>\$ 4,213,957</u></b> |

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12) Mortgage Servicing Rights (Continued)

The following is a summary of the unpaid principal balances ("UPB") of the servicing portfolio for the periods presented:

|               | As of<br>September 30<br>2017 | As of<br>December 31<br>2016 |
|---------------|-------------------------------|------------------------------|
| Servicing UPB | \$3,003,608,494               | \$2,720,441,340              |

The following key assumptions were used in determining MSR value:

|                    | Prepayment<br>Speeds | Average<br>Life (Years) | Discount<br>Rate |
|--------------------|----------------------|-------------------------|------------------|
| September 30, 2017 | 3.59                 | 6.2                     | 10.01            |
| December 31, 2016  | 3.77                 | 6.52                    | 10.01            |

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13) Acquisitions

Acquisition of First Guaranty Insurance Company

On July 11, 2016, the Company, through its wholly owned subsidiary Security National Life, completed the stock purchase transaction with the shareholders of Reppond Holding Corporation, an Arkansas corporation ("Reppond Holding") and sole shareholder of First Guaranty Insurance Company, a Louisiana domestic stock legal reserve life insurance company ("First Guaranty"), to purchase all the outstanding shares of common stock of Reppond Holding. Under the terms of the stock purchase agreement, dated February 17, 2016, between Security National Life and Reppond Holding, which was later amended on March 4 and 17, 2016, Security National Life paid a total of \$6,753,000 at the closing in consideration for the purchase of all the outstanding shares of stock of Reppond Holding from its shareholders.

The estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition were as follows:

|  |                     |
|--|---------------------|
| Fixed maturity securities, held to maturity          | \$ 43,878,084       |
| Equity securities, available for sale                | 646,335             |
| Mortgage loans held for investment                   | 4,528,582           |
| Real estate held for investment                      | 528,947             |
| Policy loans   | 145,953             |
| Short-term investments                               | 5,358,403           |
| Accrued investment income                            | 585,985             |
| Cash and cash equivalents                            | 2,424,480           |
| Receivables  | 73,347              |
| Property and equipment                               | 21,083              |
| Deferred tax asset                                   | 1,190,862           |
| Receivable from reinsurers                           | 34,948              |
| Other  | <u>57,768</u>       |
| Total assets acquired                                | <u>59,474,777</u>   |
| Future policy benefits and unpaid claims             | (52,648,838)        |
| Accounts payable                                     | (6,953)             |
| Other liabilities and accrued expenses               | <u>(65,986)</u>     |
| Total liabilities assumed                            | <u>(52,721,777)</u> |
| Fair value of net assets acquired/consideration paid | <u>\$ 6,753,000</u> |

The estimated fair value of the fixed maturity securities and the equity securities is based on unadjusted quoted prices for identical assets in an active market. These types of financial assets are considered Level 1 under the fair value hierarchy. The estimated fair value of future policy benefits and unpaid claims is based on assumptions of the future value of the business acquired. Based on the unobservable nature of certain of these assumptions, the valuation for these financial liabilities is considered to be Level 3 under the fair value hierarchy. The Company determined that the estimated fair value of the remaining assets and liabilities acquired approximated their book values. The fair value of assets acquired and liabilities assumed were subject to adjustment during the first twelve months after the acquisition date if additional information became available to indicate a more accurate or appropriate value for an asset or liability. No adjustments were made.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES  
Notes to Condensed Consolidated Financial Statements  
September 30, 2017 (Unaudited)

13) Acquisitions (Continued)

The following unaudited pro forma information has been prepared to present the results of operations of the Company assuming the acquisition of First Guaranty had occurred at the beginning of the three and nine-month periods ended September 30, 2016. This pro forma information is supplemental and does not necessarily present the operations of the Company that would have occurred had the acquisition occurred on those dates and may not reflect the operations that will occur in the future:

|   | For the Nine<br>Months<br>Ended<br>September<br>30<br><u>(unaudited)</u><br><u>2016</u> |
|---|---|
| Total revenues  | \$234,629,101   |
| Net earnings  | \$ 11,472,978   |
| Net earnings per Class A equivalent common share                      | \$ 0.78   |
| Net earnings per Class A equivalent common share<br>assuming dilution | \$ 0.76   |

The pro forma results for the three and nine-month periods ended September 30, 2017 and for the three-month period ended September 30, 2016 are not included in the table above because the operating results for the First Guaranty acquisition were included in the Company's condensed consolidated statements of earnings for these periods.

14) Income Taxes

The Company's overall effective tax rate for the three months ended September 30, 2017 and 2016 was 3.6% and 36.4%, respectively, which resulted in a provision for income taxes of \$41,000 and \$2,390,000, respectively. The Company's overall effective tax rate for the nine months ended September 30, 2017 and 2016 was 32.2% and 37.0%, respectively, which resulted in a provision for income taxes of \$2,587,000 and \$6,892,000, respectively. The Company's effective tax rates differ from the U.S. federal statutory rate of 34% largely due to its provision for state income taxes and a reduction in the valuation allowance related to the prior acquisition of First Guaranty Insurance Company that decreased the effective income tax rates for both periods, when compared to the prior year periods.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Overview

The Company's operations over the last several years generally reflect three trends or events which the Company expects to continue: (i) increased attention to "niche" insurance products, such as the Company's funeral plan policies and traditional whole life products; (ii) emphasis on cemetery and mortuary business; and (iii) capitalizing on relatively low interest rates by originating mortgage loans.

### Insurance Operations

The Company's life insurance business includes funeral plans and interest-sensitive life insurance, as well as other traditional life, accident and health insurance products. The Company places specific marketing emphasis on funeral plans through pre-need planning.

A funeral plan is a small face value life insurance policy that generally has face coverage of up to \$25,000. The Company believes that funeral plans represent a marketing niche that has lower competition because most insurance companies do not offer similar coverage. The purpose of the funeral plan policy is to pay the costs and expenses incurred at the time of a person's death. On a per thousand-dollar cost of insurance basis, these policies can be more expensive to the policyholder than many types of non-burial insurance due to their low face amount, requiring the fixed cost of the policy administration to be distributed over a smaller policy size, and the simplified underwriting practices that result in higher mortality costs.

The following table shows the condensed financial results of the insurance operations for three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

|                                  | Three months ended September 30<br>(in thousands of dollars) |           |                          | Nine months ended September 30<br>(in thousands of dollars) |           |                          |
|----------------------------------|--|-----------|--------------------------|---|-----------|--------------------------|
|                                  | 2017   | 2016      | % Increase<br>(Decrease) | 2017  | 2016      | % Increase<br>(Decrease) |
| Revenues from external customers |  |           |                          |   |           |                          |
| Insurance premiums               | \$ 17,490  | \$ 17,157 | 2%                       | \$ 52,345   | \$ 47,508 | 10%                      |
| Net investment income            | 8,110  | 7,828     | 4%                       | 24,831  | 22,768    | 9%                       |
| Other                            | (370)  | (13)      | 2746%                    | (64)  | 341       | (119%)                   |
| Total                            | \$ 25,230  | \$ 24,972 | 1%                       | \$ 77,112   | \$ 70,617 | 9%                       |
| Intersegment revenue             | \$ 3,334   | \$ 3,319  | 0%                       | \$ 9,300  | \$ 9,781  | (5%)                     |
| Earnings before income taxes     | \$ 523   | \$ 2,139  | (76%)                    | \$ 4,825  | \$ 5,785  | (17%)                    |

Intersegment revenues are primarily interest income from the warehouse line provided to SecurityNational Mortgage Company ("SecurityNational Mortgage"). Profitability in the three and nine months ended September 30, 2017 has decreased due to increases in benefits and expenses and increases in other than temporary impairments.

## Cemetery and Mortuary Operations

The Company sells mortuary services and products through its eight mortuaries in Utah. The Company also sells cemetery products and services through its five cemeteries in Utah and one cemetery in San Diego County, California. At-need product sales and services are recognized as revenue when the services are performed or when the products are delivered. Pre-need cemetery product sales are deferred until the merchandise is delivered and services performed. Recognition of revenue for cemetery land sales occurs when 10% of the purchase price is received.

The following table shows the condensed financial results of the cemetery and mortuary operations for the three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

| Revenues from external customers | Three months ended September 30<br>(in thousands of dollars) |                 |                          | Nine months ended September 30<br>(in thousands of dollars) |                  |                          |
|----------------------------------|--|-----------------|--------------------------|---|------------------|--------------------------|
|                                  | 2017   | 2016            | % Increase<br>(Decrease) | 2017  | 2016             | % Increase<br>(Decrease) |
|                                  | Mortuary revenues  | \$ 1,161        | \$ 1,059                 | 10%   | \$ 3,749         | \$ 3,711                 |
| Cemetery revenues                | 1,697  | 1,818           | (7%)                     | 6,041   | 6,186            | (2%)                     |
| Other                            | 130  | 24              | 442%                     | 117   | 148              | (21%)                    |
| Total                            | <u>\$ 2,988</u>  | <u>\$ 2,901</u> | <u>3%</u>                | <u>\$ 9,907</u>   | <u>\$ 10,045</u> | <u>(1%)</u>              |
| Earnings before income taxes     | <u>\$ 237</u>  | <u>\$ 55</u>    | <u>331%</u>              | <u>\$ 1,332</u>   | <u>\$ 1,284</u>  | <u>4%</u>                |

Included in other revenue is rental income from residential and commercial properties purchased from Security National Life. Memorial Estates purchased these properties from financing provided by Security National Life. The rental income is offset by property insurance, taxes and maintenance expenses. Memorial Estates has recorded depreciation on these properties of \$157,000 and \$176,000 for the three months ended September 30, 2017 and 2016, respectively, and \$490,000 and \$543,000 for the nine months ended September 30, 2017 and 2016, respectively.

## Mortgage Operations

The Company's wholly owned subsidiaries, SecurityNational Mortgage and EverLEND Mortgage Company (formerly known as Green Street Mortgage Services, Inc.), are mortgage lenders incorporated under the laws of the State of Utah and approved and regulated by the Federal Housing Administration (FHA), a department of the U.S. Department of Housing and Urban Development (HUD), which originate mortgage loans that qualify for government insurance in the event of default by the borrower, in addition to various conventional mortgage loan products. SecurityNational Mortgage and EverLEND Mortgage originate and refinance mortgage loans on a retail basis. Mortgage loans originated or refinanced by the Company's mortgage subsidiaries are funded through loan purchase agreements with Security National Life and unaffiliated financial institutions.

The Company's mortgage subsidiaries receive fees from borrowers that are involved in mortgage loan originations and refinancings, and secondary fees earned from third party investors that purchase the mortgage loans originated by the mortgage subsidiaries. Mortgage loans originated by the mortgage subsidiaries are generally sold with mortgage servicing rights released to third-party investors or retained by SecurityNational Mortgage. SecurityNational Mortgage currently retains the mortgage servicing rights on approximately 30% of its loan origination volume. These mortgage loans are serviced by either SecurityNational Mortgage or an approved third-party sub-servicer.

For the nine months ended September 30, 2017 and 2016, SecurityNational Mortgage originated 9,773 loans (\$1,913,207,000 total volume) and 11,720 loans (\$2,252,108,000 total volume), respectively. For the nine months ended September 30, 2017 and 2016, EverLEND Mortgage originated 29 loans (\$6,715,000 total volume) and one loan (\$256,000 total volume), respectively.

The following table shows the condensed financial results of the mortgage operations for the three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

|                                  | Three months ended September 30<br>(in thousands of dollars) |                  |                          | Nine months ended September 30<br>(in thousands of dollars) |                   |                          |
|----------------------------------|--|------------------|--------------------------|---|-------------------|--------------------------|
|                                  | 2017   | 2016             | % Increase<br>(Decrease) | 2017  | 2016              | % Increase<br>(Decrease) |
| Revenues from external customers |  |                  |                          |   |                   |                          |
| Income from loan originations    | \$ 15,204  | \$ 13,728        | 11%                      | \$ 41,788   | \$ 43,163         | (3%)                     |
| Secondary gains from investors   | 28,550   | 41,347           | (31%)                    | 87,166  | 108,667           | (20%)                    |
| <b>Total</b>                     | <b>\$ 43,754</b>   | <b>\$ 55,075</b> | <b>(21%)</b>             | <b>\$ 128,954</b>   | <b>\$ 151,830</b> | <b>(15%)</b>             |
| Earnings before income taxes     | \$ 379   | \$ 4,379         | (91%)                    | \$ 1,874  | \$ 11,561         | (84%)                    |

The decrease in earnings for the three and nine months ended September 30, 2017 was due to a reduction in mortgage loan originations and refinancings, and subsequent sales into the secondary market.

#### Mortgage Loan Loss Settlements

Future mortgage loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on mortgage loans sold. The estimated liability for indemnification losses was included in other liabilities and accrued expenses and, as of September 30, 2017 and December 31, 2016, the balances were \$2,171,000 and \$628,000, respectively.

#### Mortgage Loan Loss Litigation

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers Holdings, see Part I, Item 1. Notes to Condensed Consolidated Financial Statements (unaudited) in Note 11.

### **Consolidation**

#### **Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016**

Total revenues decreased by \$10,977,000, or 13.2%, to \$71,972,000 for the three months ended September 30, 2017, from \$82,949,000 for the comparable period in 2016. Contributing to this decrease in total revenues was a \$11,598,000 decrease in mortgage fee income, a \$280,000 decrease in realized gains on investments and other assets, a \$133,000 increase in other than temporary impairments on investments, and a \$59,000 decrease in net mortuary and cemetery sales. This decrease in total revenues was partially offset by a \$490,000 increase in other revenues, a \$332,000 increase in insurance premiums and other considerations, and a \$271,000 increase in net investment income.

Insurance premiums and other considerations increased by \$332,000, or 1.9%, to \$17,489,000 for the three months ended September 30, 2017, from \$17,157,000 for the comparable period in 2016. This increase was primarily due to an increase in renewal premiums and an increase in first year premiums as a result of increased insurance sales.

Net investment income increased by \$271,000, or 3.4%, to \$8,361,000 for the three months ended September 30, 2017, from \$8,090,000 for the comparable period in 2016. This increase was primarily attributable to a \$282,000 increase in fixed maturity securities income, a \$282,000 increase in insurance assignment income, a \$142,000 increase in mortgage loan interest, an \$89,000 increase in short-term investment income, an \$82,000 increase in rental income from real estate owned, and a \$16,000 increase in income from other investments. This increase was partially offset by a \$600,000 increase in investment expenses, a \$12,000 decrease in equity securities income, and a \$10,000 decrease in policy loan income.

Net mortuary and cemetery sales decreased by \$59,000, or 2.1%, to \$2,717,000 for the three months ended September 30, 2017, from \$2,776,000 for the comparable period in 2016. This decrease was primarily due to a decrease in sales of cemetery plots, markers and vaults.

Realized gains on investments and other assets decreased by \$280,000, or 716.1%, to \$319,000 in realized losses for the three months ended September 30, 2017, from \$39,000 in realized losses for the comparable period in 2016. This decrease in realized gains on investments and other assets was primarily attributable to a \$602,000 increase in realized losses on fixed maturity securities, and a \$6,000 increase in realized losses on securities available for sale. This increase was partially offset by a \$328,000 increase in realized gains on other assets due to the sale of various residential real estate properties.

Mortgage fee income decreased by \$11,598,000, or 21.8%, to \$41,598,000, for the three months ended September 30, 2017, from \$53,196,000 for the comparable period in 2016. This decrease was primarily due to a decline in mortgage loan originations that was indicative of the mortgage loan industry as a whole. The decline in mortgage loan originations was primarily caused by a shortage of available new housing for mortgage loan origination transactions, and the decline in mortgage loan refinancings was primarily caused by recent increases in interest rates on mortgage loans. Additionally, the decline in mortgage originations and refinancings by SecurityNational Mortgage has resulted in a decline in fees earned from third-party investors that purchase mortgage loans from SecurityNational Mortgage.

Other revenues increased by \$490,000, or 27.2%, to \$2,289,000 for the three months ended September 30, 2017, from \$1,799,000 for the comparable period in 2016. This increase was due to an increase in mortgage servicing fees.

Total benefits and expenses were \$70,834,000, or 98.4% of total revenues, for the three months ended September 30, 2017, as compared to \$76,375,000, or 92.1% of total revenues, for the comparable period in 2016.

Death benefits, surrenders and other policy benefits, and future policy benefits increased by an aggregate of \$1,791,000 or 12.6%, to \$16,055,000 for the three months ended September 30, 2017, from \$14,264,000 for the comparable period in 2016. This increase was primarily the result of a \$1,522,000 increase in death benefits and a \$352,000 increase in future policy benefits. This increase was partially offset by a \$83,000 decrease in surrender and other policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired decreased by \$62,000, or 2.7%, to \$2,239,000 for the three months ended September 30, 2017, from \$2,301,000 for the comparable period in 2016. This decrease was primarily due to improved persistency in the traditional life business.

Selling, general and administrative expenses decreased by \$7,417,000, or 12.8%, to \$50,431,000 for the three months ended September 30, 2017, from \$57,848,000 for the comparable period in 2016. This decrease was primarily the result of a \$5,396,000 decrease in commissions resulting from a decrease in sales (primarily mortgage fee income), a \$1,040,000 decrease in other expenses, a \$600,000 decrease in the provision for loan loss reserve, a \$555,000 decrease in personnel expenses, a \$394,000 decrease in advertising, and a \$11,000 decrease in depreciation on property and equipment. This decrease was partially offset by a \$444,000 increase in costs related to funding mortgage loans, and a \$135,000 increase in rent and rent related expenses.

Interest expense increased by \$180,000, or 12.2%, to \$1,656,000 for the three months ended September 30, 2017, from \$1,476,000 for the comparable period in 2016. This increase was primarily due to an increase in interest expense on mortgage warehouse lines and interest expense on bank loans for real estate held for investment.

Comprehensive income for the three months ended September 30, 2017 and 2016 amounted to gains of \$1,191,000 and \$4,321,000, respectively. This \$3,130,000 decrease in comprehensive income was primarily the result of a \$3,086,000 decrease in net income and a \$44,000 decrease in unrealized gains in securities available for sale.

## Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

Total revenues decreased by \$16,519,000, or 7.1%, to \$215,973,000 for the nine months ended September 30, 2017, from \$232,492,000 for the comparable period in 2016. Contributing to this decrease in total revenues was a \$24,881,000 decrease in mortgage fee income, a \$348,000 increase in other than temporary impairments on investments, and a \$185,000 decrease in net mortuary and cemetery sales. This decrease in total revenues was partially offset by \$4,837,000 increase in insurance premiums and other considerations, a \$2,075,000 increase in net investment income, a \$1,449,000 increase in other revenues, and a \$534,000 increase in realized gains on investments and other assets.

Insurance premiums and other considerations increased by \$4,837,000, or 10.2%, to \$52,345,000 for the nine months ended September 30, 2017, from \$47,508,000 for the comparable period in 2016. This increase was primarily due to an increase in renewal premiums and an increase in first year premiums as a result of increased insurance sales.

Net investment income increased by \$2,074,000, or 8.8%, to \$25,559,000 for the nine months ended September 30, 2017, from \$23,484,000 for the comparable period in 2016. This increase was primarily attributable to a \$1,028,000 increase in insurance assignment income, a \$1,002,000 increase in fixed maturity securities income, a \$565,000 increase in mortgage loan interest, a \$378,000 increase in rental income from real estate owned, a \$246,000 increase in short-term investment income, a \$63,000 increase in policy loan income, and a \$22,000 increase in income from other investments. This increase was partially offset by a \$1,230,000 increase in investment expenses.

Net mortuary and cemetery sales decreased by \$185,000, or 1.9%, to \$9,357,000 for the nine months ended September 30, 2017, from \$9,542,000 for the comparable period in 2016. This decrease was primarily due to a decrease in sales of cemetery plots, markers and vaults.

Realized gains on investments and other assets increased by \$534,000, or 297.7%, to \$713,000 in realized gains for the nine months ended September 30, 2017, from \$179,000 in realized gains for the comparable period in 2016. This increase in realized gains on investments and other assets was primarily attributable to a \$1,374,000 increase in realized gains on other assets due to the sale of a commercial real estate property and various residential real estate properties. This increase was partially offset by a \$775,000 increase in realized losses on fixed maturity securities, and a \$65,000 increase in realized losses on securities available for sale.

Mortgage fee income decreased by \$24,881,000, or 16.9%, to \$122,086,000, for the nine months ended September 30, 2017, from \$146,967,000 for the comparable period in 2016. This decrease was primarily due to a decline in mortgage loan originations that was indicative of the mortgage loan industry as a whole. The decline in mortgage loan originations was primarily caused by a shortage of available new housing for mortgage loan origination transactions, and the decline in mortgage loan refinancings was primarily caused by recent increases in interest rates on mortgage loans. Additionally, the decline in mortgage originations and refinancings by SecurityNational Mortgage has resulted in a decline in fees earned from third-party investors that purchase mortgage loans from SecurityNational Mortgage.

Other revenues increased by \$1,449,000, or 29.3%, to \$6,394,000 for the nine months ended September 30, 2017, from \$4,945,000 for the comparable period in 2016. This increase was due to an increase in mortgage servicing fees.

Total benefits and expenses were \$207,943,000, or 96.3% of total revenues, for the nine months ended September 30, 2017, as compared to \$213,862,000, or 92.0% of total revenues, for the comparable period in 2016.

Death benefits, surrenders and other policy benefits, and future policy benefits increased by an aggregate of \$5,971,000 or 15.0%, to \$45,868,000 for the nine months ended September 30, 2017, from \$39,897,000 for the comparable period in 2016. This increase was primarily the result of a \$3,704,000 increase in death benefits, a \$1,892,000 increase in future policy benefits, and a \$375,000 increase in surrender and other policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired increased by \$50,000, or 0.8%, to \$6,271,000 for the nine months ended September 30, 2017, from \$6,221,000 for the comparable period in 2016. This increase was primarily due to an increase in insurance sales expenses.

Selling, general and administrative expenses decreased by \$12,571,000, or 7.7%, to \$150,000,000 for the nine months ended September 30, 2017, from \$162,571,000 for the comparable period in 2016. This decrease was primarily the result of a \$14,338,000 decrease in commissions resulting from a decrease in sales (primarily mortgage fee income), a \$646,000 decrease in advertising, and a \$600,000 decrease in the provision for loan loss reserve. This increase was partially offset by a \$1,220,000 increase in personnel expenses, a \$839,000 increase in other expenses, a \$458,000 increase in rent and rent related expenses, a \$358,000 increase in costs related to funding mortgage loans, and a \$138,000 increase in depreciation on property and equipment.

Interest expense increased by \$520,000, or 13.8%, to \$4,295,000 for the nine months ended September 30, 2017, from \$3,775,000 for the comparable period in 2016. This increase was primarily due to an increase in interest expense on mortgage warehouse lines and interest expense on bank loans related to real estate held for investment.

Comprehensive income for the nine months ended September 30, 2017 and 2016 amounted to gains of \$5,515,000 and \$12,188,000, respectively. This \$6,673,000 decrease in comprehensive income was primarily the result of a \$6,295,000 decrease in net income and a \$378,000 decrease in unrealized gains in securities available for sale.

#### **Liquidity and Capital Resources**

The Company's life insurance subsidiaries and cemetery and mortuary subsidiaries realize cash flow from premiums, contract payments and sales on personal services rendered for cemetery and mortuary business, from interest and dividends on invested assets, and from the proceeds from the maturity of held to maturity investments or sale of other investments. The mortgage subsidiaries realize cash flow from fees generated by originating and refinancing mortgage loans, and fees earned from mortgage loans sold to investors. The Company considers these sources of cash flow to be adequate to fund future policyholder and cemetery and mortuary liabilities, which generally are long-term and adequate to pay current policyholder claims, annuity payments, expenses related to the issuance of new policies, the maintenance of existing policies, debt service, and to meet current operating expenses.

During the nine months ended September 30, 2017 and 2016, the Company's operations provided cash of \$6,030,000 and \$17,639,672, respectively. This decrease was due primarily to a decline in cash collected on loans held for sale during the nine months ended September 30, 2017.

The Company's liability for future policy benefits is expected to be paid out over the long-term due to the Company's market niche of selling funeral plans. Funeral plans are small face value life insurance that will pay the costs and expenses incurred at the time of a person's death. A person generally will keep these policies in force and will not surrender them prior to a person's death. Because of the long-term nature of these liabilities, the Company is able to hold to maturity its bonds, real estate and mortgage loans, thus reducing the risk of liquidating these long-term investments as a result of any sudden changes in fair values.

The Company attempts to match the duration of invested assets with its policyholder and cemetery and mortuary liabilities. The Company may sell investments other than those held to maturity in the portfolio to help in this timing. The Company purchases short-term investments on a temporary basis to meet the expectations of short-term requirements of the Company's products. The Company's investment philosophy is intended to provide a rate of return that will persist during the expected duration of policyholder and cemetery and mortuary liabilities regardless of future interest rate movements.

The Company's investment policy is to invest predominantly in fixed maturity securities, real estate, mortgage loans, and warehousing of mortgage loans on a short-term basis before selling the loans to investors in accordance with the requirements and laws governing the life insurance subsidiaries. Bonds owned by the insurance subsidiaries amounted to \$230,188,000 and \$184,356,000 as of September 30, 2017 and December 31, 2016, respectively. This represents 38.5% and 33.1% of the total investments as of September 30, 2017 and December 31, 2016, respectively. Generally, all bonds owned by the life insurance subsidiaries are rated by the National Association of Insurance Commissioners. Under this rating system, there are six categories used for rating bonds. At September 30, 2017, 5.4% (or \$12,449,000) and at December 31, 2016, 9.0% (or \$16,513,000) of the Company's total bond investments were invested in bonds in rating categories three through six, which were considered non-investment grade.

The Company has classified its fixed income securities, including high-yield securities, in its portfolio as held to maturity. Notwithstanding, business conditions may develop in the future which may indicate a need for a higher level of liquidity in the investment portfolio. In that event, the Company believes it could sell short-term investment grade securities before liquidating higher yielding longer-term securities.

The Company is subject to risk based capital guidelines established by statutory regulators requiring minimum capital levels based on the perceived risk of assets, liabilities, disintermediation, and business risk. At September 30, 2017 and December 31, 2016, the life insurance subsidiaries were in compliance with the regulatory criteria.

The Company's total capitalization of stockholders' equity, bank and other loans payable was \$322,114,000 as of September 30, 2017, as compared to \$284,700,000 as of December 31, 2016. Stockholders' equity as a percent of total capitalization was 43.3% and 46.6% as of September 30, 2017 and December 31, 2016, respectively.

Lapse rates measure the amount of insurance terminated during a particular period. The Company's lapse rate for life insurance in 2016 was 9.6% as compared to a rate of 7.4% for 2015. The 2017 lapse rate to date has been approximately the same as 2016.

At September 30, 2017, the statutory capital and surplus of the Company's life insurance subsidiaries was \$42,584,000. The life insurance subsidiaries cannot pay a dividend to its parent company, without approval of state insurance regulatory authorities.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

As a smaller reporting company, the Company is not required to provide information typically disclosed under this item.

### **Item 4. Controls and Procedures.**

#### Disclosure Controls and Procedures

As of September 30, 2017, the Company carried out an evaluation under the supervision and with the participation of its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the Securities and Exchange Commission (SEC) reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified by the SEC's rules and forms and that such information is accumulated and communicated to management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. The officers have concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2017, and that the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented in conformity with United States Generally Accepted Accounting Principles (GAAP).

#### Changes in Internal Control over Financial Reporting

Except for the material weaknesses discussed in the Company's Annual Report on Form 10K/A, there have not been any significant changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) in the third quarter of 2017 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

#### ***Remediation Efforts to Address Material Weakness***

During the fourth quarter of 2016, there were changes in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. Two of the prior errors were determined to be immaterial errors and were noted in connection with the annual audit of the Company's consolidated financial statements for the fiscal year ended December 31, 2016. The other two errors were discovered as a result of a review of current accounting policies and were determined to be material errors. Management has corrected these errors in the Form 10-K/A for the fiscal year ended December 2016. See Notes 21 and 22 to the Company's consolidated financial statements.

The Company is implementing measures to remediate the underlying causes that gave rise to the material weaknesses. The following remediation steps are among the measures currently being implemented at the time of this filing by management: (i) a thorough review of the accounting department to ensure that the staff has the appropriate training and the level of reviews are commensurate with the complexity of the accounting; (ii) a thorough review of the processes and procedures used in the Company's accounting policies and the implementation of those policies; and (iii) engaging an outside specialist to help with the complex accounting matters related to the Company's mortgage banking operations.

The Company believes the measures described above will remediate the control deficiencies that it identified and strengthened its internal control over financial reporting. The Company is committed to continuous improvement of its internal control processes and will continue to diligently review its financial reporting controls and procedures.

## **Part II - Other Information**

### **Item 1. Legal Proceedings.**

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers Holdings, see Part I, Item 1. Notes to Condensed Consolidated Financial Statements (unaudited) in Note 11.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which if adversely determined, would have a material adverse effect on its financial condition or results of operation.

### **Item 1A. Risk Factors.**

As a smaller reporting company, the Company is not required to provide information typically disclosed under this item.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

#### **Recent Sales of Unregistered Securities and Use of Proceeds from Registered Securities**

None.

### Issuer Purchases of Equity Securities

On September 11, 2015, the Board approved the Company's Stock Purchase Plan for the mutual benefit of the Company and its stockholders. Under the terms of the Plan, the Company may, in its discretion, purchase shares of Class A common stock from its officers and directors who exercise the stock options granted to them under any of the Company's stock option plans with the proceeds from such purchase to be used to pay the taxes owed by such officers and directors as a result of the exercise of their stock options. Additionally, the officers and directors who exercise their stock options may, in their discretion, request that the Company purchase shares of their Class A common stock with the proceeds from such sale to be used to pay the taxes owed by such officers and directors as a result of the exercise of their stock options.

The Company is authorized under the plan to purchase no more than 60,000 shares of Class A common stock in any calendar year to pay the taxes owed by the officers and directors who exercise their stock options under the Stock Purchase Plan. The Company's purchase price for the Class A common stock under the Stock Purchase Plan shall be equal to the closing sales price of the Company's Class A common stock as reported by The Nasdaq National Market on the day that the applicable stock options are exercised by such officers and directors. The Company may only purchase shares of Class A common stock from the officers and directors exercising their stock options under the Stock Purchase Plan during the "Trading Window" as defined in the Company's Insider Trading Policy and Guidelines.

The following table shows the Company's repurchase activity during the nine months ended September 30, 2017 under the Stock Purchase Plan.

| Period             | (a) Total<br>Number of<br>Class A<br>Shares<br>Purchased | (b) Average<br>Price Paid<br>per Class A<br>Share | (c) Total<br>Number of<br>Class A Shares<br>Purchased as<br>Part of Publicly<br>Announced Plan<br>or Program | (d) Maximum<br>Number (or<br>Approximate<br>Dollar Value) of<br>Class A Shares<br>that May Yet Be<br>Purchased Under<br>the Plan or<br>Program |
|--------------------|--|---|--|--|
| 1/1/2017-1/31/2017 | -  | -   | -  | -  |
| 2/1/2017-2/28/2017 | -  | -   | -  | -  |
| 3/1/2017-3/31/2017 | 29,393 (1)   | \$ 6.31   | -  | -  |
| 4/1/2017-4/30/2017 | -  | -   | -  | -  |
| 5/1/2017-5/31/2017 | -  | -   | -  | -  |
| 6/1/2017-6/30/2017 | -  | -   | -  | -  |
| 7/1/2017-7/31/2017 | -  | -   | -  | -  |
| 8/1/2017-8/31/2017 | -  | -   | -  | -  |
| 9/1/2017-9/30/2017 | -  | -   | -  | -  |
| <b>Total</b>       | <b>29,393</b>  | <b>\$ 6.31</b>                                    | <b>-</b>   | <b>-</b>   |

(1) On March 29, 2017, the Company purchased 29,393 shares of its Class A common stock from Scott M. Quist, Chairman, President and Chief Executive Officer of the Company, pursuant to the Company's Stock Purchase Plan.

### Item 3. Defaults Upon Senior Securities.

None.

### Item 4. Mine Safety Disclosures.

None.

### Item 5. Other Information.

None.

**Item 6. Exhibits, Financial Statements Schedules and Reports on Form 8-K.**

(a)(1) Financial Statements

See "Table of Contents – Part I – Financial Information" under page 2 above

(a)(2) Financial Statement Schedules

None

All other schedules to the consolidated financial statements required by Article 7 of Regulation S-X are not required under the related instructions or are inapplicable and therefore have been omitted.

(a)(3) Exhibits

The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S-K or are incorporated by reference to previous filings.

|      |   |
|------|---|
| 3.1  | <a href="#">Articles of Amendment to Articles of Incorporation (9)</a>  |
| 3.2  | <a href="#">Amended Bylaws (11)</a>   |
| 4.1  | Specimen Class A Stock Certificate (1)  |
| 4.2  | Specimen Class C Stock Certificate (1)  |
| 4.3  | Specimen Preferred Stock Certificate and Certificate of Designation of Preferred Stock (1)  |
| 7.1  | <a href="#">Letter from Eide Bailly, LLP (10)</a>   |
| 10.1 | Amended Employee Stock Ownership Plan (ESOP) and Trust Agreement (1)  |
| 10.2 | <a href="#">2003 Stock Option Plan (2)</a>  |
| 10.3 | <a href="#">2006 Director Stock Option Plan (3)</a>   |
| 10.4 | <a href="#">2013 Amended Stock Option and Other Equity Incentive Awards Plan (8)</a>  |
| 10.5 | <a href="#">2014 Director Stock Option Plan (4)</a>   |
| 10.6 | <a href="#">Employment agreement with Scott M. Quist (6)</a>  |
| 10.7 | <a href="#">Purchase Agreement among Security National Financial Corporation, SNFC Subsidiary, LLC, American Funeral Financial, LLC, and Hypershop, LLC (5)</a>       |
| 10.8 | <a href="#">Stock Purchase Agreement among Security National Financial Corporation, and Reppond Holding Company, to purchase First Guaranty Insurance Company (8)</a> |

|         |  |
|---------|--|
| 21      | <a href="#">Subsidiaries of the Registrant (11)</a>  |
| 23.1    | <a href="#">Consent of Eide Bailly LLP (7)</a>   |
| 23.2    | <a href="#">Consent of Mackey Price &amp; Mecham (7)</a>   |
| 31.1    | Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002          |
| 31.2    | Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002          |
| 32.1    | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2    | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.xml | Instance Document  |
| 101.xsd | Taxonomy Extension Schema Document   |
| 101.cal | Taxonomy Extension Calculation Linkbase Document   |
| 101.def | Taxonomy Extension Definition Linkbase Document  |
| 101.lab | Taxonomy Extension Label Linkbase Document   |
| 101.pre | Taxonomy Extension Presentation Linkbase Document  |

- (1) Incorporated by reference from Registration Statement on Form S-1, as filed on September 29, 1987
- (2) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 5, 2003, relating to the Company's Annual Meeting of Stockholders
- (3) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 1, 2007, relating to the Company's Annual Meeting of Stockholders
- (4) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 2, 2014, related to Company's Annual Meeting of Stockholders
- (5) Incorporated by reference from Report on Form 8-K, as filed on June 13, 2014
- (6) Incorporated by reference from Report on Form 10-Q, as filed on August 14, 2015
- (7) Incorporated by reference from Registration Statement on Form S-8, as filed on October 20, 2015
- (8) Incorporated by reference from Report on Form 10-Q, as filed on August 15, 2016
- (9) Incorporated by reference from Report on Form 10-K, as filed on March 31, 2017
- (10) Incorporated by reference from Report on Form 8-K, as filed on August 4, 2017
- (11) Incorporated by reference from Report on Form 10-Q, as filed on August 25, 2017

**SIGNATURES**

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

***REGISTRANT***

SECURITY NATIONAL FINANCIAL CORPORATION  
Registrant

Dated: November 14, 2017

/s/ Scott M. Quist  
Scott M. Quist  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer)

Dated: November 14, 2017

/s/ Garrett S. Sill  
Garrett S. Sill  
Chief Financial Officer and Treasurer  
(Principal Financial Officer and Principal Accounting Officer)