

SECURITY NATIONAL FINANCIAL CORP
Form 10-Q
May 15, 2018

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 March 31, 2018, 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

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

Accelerated filer

Smaller reporting company

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

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

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

<u>Class A Common Stock, \$2.00 par value</u>	<u>14,569,321</u>
Title of Class	Number of Shares Outstanding as of May 15, 2018

<u>Class C Common Stock, \$2.00 par value</u>	<u>2,089,372</u>
Title of Class	Number of Shares Outstanding as of May 15, 2018

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
FORM 10-Q

QUARTER ENDED MARCH 31, 2018

Table of Contents

	Page No.
Part I - Financial Information	
Item 1. Financial Statements	
Condensed Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017 (unaudited)	3-4
Condensed Consolidated Statements of Earnings for the Three Months Ended March 31, 2018 and 2017 (unaudited)	5
Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2018 and 2017 (unaudited)	6
Condensed Consolidated Statements of Stockholders' Equity as of March 31, 2018 and March 31, 2017 (unaudited)	7
Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017 (unaudited)	8
Notes to Condensed Consolidated Financial Statements (unaudited)	10
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	46
Item 3. Quantitative and Qualitative Disclosures about Market Risk	50
Item 4. Controls and Procedures	50
Part II - Other Information	
Item 1. Legal Proceedings	50
Item 1A. Risk Factors	51
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3. Defaults Upon Senior Securities	51
Item 4. Mine Safety Disclosures	51
Item 5. Other Information	51
Item 6. Exhibits	51
Signature Page	53

SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

Part I - Financial Information

Item 1. Financial Statements.

	March 31 2018 (Unaudited)	December 31 2017
Assets		
Investments:		
Fixed maturity securities, held to maturity, at amortized cost	\$231,474,083	\$228,397,623
Equity securities at estimated fair value	5,889,151	6,037,855
Mortgage loans held for investment (net of allowances for loan losses of \$1,696,371 and \$1,768,796 for 2018 and 2017)	204,989,906	204,210,885
Real estate held for investment (net of accumulated depreciation of \$15,540,213 and \$18,788,869 for 2018 and 2017)	105,063,331	141,298,706
Other investments and policy loans (net of allowances for doubtful accounts of \$931,029 and \$846,641 for 2018 and 2017)	45,550,795	45,895,472
Accrued investment income	3,886,170	3,644,077
Total investments	596,853,436	629,484,618
Cash and cash equivalents	101,728,202	45,315,661
Loans held for sale at estimated fair value	124,866,313	133,414,188
Receivables (net of allowances for doubtful accounts of \$1,569,422 and \$1,544,518 for 2018 and 2017)	9,398,972	10,443,869
Restricted assets (including \$800,510 and \$809,958 for 2018 and 2017 at estimated fair value)	11,146,540	11,830,621
Cemetery perpetual care trust investments (including \$648,381 and \$682,315 for 2018 and 2017 at estimated fair value)	3,806,645	4,623,563
Receivable from reinsurers	13,263,304	13,394,603
Cemetery land and improvements	9,920,554	9,942,933
Deferred policy and pre-need contract acquisition costs	82,496,322	80,625,304
Mortgage servicing rights, net	21,554,050	21,376,937
Property and equipment, net	7,713,599	8,069,380
Value of business acquired	6,389,260	6,588,759
Goodwill	2,765,570	2,765,570
Other	6,069,569	4,297,048
Total Assets	\$997,972,336	\$982,173,054

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

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

	March 31 2018 (Unaudited)	December 31 2017
Liabilities and Stockholders' Equity		
Liabilities		
Future policy benefits and unpaid claims	\$605,543,124	\$604,746,951
Unearned premium reserve	4,123,289	4,222,410
Bank and other loans payable	151,451,152	157,450,925
Deferred pre-need cemetery and mortuary contract revenues	12,150,924	12,873,068
Cemetery perpetual care obligation	3,729,150	3,710,740
Accounts payable	3,411,619	3,613,100
Other liabilities and accrued expenses	30,063,978	29,655,087
Income taxes	21,593,873	17,332,783
Total liabilities	832,067,109	833,605,064
Stockholders' Equity		
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 14,569,321 shares in 2018 and 14,535,577 shares in 2017	29,138,642	29,071,154
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 2,089,372 shares in 2018 and 2,089,374 shares in 2017	4,178,744	4,178,748
Additional paid-in capital	38,255,340	38,125,042
Accumulated other comprehensive income, net of taxes	-	603,170
Retained earnings	95,041,166	77,520,951
Treasury stock at cost - 468,770 Class A shares in 2018 and 537,203 Class A shares in 2017	(708,665)	(931,075)
Total stockholders' equity	165,905,227	148,567,990
Total Liabilities and Stockholders' Equity	\$997,972,336	\$982,173,054

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

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

	Three Months Ended March 31	
	2018	2017
Revenues:		
Insurance premiums and other considerations	\$ 18,810,358	\$ 17,357,124
Net investment income	10,074,431	9,016,376
Net mortuary and cemetery sales	3,232,729	3,358,973
Gains on investments and other assets	22,020,939	145,330
Other than temporary impairments on investments	-	(52,139)
Mortgage fee income	25,460,160	38,974,760
Other	2,477,492	2,028,873
Total revenues	82,076,109	70,829,297
Benefits and expenses:		
Death benefits	9,608,098	8,794,598
Surrenders and other policy benefits	810,128	857,531
Increase in future policy benefits	5,584,936	5,568,042
Amortization of deferred policy and pre-need acquisition costs and value of business acquired	3,109,933	2,264,039
Selling, general and administrative expenses:		
Commissions	11,282,401	16,355,048
Personnel	16,566,688	18,589,687
Advertising	1,029,591	1,310,674
Rent and rent related	1,963,350	2,223,996
Depreciation on property and equipment	477,031	625,812
Costs related to funding mortgage loans	1,369,281	2,219,649
Other	6,810,324	7,346,493
Interest expense	1,761,677	1,254,039
Cost of goods and services sold-mortuaries and cemeteries	515,490	521,919
Total benefits and expenses	60,888,928	67,931,527
Earnings before income taxes	21,187,181	2,897,770
Income tax expense	(4,261,258)	(1,037,770)
Net earnings	\$ 16,925,923	\$ 1,860,000
Net earnings per Class A Equivalent common share (1)	\$ 1.05	\$ 0.12
Net earnings per Class A Equivalent common share-assuming dilution (1)	\$ 1.04	\$ 0.11
Weighted-average Class A equivalent common share outstanding (1)	16,171,412	15,827,495
Weighted-average Class A equivalent common shares outstanding-assuming dilution (1)	16,347,777	16,320,830

(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).

5

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

	Three Months Ended	
	March 31	
	2018	2017
Net earnings	\$ 16,925,923	\$ 1,860,000
Other comprehensive income:		
Unrealized gains on equity securities	-	29,871
Unrealized gains on derivative instruments	-	1,595
Other comprehensive income, before income tax	-	31,466
Income tax expense	-	(10,174)
Other comprehensive income, net of income tax	-	21,292
Comprehensive income	\$ 16,925,923	\$ 1,881,292

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

6

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

	Class A Common Stock	Class C Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2016	\$27,638,012	\$3,804,458	\$34,813,246	\$264,822	\$67,409,204	\$(1,370,611)	\$132,559,131
Net earnings	-	-	-	-	1,860,000	-	1,860,000
Other comprehensive income	-	-	-	21,292	-	-	21,292
Grant of stock options	-	-	101,996	-	-	-	101,996
Sale of treasury stock	-	-	178,002	-	-	146,065	324,067
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)	-	-	-	-	-
Balance at March 31, 2017	\$27,640,156	\$3,803,248	\$35,095,594	\$286,114	\$69,265,920	\$(1,410,016)	\$134,681,016
Balance at December 31, 2017	\$29,071,154	\$4,178,748	\$38,125,042	\$603,170	\$77,520,951	\$(931,075)	\$148,567,990
Cumulative effect adjustment upon adoption of new accounting standard (ASU 2016-01)	-	-	-	(603,170)	603,170	-	-
Net earnings	-	-	-	-	16,925,923	-	16,925,923
Grant of stock options	-	-	58,087	-	-	-	58,087
Exercise of stock options	63,968	-	(22,115)	-	-	-	41,853
Sale of treasury stock	-	-	88,964	-	-	222,410	311,374
Stock dividends	3,520	(4)	5,362	-	(8,878)	-	-

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Balance at

March 31, 2018 \$29,138,642 \$4,178,744 \$38,255,340 \$ - \$95,041,166 \$(708,665) \$165,905,227

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

7

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

	Three Months Ended	
	March 31	
	2018	2017
Cash flows from operating activities:		
Net cash provided by operating activities	\$8,712,560	\$30,431,376
Cash flows from investing activities:		
Purchases of fixed maturity securities	(7,155,114)	(2,575,997)
Calls and maturities of fixed maturity securities	3,604,516	830,595
Purchases of equity securities	(1,084,398)	(4,190,458)
Sales of equity securities	922,402	4,092,734
Purchases of short-term investments	-	(3,053,797)
Sales of short-term investments	-	2,266,915
Net changes in restricted assets	(48,832)	(77,151)
Net changes in perpetual care trusts	2,376,461	(23,039)
Mortgage loans, other investments and policy loans made	(132,321,562)	(108,649,435)
Payments received for mortgage loans, other investments and policy loans	131,816,474	127,506,014
Purchase of property and equipment	(169,564)	(312,640)
Sale of property and equipment	48,314	-
Purchase of real estate	(768,942)	(3,103,471)
Sale of real estate	58,476,379	2,891,887
Net cash provided by investing activities	55,696,134	15,602,157
Cash flows from financing activities:		
Investment contract receipts	2,867,412	3,051,883
Investment contract withdrawals	(4,410,074)	(4,468,624)
Proceeds from stock options exercised	41,853	-
Purchase of treasury stock	-	(185,470)
Repayment of bank loans	(27,369,431)	(673,454)
Proceeds from borrowing on bank loans	421,042	7,255,187
Net change in warehouse line borrowings	(309,286)	(6,376,739)
Net change in line of credit borrowings	21,250,000	1,250,000
Net cash used in financing activities	(7,508,484)	(147,217)
Net change in cash, cash equivalents, restricted cash and restricted cash equivalents	56,900,210	45,886,316
Cash, cash equivalents, restricted cash and restricted cash equivalents at beginning of period	54,501,923	46,942,293
Cash, cash equivalents, restricted cash and restricted cash equivalents at end of period	\$111,402,133	\$92,828,609
Supplemental Disclosure of Cash Flow Information:		
Cash paid (received) during the year for:		
Interest (net of amount capitalized)	\$1,617,074	\$1,234,420
Income taxes (net of refunds)	164	(3,215)

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Non Cash Operating, Investing and Financing Activities:

Accrued real estate construction costs and retainage	\$26,769	\$6,794,065
Transfer of loans held for sale to mortgage loans held for investment	139,464	5,032,147
Benefit plans funded with treasury stock	311,374	324,067
Mortgage loans foreclosed into real estate	225,166	204,839

8

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

Reconciliation of cash, cash equivalents, restricted cash and restricted cash equivalents as shown in the condensed consolidated statements of cash flows is presented in the table below:

	Three Months Ended	
	March 31	
	2018	2017
Cash and cash equivalents	\$101,728,202	\$85,069,717
Restricted assets	7,468,609	6,837,786
Cemetery perpetual care trust investments	2,205,322	921,106
Total cash, cash equivalents, restricted cash and restricted cash equivalents	\$111,402,133	\$92,828,609

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

9

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (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, 2017, included in the Company's Annual Report on Form 10-K (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 three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The presentation of certain amounts in the prior year have been reclassified to conform to the 2018 presentation.

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

Accounting Standards Adopted in 2018

Accounting Standards Update ("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. 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 would have been considered asset acquisitions under the new standard. As a result, transaction costs may be capitalized more often 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 2017-01 was adopted by the Company on January 1, 2018 and it will be applied prospectively to

transactions occurring after the adoption date, as applicable.

ASU No. 2016-18: "Statement of Cash Flows (Topic 230): Restricted Cash" – Issued in November 2016, ASU 2016-18 requires restricted cash and cash equivalents to be included with cash and cash equivalents in the consolidated statement of cash flows and disclose the nature of the restrictions on cash and cash equivalents. The Company currently discloses the restrictions on cash and cash equivalents in Note 8 of the Notes to Consolidated Financial Statements in the Company's Annual Report on Form 10-K and will continue these disclosures. Note 8 also discloses the components of the Company's restricted assets and cemetery perpetual care trust investments which include restricted cash and cash equivalents. ASU 2016-18 was adopted by the Company on January 1, 2018. The Company previously presented changes in restricted cash and cash equivalents under investing activities on the consolidated statements of cash flows. Upon adoption of ASU 2016-18, the Company amended the presentation in the consolidated statements of cash flows to include the restricted cash and cash equivalents with cash and cash equivalents and retrospectively reclassified all periods presented. The adoption of this standard does not impact the Company's total cash and cash equivalents but is a change in presentation within the consolidated statements of cash flows.

10

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

2) Recent Accounting Pronouncements (Continued)

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. The Company adopted this standard on January 1, 2018 using the modified retrospective approach with the cumulative effect of the adoption made to the balance sheet as of the date of adoption. Thus, the adoption resulted in a reclassification of the related accumulated net unrealized gains of \$603,170 included in accumulated other comprehensive income as of December 31, 2017 to retained earnings. Under previous guidance, changes in fair value for investments of this nature were 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 that were previously measured at fair value with changes in fair value recognized through other comprehensive income. Upon adoption of ASU 2016-01 the Company now recognizes the changes in the fair value of these equity securities through earnings as part of gains on investments and other assets on the condensed consolidated statements of earnings, thus increasing the volatility of the Company's earnings. The adoption of this standard does not significantly affect the Company's comprehensive income or stockholders' equity.

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 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. Premiums and related fees from insurance contracts and mortgage banking revenues are excluded from the scope of this new guidance.

The Company adopted this standard on January 1, 2018 using a modified retrospective approach. No cumulative effect adjustment was made to beginning retained earnings. The Company's revenues from contracts with customers that are subject to ASU 2014-09 include revenues on mortuary and cemetery contracts, which is less than 5% of the Company's total revenues. The recognition and measurement of these items did not change as a result of the Company's adoption of ASU 2014-09 and thus the adoption of ASU 2014-09 does not significantly impact the Company's condensed consolidated statements of earnings or condensed consolidated statements of cash flows. The Company reclassified \$856,479 of amounts due from customers for unfulfilled performance obligations on cancelable pre-need contracts from Receivables, net to Deferred pre-need cemetery and mortuary contract revenues on the Company's condensed consolidated balance sheets.

The standard primarily impacts the manner in which the Company recognizes a) certain nonrefundable up-front fees and b) incremental costs to acquire new pre-need funeral trust contracts and pre-need and at-need cemetery contracts (i.e., selling costs). The nonrefundable fees will continue to be deferred and recognized as revenue when the underlying goods and services are delivered to the customer. The incremental selling costs will continue to be deferred and amortized by specific identification to the delivery of the underlying goods and services. Additionally, the amounts due from customers for undelivered performance obligations on cancelable pre-need contracts represent contract assets, which are required to be netted with deferred pre-need cemetery and mortuary contract revenues,

instead of receivables on the Company's consolidated balance sheets.

11

Accounting Standards Issued But Not Yet Adopted

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 (such as mortgage loans and held to maturity debt securities) and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current general 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 will be effective for the Company on January 1, 2020. The Company is in the process of evaluating the potential impact of this standard.

ASU No. 2016-02: "Leases (Topic 842)" - Issued in February 2016, ASU 2016-02 supersedes the requirements in Accounting Standards Codification ("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 will be effective for the Company on January 1, 2019. 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.

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.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments

The Company's investments as of March 31, 2018 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>March 31, 2018</u>				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S. Government agencies				
	\$54,286,773	\$178,830	\$(960,777)	\$53,504,826
Obligations of states and political subdivisions	6,742,875	71,014	(145,551)	6,668,338
Corporate securities including public utilities	157,715,073	10,498,181	(1,305,125)	166,908,129
Mortgage-backed securities	12,105,727	268,842	(249,019)	12,125,550
Redeemable preferred stock	623,635	28,808	(344)	652,099
Total fixed maturity securities held to maturity	\$231,474,083	\$11,045,675	\$(2,660,816)	\$239,858,942
Equity securities at estimated fair value:				
Common stock:				
Industrial, miscellaneous and all other				
	\$6,230,113	\$498,655	\$(839,617)	\$5,889,151
Total equity securities at estimated fair value	\$6,230,113	\$498,655	\$(839,617)	\$5,889,151
Mortgage loans held for investment at amortized cost:				
Residential	\$101,665,364			
Residential construction	54,254,054			
Commercial	52,384,376			
Less: Unamortized deferred loan fees, net	(1,617,517)			
Less: Allowance for loan losses	(1,696,371)			
Total mortgage loans held for investment	\$204,989,906			
Real estate held for investment net of accumulated depreciation:				
Residential	\$31,874,263			
Commercial	73,189,068			
Total real estate held for investment	\$105,063,331			
Policy loans and other investments at amortized cost:				
Policy loans	\$6,403,888			
Insurance assignments	35,088,585			

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Federal Home Loan Bank stock	708,700
Other investments	4,280,651
Less: Allowance for doubtful accounts	(931,029)
Total policy loans and other investments	\$45,550,795
Accrued investment income	\$3,886,170
Total investments	\$596,853,436

13

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

The Company's investments as of December 31, 2017 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2017:</u>				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S.				
Government agencies	\$54,077,069	\$211,824	\$(579,423)	\$53,709,470
Obligations of states and political subdivisions	5,843,176	112,372	(71,013)	5,884,535
Corporate securities including public utilities	158,350,727	14,336,452	(1,007,504)	171,679,675
Mortgage-backed securities	9,503,016	210,652	(162,131)	9,551,537
Redeemable preferred stock	623,635	49,748	(191)	673,192
Total fixed maturity securities held to maturity	\$228,397,623	\$14,921,048	\$(1,820,262)	\$241,498,409
Equity securities at estimated fair value:				
Common stock:				
Industrial, miscellaneous and all other	\$6,002,931	\$667,593	\$(632,669)	\$6,037,855
Total equity securities at estimated fair value	\$6,002,931	\$667,593	\$(632,669)	\$6,037,855
Mortgage loans held for investment at amortized cost:				
Residential	\$102,527,111			
Residential construction	50,157,533			
Commercial	54,954,865			
Less: Unamortized deferred loan fees, net	(1,659,828)			
Less: Allowance for loan losses	(1,768,796)			
Total mortgage loans held for investment	\$204,210,885			
Real estate held for investment net of accumulated depreciation:				
Residential	\$68,329,917			
Commercial	72,968,789			
Total real estate held for investment	\$141,298,706			
Policy loans and other investments at amortized cost:				
Policy loans	\$6,531,352			
Insurance assignments	36,301,739			
Federal Home Loan Bank stock	689,400			

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Other investments	3,219,622
Less: Allowance for doubtful accounts	(846,641)
Total policy loans and other investments	\$45,895,472
Accrued investment income	\$3,644,077
Total investments	\$629,484,618

14

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 March 31, 2018 and December 31, 2017. 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 Losses for Less than Twelve Months		Unrealized Losses for More than Twelve Months		Total Unrealized Loss	Fair Value
		Fair Value		Fair Value		
<u>At March 31, 2018</u>						
U.S. Treasury Securities and Obligations of U.S. Government Agencies	\$ 897,420	\$ 51,456,932	\$ 63,356	\$ 623,360	\$ 960,776	\$ 52,080,292
Obligations of states and political subdivisions	17,903	1,419,010	127,648	2,690,329	145,551	4,109,339
Corporate securities	620,598	33,678,083	684,528	11,365,056	1,305,126	45,043,139
Mortgage and other asset-backed securities	107,265	2,102,664	141,754	1,658,340	249,019	3,761,004
Redeemable preferred stock	344	11,268	-	-	344	11,268
Total unrealized losses	\$ 1,643,530	\$ 88,667,957	\$ 1,017,286	\$ 16,337,085	\$ 2,660,816	\$ 105,005,042
<u>At December 31, 2017</u>						
U.S. Treasury Securities and Obligations of U.S. Government Agencies	\$ 532,010	\$ 51,606,699	\$ 47,413	\$ 643,380	\$ 579,423	\$ 52,250,079
Obligations of states and political subdivisions	296	214,882	70,717	2,225,021	71,013	2,439,903
Corporate securities	167,786	11,551,865	839,718	13,193,258	1,007,504	24,745,123
Mortgage and other asset-backed securities	56,756	2,516,660	105,375	1,676,494	162,131	4,193,154
Redeemable preferred stock	191	11,421	-	-	191	11,421
Total unrealized losses	\$ 757,039	\$ 65,901,527	\$ 1,063,223	\$ 17,738,153	\$ 1,820,262	\$ 83,639,680

There were 238 securities with fair value of 97.5% of amortized cost at March 31, 2018. There were 141 securities with fair value of 97.9% of amortized cost at December 31, 2017. During the three months ended March 31, 2018 and 2017 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of \$-0- and \$52,139, 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 Commissioners ("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.

15

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

The amortized cost and estimated fair value of fixed maturity securities held to maturity, at March 31, 2018, 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 Cost	Estimated Fair Value
Held to Maturity:		
Due in 1 year	\$17,978,827	\$18,098,867
Due in 2-5 years	67,126,658	67,514,026
Due in 5-10 years	53,791,068	55,097,433
Due in more than 10 years	79,848,168	86,370,967
Mortgage-backed securities	12,105,727	12,125,550
Redeemable preferred stock	623,635	652,099
Total held to maturity	\$231,474,083	\$239,858,942

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 March 31, 2018, the Company owed \$20,000,000 to FHLB. This amount owed was paid on April 2, 2018.

Equity Securities

The following tables summarize unrealized losses on equity securities, that were carried at estimated fair value based on quoted trading prices at December 31, 2017. 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 in a loss position:

	Unrealized Losses for Less than Twelve Months		No. of Investment Positions	Unrealized Losses for More than Twelve Months		No. of Investment Positions	Total Unrealized Losses
<u>At December 31, 2017</u>							
Industrial, miscellaneous and all other	\$213,097	98	\$419,572	81	\$632,669		
Total unrealized losses	\$213,097	98	\$419,572	81	\$632,669		
Fair Value	\$847,718		\$1,329,213		\$2,176,931		

The average fair value of the equity securities was 77.5% of the original investment as of December 31, 2017. 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.

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

See Note 2 regarding the adoption of ASU 2016-01 on January 1, 2018. The Company now recognizes the changes (unrealized gains and losses) in the fair value of these equity securities through earnings as part of realized gains on investments and other assets on the condensed consolidated statements of earnings instead of other comprehensive income on the condensed consolidated balance sheets.

16

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

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

	Three Months Ended	
	March 31 2018	March 31 2017
Fixed maturity securities held to maturity:		
Gross realized gains	\$28,133	\$2,434
Gross realized losses	(308,931)	-
Other than temporary impairments	-	(52,139)
Equity securities:		
Gross realized gains	-	60,978
Gross realized losses	-	(4,556)
Gains and losses during 2018 on securities sold in 2018	14,650	-
Unrealized gains and losses on securities held at the end of the period	(372,042)	-
Other assets:		
Gross realized gains	22,951,723	456,275
Gross realized losses	(292,594)	(369,801)
Total	\$22,020,939	\$93,191

(1) Includes a one-time gain of \$22,252,000 from the sale of Dry Creek at East Village apartments.

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 \$472,883 and \$28,073 for the three months March 31, 2018 and 2017, respectively. The net realized loss related to these sales was \$306,851 for the three months ended March 31, 2018 and the net realized gain related to these sales was \$2,434 for the three months ended March 31, 2017. 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

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

Major categories of net investment income are as follows:

	Three Months Ended	
	March 31	
	2018	2017
Fixed maturity securities held to maturity	\$2,529,841	\$2,424,805
Equity securities	58,292	54,786
Mortgage loans held for investment	4,531,927	3,410,761
Real estate held for investment	2,670,440	2,894,331
Policy loans	102,866	116,845
Insurance assignments	3,860,937	3,364,642
Other investments	53,673	7,543
Cash and cash equivalents	137,368	91,012
Gross investment income	13,945,344	12,364,725
Investment expenses	(3,870,913)	(3,348,349)
Net investment income	\$10,074,431	\$9,016,376

Net investment income includes income earned by the restricted assets of the cemeteries and mortuaries of \$110,802 and \$115,501 for the three months ended March 31, 2018 and 2017, 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 \$9,247,333 at March 31, 2018 and \$9,264,977 at December 31, 2017. These restricted securities are included in various assets under investments on the accompanying condensed consolidated balance sheets.

There were no investments, aggregated by issuer, in excess of 10% of shareholders' equity (before net unrealized gains and losses on equity securities) at March 31, 2018, other than investments issued or guaranteed by the United States Government.

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 mortgage foreclosures.

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 8 states. These properties include industrial warehouses, office buildings, retail centers, and undeveloped land, and the redevelopment and expansion of its corporate campus ("Center53") 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.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

The aggregated net ending balance of commercial real estate that serves as collateral for bank borrowings was approximately \$64,864,000 and \$64,704,000 as of March 31, 2018 and December 31, 2017, respectively. The associated bank loan carrying values totaled approximately \$41,309,000 and \$40,994,000 as of March 31, 2018 and December 31, 2017, respectively.

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	
	March 31	December 31	March 31	December 31
	2018	2017	2018	2017
Arizona	\$4,000	(1) \$4,000	(1) -	-
Arkansas	95,118	96,169	3,200	3,200
Kansas	7,264,086	7,200,000	222,679	222,679
Louisiana	486,821	493,197	7,063	7,063
Mississippi	3,701,754	3,725,039	33,821	33,821
New Mexico	7,000	(1) 7,000	(1) -	-
Texas	335,000	(1) 335,000	(1) -	23,470
Utah	61,295,289	(1) 61,108,384	(2) 433,244	433,244
	\$73,189,068	\$72,968,789	700,007	723,477

(1) Includes undeveloped land

(2) Includes Center53 completed in July 2017. The Company is currently in the process of leasing the building.

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 March 31, 2018, SNRE manages 101 residential properties in 7 states across the United States.

The net ending balance of residential real estate that serves as collateral for a bank borrowing was approximately \$-0- and \$34,431,000, as of March 31, 2018 and December 31, 2017, respectively. The associated bank loan carrying value was approximately \$-0- and \$26,773,000 as of March 31, 2018 and December 31, 2017, respectively. This real estate relates to the Company's Dry Creek at East Village apartment complex sold in March 2018.

The net ending balance of foreclosed residential real estate included in residential real estate held for investment is \$31,349,678 and \$33,372,228 as of March 31, 2018 and December 31, 2017, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (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	
	March 31 2018	December 31 2017
Arizona	\$-	\$217,105
California	5,407,203	5,463,878
Florida	6,839,021	7,000,684
Hawaii	712,286	712,286
Ohio	10,000	10,000
Oklahoma	-	17,500
Texas	554,486	509,011
Utah	18,065,086	54,113,272
Washington	286,181	286,181
	\$31,874,263	\$68,329,917

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 70,000 square feet, or approximately 10% of the overall commercial real estate holdings.

As of March 31, 2018, real estate owned and occupied by the Company is summarized as follows:

Location	Business Segment	Approximate Square Footage	Square Footage Occupied by the Company	
5300 South 360 West, Salt Lake City, UT (1)	Corporate Offices, Life Insurance 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	21,521	27	%
121 West Election Road, Draper, UT	Mortgage Sales	78,978	19	%

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

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 March 31, 2018, the Company had 42%, 16%, 12%, 10%, 6%, 3% and 3% of its mortgage loans from borrowers located in the states of Utah, Florida, Texas, California, Nevada, Arizona, 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. In addition, when a mortgage loan is past due more than 90 days, the Company does not accrue any interest income. 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.

21

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (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

	Commercial	Residential	Residential Construction	Total
March 31, 2018				
Allowance for credit losses:				
Beginning balance - January 1, 2018	\$ 187,129	\$ 1,546,447	\$ 35,220	\$ 1,768,796
Charge-offs	-	-	-	-
Provision	-	(72,425)	-	(72,425)
Ending balance - March 31, 2018	\$ 187,129	\$ 1,474,022	\$ 35,220	\$ 1,696,371
Ending balance: individually evaluated for impairment	\$-	\$ 292,220	\$-	\$ 292,220
Ending balance: collectively evaluated for impairment	\$ 187,129	\$ 1,181,802	\$ 35,220	\$ 1,404,151
Mortgage loans:				
Ending balance	\$ 52,384,376	\$ 101,665,364	\$ 54,254,054	\$ 208,303,794
Ending balance: individually evaluated for impairment	\$-	\$ 5,362,963	\$-	\$ 5,362,963
Ending balance: collectively evaluated for impairment	\$ 52,384,376	\$ 96,302,401	\$ 54,254,054	\$ 202,940,831
December 31, 2017				
Allowance for credit losses:				
Beginning balance - January 1, 2017	\$ 187,129	\$ 1,461,540	\$ 100,114	\$ 1,748,783
Charge-offs	-	(351,357)	(64,894)	(416,251)
Provision	-	436,264	-	436,264
Ending balance - December 31, 2017	\$ 187,129	\$ 1,546,447	\$ 35,220	\$ 1,768,796
Ending balance: individually evaluated for impairment	\$-	\$ 237,560	\$-	\$ 237,560
Ending balance: collectively evaluated for impairment	\$ 187,129	\$ 1,308,887	\$ 35,220	\$ 1,531,236
Mortgage loans:				
Ending balance	\$ 54,954,865	\$ 102,527,111	\$ 50,157,533	\$ 207,639,509
Ending balance: individually evaluated for impairment	\$-	\$ 4,923,552	\$ 461,834	\$ 5,385,386
Ending balance: collectively evaluated for impairment	\$ 54,954,865	\$ 97,603,559	\$ 49,695,699	\$ 202,254,123

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

3) Investments (Continued)

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

Mortgage Loans Held for Investment

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days (1)	In Process of Foreclosure (1)	Total Past Due	Current	Total Mortgage Loans	Allowance for Loan Losses	Unamortize deferred loan fees, net
	\$5,211,276	\$-	\$-	\$-	\$5,211,276	\$47,173,100	\$52,384,376	\$(187,129)	\$(67,717
	7,223,352	1,150,067	2,800,231	2,562,732	13,736,382	87,928,982	101,665,364	(1,474,022)	(1,125,974
uction	441,310	-	-	-	441,310	53,812,744	54,254,054	(35,220)	(423,826
	\$12,875,938	\$1,150,067	\$2,800,231	\$2,562,732	\$19,388,968	\$188,914,826	\$208,303,794	\$(1,696,371)	\$(1,617,511
	\$1,943,495	\$-	\$-	\$-	\$1,943,495	\$53,011,370	\$54,954,865	\$(187,129)	\$(67,411
	6,613,479	495,347	3,591,333	1,332,219	12,032,378	90,494,733	102,527,111	(1,546,447)	(1,164,130
uction	-	-	461,834	-	461,834	49,695,699	50,157,533	(35,220)	(428,287
	\$8,556,974	\$495,347	\$4,053,167	\$1,332,219	\$14,437,707	\$193,201,802	\$207,639,509	\$(1,768,796)	\$(1,659,826

is not recognized on loans past due greater than 90 days or in foreclosure.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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:

Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>March 31, 2018</u>					
With no related allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	3,653,126	3,653,126	-	3,653,126	-
Residential construction	-	-	-	-	-
With an allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	1,709,837	1,709,837	292,220	1,709,837	-
Residential construction	-	-	-	-	-
Total:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	5,362,963	5,362,963	292,220	5,362,963	-
Residential construction	-	-	-	-	-
<u>December 31, 2017</u>					
With no related allowance recorded:					
Commercial	\$-	\$-	\$-	\$365,220	\$ -
Residential	3,322,552	3,322,552	-	3,290,094	-
Residential construction	461,834	461,834	-	277,232	-
With an allowance recorded:					
Commercial	\$-	\$-	\$-	\$-	\$ -
Residential	1,601,000	1,601,000	237,560	1,350,115	-
Residential construction	-	-	-	-	-
Total:					
Commercial	\$-	\$-	\$-	\$365,220	\$ -
Residential	4,923,552	4,923,552	237,560	4,640,209	-
Residential construction	461,834	461,834	-	277,232	-

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

March 31, 2018 (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

	Commercial		Residential		Residential Construction		Total	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
Performing	\$52,384,376	\$54,954,865	\$96,302,401	\$97,603,559	\$54,254,054	\$49,695,699	\$202,940,831	\$202,254,123
Non-performing	-	-	5,362,963	4,923,552	-	461,834	5,362,963	5,385,386
Total	\$52,384,376	\$54,954,865	\$101,665,364	\$102,527,111	\$54,254,054	\$50,157,533	\$208,303,794	\$207,639,509

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 \$223,000 and \$204,083 as of March 31, 2018 and December 31, 2017, respectively.

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

	Mortgage Loans on Non-Accrual Status	
	As of March 31 2018	As of December 31 2017
Residential	\$5,362,963	\$4,923,552
Residential construction	-	461,834
Total	\$5,362,963	\$5,385,386

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

4) Loans Held for SaleFair 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 March 31, 2018. 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 of loans held for sale for the periods presented:

	As of March 31 2018
Aggregate fair value	\$124,866,313
Unpaid principal balance	121,111,768
Unrealized gain	3,754,545

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 March 31	
	2018	2017
Loan fees	\$5,745,309	\$9,304,925
Interest income	1,116,454	1,734,527
Secondary gains	15,578,495	26,194,350
Change in fair value of loan commitments	440,958	2,167,593
Change in fair value of loans held for sale	2,929,996	(1) -

Provision for loan loss reserve	(351,051)	(426,634)
Mortgage fee income	\$25,460,160	\$38,974,760

(1) See Fair Value Option Election

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.

26

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 March 31 2018	As of December 31 2017
Balance, beginning of period	\$2,571,524	\$627,733
Provision on current loan originations (1)	351,051	1,851,187
Charge-offs, net of recaptured amounts	(10,420)	92,604
Balance, end of period	\$2,912,155	\$2,571,524

(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.

27

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 \$58,087 and \$101,996 has been recognized for these plans for the three months ended March 31, 2018 and 2017, respectively. As of March 31, 2018, the total unrecognized compensation expense related to the options issued was \$155,658, which is expected to be recognized over the vesting period of one year.

The fair value of each option granted is estimated on the date of grant using the Black Scholes Option Pricing Model. The Company estimates the expected life of the options using the simplified method. Future volatility is estimated based upon the weighted historical volatility of the Company's Class A common stock over a period equal to the expected life of the options. The risk-free interest rate for the expected life of the options is based upon the Federal Reserve Board's daily interest rates in effect at the time of the grant.

A summary of the status of the Company's stock compensation plans as of March 31, 2018, and the changes during the three months ended March 31, 2018, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2017	880,426	\$ 4.35	523,603	\$ 5.24
Granted	-		-	
Exercised	(31,984)		-	
Cancelled	(5,704)		-	
Outstanding at March 31, 2018	842,738	\$ 4.48	523,603	\$ 5.24
As of March 31, 2018:				
Options exercisable	744,686	\$ 4.40	468,477	\$ 5.29
As of March 31, 2018:				
Available options for future grant	421,241		165,638	
Weighted average contractual term of options outstanding at March 31, 2018	6.55 years		3.19 years	
Weighted average contractual term of options exercisable at March 31, 2018	6.53 years		2.43 years	
Aggregated intrinsic value of options outstanding at March 31, 2018 (1)	\$850,528		\$251,961	
Aggregated intrinsic value of options exercisable at March 31, 2018 (1)	\$836,882		\$232,667	

(1) The Company used a stock price of \$5.15 as of March 31, 2018 to derive intrinsic value.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

5) Stock Compensation Plans (Continued)

A summary of the status of the Company's stock compensation plans as of March 31, 2017, and the changes during the three months ended March 31, 2017, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2016	741,973	\$ 4.33	556,298	\$ 4.61
Granted	-		-	
Exercised	-		-	
Cancelled	-		-	
Outstanding at March 31, 2017	741,973	\$ 4.33	556,298	\$ 4.61
As of March 31, 2017:				
Options exercisable	636,764	\$ 3.94	493,298	\$ 4.26
As of March 31, 2017:				
Available options for future grant	253,432		-	
Weighted average contractual term of options outstanding at March 31, 2017	7.12 years		2.42 years	
Weighted average contractual term of options exercisable at March 31, 2017	6.70 years		2.13 years	
Aggregated intrinsic value of options outstanding at March 31, 2017 (1)	\$1,837,828		\$1,264,540	
Aggregated intrinsic value of options exercisable at March 31, 2017 (1)	\$1,824,086		\$1,264,540	

(1) The Company used a stock price of \$6.80 as of March 31, 2017 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 three months March 31, 2018 and 2017 was \$111,157 and \$-0-, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

6) Earnings Per Share

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

	Three Months Ended	
	March 31 2018	2017
Net earnings	\$ 16,925,923	\$ 1,860,000
Basic weighted-average shares outstanding	16,171,412	15,827,495
Employee stock options	176,365	493,335
Diluted weighted-average shares outstanding	16,347,777	16,320,830
Basic net earnings per share	\$ 1.05	\$ 0.12
Diluted net earnings per share	\$ 1.04	\$ 0.11

Net earnings per share amounts have been retroactively adjusted for the effect of annual stock dividends. For the three months March 31, 2018 and 2017, there were 589,822 and 89,250 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 InformationDescription 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 for the year ended December 31, 2017. 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.

30

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

7) Business Segment Information (Continued)

	Life Insurance	Cemetery/ Mortuary	Mortgage	Intercompany Eliminations	Consolidated
For the Three Months Ended					
<u>March 31, 2018</u>					
Revenues from external customers	\$50,860,529	\$3,775,745	\$27,439,835	\$-	\$82,076,109
Intersegment revenues	2,408,163	117,117	133,597	(2,658,877)	-
Segment profit before income taxes	23,711,810	860,763	(3,385,391)	-	21,187,182
		-			
Identifiable Assets	873,263,596	92,747,811	163,896,491	(134,701,132)	995,206,766
Goodwill	2,765,570	-	-	-	2,765,570
Total Assets	876,029,166	92,747,811	163,896,491	(134,701,132)	997,972,336
For the Three Months Ended					
<u>March 31, 2017</u>					
Revenues from external customers	\$26,158,701	\$3,604,897	\$41,065,699	\$-	\$70,829,297
Intersegment revenues	2,988,651	109,351	95,770	(3,193,772)	-
Segment profit before income taxes	1,483,480	758,911	655,379	-	2,897,770
Identifiable Assets	831,233,557	99,554,821	164,990,647	(139,027,232)	956,751,793
Goodwill	2,765,570	-	-	-	2,765,570
Total Assets	833,999,127	99,554,821	164,990,647	(139,027,232)	959,517,363

8) Fair Value of Financial Instruments

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:

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:

31

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

8) Fair Value of Financial Instruments (Continued)

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

Equity Securities: 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: 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.

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.

32

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

8) Fair Value of Financial Instruments (Continued)

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.

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 March 31, 2018.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	\$5,889,151	\$5,889,151	\$ -	\$-
Total equity securities	\$5,889,151	\$5,889,151	\$ -	\$-
Loans held for sale	\$124,866,313	\$-	\$ -	\$124,866,313
Restricted assets (1)	800,510	800,510	-	-
Cemetery perpetual care trust investments (1)	648,381	648,381	-	-
Derivatives - loan commitments (2)	2,786,371	-	-	2,786,371
Total assets accounted for at fair value on a recurring basis	\$134,990,726	\$7,338,042	\$ -	\$127,652,684
Liabilities accounted for at fair value on a recurring basis				
Derivatives - call options (3)	\$(13,277)	\$(13,277)	\$ -	\$-
Derivatives - put options (3)	(128,598)	(128,598)	-	-
Derivatives - loan commitments (3)	(348,824)	-	-	(348,824)
Total liabilities accounted for at fair value on a recurring basis	\$(490,699)	\$(141,875)	\$ -	\$(348,824)

(1) Mutual funds and equity securities

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

(3) Included in other liabilities and accrued expenses on the condensed consolidated balance sheets

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 Commitments	Loans Held for Sale
Balance - December 31, 2017	\$ 1,996,589	\$ 133,414,188
Originations		479,953,484
Sales		(505,586,040)
Transfer to mortgage loans held for investment		(139,464)
Total gains (losses):		
Included in earnings (1)	440,958	17,224,145
Balance - March 31, 2018	\$ 2,437,547	\$ 124,866,313

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

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 March 31, 2018.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Impaired mortgage loans held for investment	\$ 1,417,617	\$ -	\$ -	\$ 1,417,617
Impaired real estate held for investment	1,005,866	-	-	1,005,866
Mortgage servicing rights additions	997,497	-	-	997,497
Total assets accounted for at fair value on a nonrecurring basis	\$ 3,420,980	\$ -	\$ -	\$ 3,420,980

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, 2017.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

8) Fair Value of Financial Instruments (Continued)

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	\$6,037,855	\$6,037,855	\$ -	\$-
Total equity securities	\$6,037,855	\$6,037,855	\$ -	\$-
Loans held for sale	\$133,414,188	\$-	\$ -	\$133,414,188
Restricted assets (1)	809,958	809,958	-	-
Cemetery perpetual care trust investments (1)	682,315	682,315	-	-
Derivatives - loan commitments (2)	2,032,782	-	-	2,032,782
Total assets accounted for at fair value on a recurring basis	\$9,562,910	\$7,530,128	\$ -	\$2,032,782
Liabilities accounted for at fair value on a recurring basis				
Derivatives - call options (3)	(64,689)	(64,689)	-	-
Derivatives - put options (3)	(20,568)	(20,568)	-	-
Derivatives - loan commitments (3)	(36,193)	-	-	(36,193)
Total liabilities accounted for at fair value on a recurring basis	\$(121,450)	\$(85,257)	\$ -	\$(36,193)

(1) Mutual funds and equity securities

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

(3) Included in other liabilities and accrued expenses on the condensed consolidated balance sheets

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

	Net Loan Commitments	Bank Loan Interest Rate Swaps	Loans Held for Sale
Balance - December 31, 2016	\$ 6,809,332	\$(3,308)	\$-
Originations			\$1,233,683,666
Sales			(1,151,031,388)
Total gains (losses):			
Included in earnings (1)	(4,812,743)	-	50,761,910
Included in other comprehensive income (2)	-	3,308	-

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Balance - December 31, 2017	\$ 1,996,589	\$-	\$133,414,188
-----------------------------	--------------	-----	---------------

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

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

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 December 31, 2017.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Impaired mortgage loans held for investment	\$ 1,363,440	\$ -	\$ -	\$ 1,363,440
Mortgage servicing rights additions	6,085,352	-	-	6,085,352
Impaired real estate held for investment	8,500,000	-	-	8,500,000
Impaired fixed maturity securities, held to maturity	426,984	-	426,984	-
Total assets accounted for at fair value on a nonrecurring basis	\$ 16,375,776	\$ -	\$ 426,984	\$ 15,948,792

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 March 31, 2018 and December 31, 2017.

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 March 31, 2018:

	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
<u>Assets</u>					
Fixed maturity securities held to maturity	\$ 231,474,083	\$ -	\$ 232,634,878	\$ 7,224,064	\$ 239,858,942
Mortgage loans held for investment:					
Residential	99,065,368	-	-	104,999,136	104,999,136
Residential construction	53,795,008	-	-	53,795,008	53,795,008
Commercial	52,129,530	-	-	53,487,729	53,487,729
Mortgage loans held for investment, net	\$ 204,989,906	\$ -	\$ -	\$ 212,281,873	\$ 212,281,873
Policy loans	6,403,888	-	-	6,403,888	6,403,888

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Insurance assignments, net (1)	34,157,556	-	-	34,157,556	34,157,556
Restricted assets (2)	1,142,355	-	1,146,584	-	1,146,584
Restricted assets (3)	1,735,066	-	-	1,819,012	1,819,012
Cemetery perpetual care trust investments (2)	948,735	-	941,823	-	941,823
Cemetery perpetual care trust investments (3)	4,209	-	-	4,475	4,475
Mortgage servicing rights, net	21,554,050	-	-	30,086,162	30,086,162

Liabilities

Bank and other loans payable	\$(151,451,152)	\$ -	\$-	\$(151,451,152)	\$(151,451,152)
Policyholder account balances (4)	(47,448,620)	-	-	(33,948,014)	(33,948,014)
Future policy benefits - annuities (4)	(98,569,032)	-	-	(97,549,438)	(97,549,438)

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

(2) Fixed maturity securities held to maturity

(3) Participation in mortgage loans held for investment (commercial)

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

36

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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, 2017:

	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
<u>Assets</u>					
Fixed maturity securities held to maturity	\$ 228,397,623	\$ -	\$ 233,806,219	\$ 7,692,190	\$ 241,498,409
Mortgage loans held for investment:					
Residential	99,816,535	-	-	106,050,169	106,050,169
Residential construction	49,694,025	-	-	49,694,025	49,694,025
Commercial	54,700,325	-	-	56,473,156	56,473,156
Mortgage loans held for investment, net	\$ 204,210,885	\$ -	\$ -	\$ 212,217,350	\$ 212,217,350
Policy loans	6,531,352	-	-	6,531,352	6,531,352
Insurance assignments, net (1)	35,455,098	-	-	35,455,098	35,455,098
Restricted assets (2)	1,130,088	-	1,152,324	-	1,152,324
Restricted assets (3)	1,701,811	-	-	1,796,910	1,796,910
Cemetery perpetual care trust investments (2)	943,211	-	953,404	-	953,404
Cemetery perpetual care trust investments (3)	4,128	-	-	4,411	4,411
Mortgage servicing rights, net	21,376,937	-	-	27,427,174	27,427,174
<u>Liabilities</u>					
Bank and other loans payable	\$(157,450,925)	\$ -	\$ -	\$(157,450,925)	\$(157,450,925)
Policyholder account balances (4)	(47,867,037)	-	-	(34,557,111)	(34,557,111)
Future policy benefits - annuities (4)	(99,474,392)	-	-	(98,827,107)	(98,827,107)

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

(2) Fixed maturity securities held to maturity

(3) Participation in mortgage loans held for investment (commercial)

(4) 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 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.

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.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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.

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.

38

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

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 mortgage-backed securities ("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 loan commitments and forward sale commitments are shown in current earnings as a component of mortgage fee income on the consolidated statements of earnings. Mortgage banking derivatives are shown in other assets and other liabilities and accrued expenses on the condensed consolidated balance sheets.

Call and Put Options

The Company uses a strategy of selling "out of the money" call options on its 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 realizes 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. The net changes in the fair value of call and put options are shown in current earnings as a component of gains (losses) on investments and other assets. Call and put options are shown in other liabilities and accrued expenses on the condensed consolidated balance sheets.

39

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

10) Derivative Instruments (Continued)

The following table shows the notional amount and fair value of derivatives as of March 31, 2018 and December 31, 2017.

		Fair Values and Notional Values of Derivative Instruments					
		March 31, 2018			December 31, 2017		
Balance Sheet Location		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	\$170,365,863	\$2,786,371	\$348,824	\$105,679,107	\$2,032,782	\$36,193
Call options	Other liabilities	1,266,050	--	13,277	1,488,550	--	64,689
Put options	Other liabilities	5,128,950	--	128,598	2,265,900	--	20,568
Total		\$176,760,863	\$2,786,371	\$490,699	\$109,433,557	\$2,032,782	\$121,450

The following table shows the gains and losses on derivatives for the periods presented.

Derivative	Classification	Three Months Ended	
		March 31 2018	2017
Loan commitments	Mortgage fee income	\$440,958	\$2,167,593
Call and put options	Gains on investments and other assets	\$79,171	\$134,563

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 March 31, 2018 and December 31, 2017, the balances were \$2,912,000 and \$2,572,000, 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.

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.

40

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

11) Reinsurance, Commitments and Contingencies (Continued)

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 is set for June 12, 2018. 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 March 31, 2018, the Company's commitments were approximately \$82,523,000 for these loans, of which \$54,254,000 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.

41

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

12) Mortgage Servicing Rights

The Company initially records these MSR's at fair value as discussed in Note 8.

The Company's subsequent accounting for MSR's is based on the class of MSR's. The Company has identified two classes of MSR's: MSR's backed by mortgage loans with initial term of 30 years and MSR's backed by mortgage loans with initial term of 15 years. The Company distinguishes between these classes of MSR's due to their differing sensitivities to change in value as the result of changes in market. After being initially recorded at fair value, MSR's backed by mortgage loans are accounted for using the amortization method. Amortization expense is included in other expenses on the consolidated statements of earnings. MSR amortization is determined by amortizing the MSR balance in proportion to, and over the period of the estimated future net servicing income of the underlying financial assets.

The Company periodically assesses MSR's 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 MSR's are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSR's is adjusted through a valuation allowance.

Management periodically reviews the various loan strata to determine whether the value of the MSR's 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 MSR's for that stratum to its estimated recoverable value is charged to the valuation allowance.

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

	As of March 31 2018	As of December 31 2017
Amortized cost:		
Balance before valuation allowance at beginning of year	\$21,376,937	\$18,872,362
MSR additions resulting from loan sales	997,497	6,085,352
Amortization (1)	(820,384)	(3,580,777)
Application of valuation allowance to write down MSR's with other than temporary impairment	-	-
Balance before valuation allowance at end of period	\$21,554,050	\$21,376,937
Valuation allowance for impairment of MSR's:		
Balance at beginning of year	\$-	\$-
Additions	-	-
Application of valuation allowance to write down MSR's with other than temporary impairment	-	-
Balance at end of period	\$-	\$-
Mortgage servicing rights, net	\$21,554,050	\$21,376,937
Estimated fair value of MSR's at end of period	\$30,086,162	\$27,427,174

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

42

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

12) Mortgage Servicing Rights (Continued)

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

	Estimated MSR Amortization
2018	4,091,450
2019	4,091,450
2020	4,091,450
2021	4,091,303
2022	3,269,025
Thereafter	1,919,372
Total	\$ 21,554,050

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 March 31	
	2018	2017
Contractual servicing fees	\$ 1,876,883	\$ 1,835,873
Late fees	111,748	86,338
Total	\$ 1,988,631	\$ 1,922,211

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

	As of March 31, 2018	As of December 31 2017
Servicing UPB	\$ 2,941,337,111	\$ 2,924,868,843

The following key assumptions were used in determining MSR value:

	Prepayment Speeds		Average Life (Years)	Discount Rate
March 31, 2017	4.01	%	6.92	10.01
December 31, 2017	3.67	%	6.34	10.01

13) Income Taxes

The Company's overall effective tax rate for the three months ended March 31, 2018 and 2017 was 20.1% and 35.8%, respectively, which resulted in a provision for income taxes of \$4,261,000 and \$1,038,000, respectively. The Company's effective tax rates differ from the U.S. federal statutory rate of 21% largely due to its provision for state income taxes. The effective tax rate in the current period decreased when compared to the prior year period largely due to the Tax Cuts and Jobs Act reduction of the federal statutory rate from 35% to 21%.

43

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

14) Revenues from Contracts with Customers

See Note 2 regarding the adoption of ASU No. 2014-09. The Company's cemetery and mortuary revenues are the only revenues recognized from contracts with customers, thus they are the only revenues subject to ASU No. 2014-09.

Pre-need contract sales of funeral services and caskets - revenue and costs associated with the sales of pre-need funeral services and caskets are deferred until the services are performed or the caskets are delivered.

Sales of cemetery interment rights (cemetery burial property) - revenue and costs associated with the sale of cemetery interment rights are recognized in accordance with the retail land sales provisions based on GAAP. Under GAAP, recognition of revenue and associated costs from constructed cemetery property must be deferred until 10% of the sales price has been collected.

Pre-need contract sales of cemetery merchandise (primarily markers and vaults) - revenue and costs associated with the sale of pre-need cemetery merchandise is deferred until the merchandise is delivered.

Pre-need contract sales of cemetery services (primarily merchandise delivery and installation fees) - revenue and costs associated with the sales of pre-need cemetery services are deferred until the services are performed.

Prearranged funeral and pre-need cemetery customer acquisition costs - costs incurred related to obtaining new pre-need contract cemetery and prearranged funeral services are accounted for under the guidance of the provisions based on GAAP. Obtaining costs, which include only costs that vary with and are primarily related to the acquisition of new pre-need cemetery and prearranged funeral services, are deferred until the merchandise is delivered or services are performed.

Revenues and costs for at need sales are recorded when a valid contract exists, the services are performed, collection is reasonably assured and there are no significant obligations remaining.

The following table disaggregates revenue for the Company's cemetery and mortuary contracts.

	Three Months Ended March 31 2018
Major goods/service lines	
At-need	\$2,737,625
Pre-need	495,104
	\$3,232,729
Timing of Revenue Recognition	
Goods transferred at a point in time	\$2,072,481
Services transferred at a point in time	1,160,248
	\$3,232,729

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

March 31, 2018 (Unaudited)

14) Revenues from Contracts with Customers (Continued)

The following table reconciles revenues from cemetery and mortuary contracts to Note 7 – Business Segment Information for the three months ended March 31, 2018:

	Cemetery/Mortuary Segment
Net mortuary and cemetery sales	\$ 3,232,729
Gains on investments and other assets	409,088
Net investment income	88,078
Other revenues	45,850
Revenues from external customers	3,775,745

The opening and closing balances of the Company's receivables, contract assets and contract liabilities are as follows:

	Contract Balances		
	Receivables (1)	Contract Asset (2)	Contract Liability (2)
Opening (1/1/2018)	\$2,742,765	\$856,479	\$13,729,547
Closing (3/31/2018)	2,595,611	731,626	12,882,550
Increase/(decrease)	(147,154)	(124,853)	(846,997)

(1) Included in Receivables, net on the condensed consolidated balance sheets

(2) The contract asset and liability are netted together in Deferred pre-need cemetery and mortuary contract revenues on the condensed consolidated balance sheets.

The amount of revenue recognized for the three months ended March 31, 2018 that was included in the opening contract liability balance was \$724,771.

The difference between the opening and closing balances of the Company's contract assets and contract liabilities primarily results from the timing difference between the Company's performance and the customer's payment.

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 is less competitive 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 months ended March 31, 2018 and 2017. See Note 7 to the condensed consolidated financial statements.

	Three months ended March 31			
	(in thousands of dollars)			
	2018	2017	% Increase (Decrease)	
Revenues from external customers				
Insurance premiums	\$18,810	\$17,357	8	%
Net investment income	9,778	8,774	11	%
Gains on investments and other assets	21,860	(59)	37151	%
Other	412	87	374	%
Total	\$50,860	\$26,159	94	%
Intersegment revenue	\$2,408	\$2,989	(19	%)
Earnings before income taxes	\$23,712	\$1,483	1499	%

Intersegment revenues are primarily interest income from the warehouse line provided to SecurityNational Mortgage Company ("SecurityNational Mortgage"). Profitability in the three months ended March 31, 2018 has increased due to the realized gain on the sale of Dry Creek at East Village Apartments, increases in investment income and increases in insurance premiums. These increases were partially offset by increases in benefits and expenses.

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 months ended March 31, 2018 and 2017. See Note 7 to the condensed consolidated financial statements.

46

	Three months ended March 31 (in thousands of dollars)			
	2018	2017	% Increase (Decrease)	
Revenues from external customers				
Mortuary revenues	\$ 1,391	\$ 1,406	(1	%)
Cemetery revenues	1,951	2,131	(8	%)
Other	434	68	538	%
Total	\$3,776	\$3,605	5	%
Earnings before income taxes	\$861	\$759	13	%

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 \$154,000 and \$170,000 for the three months ended March 31, 2018 and 2017, respectively. Profitability in the three months ended March 31, 2018 has increased due to the realized gain on the sale of real estate.

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 three months March 31, 2018 and 2017, SecurityNational Mortgage originated 2,368 loans (\$471,508,000 total volume) and 2,985 loans (\$568,846,000 total volume), respectively. For the three months March 31, 2018 and 2017, EverLEND Mortgage originated 31 loans (\$8,446,000 total volume) and one loan (\$310,000 total volume), respectively.

The following table shows the condensed financial results of the mortgage operations for the three months ended March 31, 2018 and 2017. See Note 7 to the condensed consolidated financial statements.

	Three months ended March 31 (in thousands of dollars)		
	2018	2017	% Increase (Decrease)

Edgar Filing: SECURITY NATIONAL FINANCIAL CORP - Form 10-Q

Revenues from external customers				
Income from loan originations	\$11,862	\$14,872	(20	%)
Secondary gains from investors	15,578	26,194	(41	%)
Total	\$27,440	\$41,066	(33	%)
Earnings before income taxes	\$(3,385)	\$655	(617	%)

The decrease in earnings for the three months ended March 31, 2018 was due to a reduction in mortgage loan originations and refinancings, and subsequent sales into the secondary market.

47

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 March 31, 2018 and December 31, 2017, the balances were \$2,912,000 and \$2,572,000, 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 March 31, 2018 Compared to Three Months Ended March 31, 2017

Total revenues increased by \$11,247,000, or 15.9%, to \$82,076,000 for the three months ended March 31, 2018, from \$70,829,000 for the comparable period in 2017. Contributing to this increase in total revenues was a \$21,876,000 increase in gains on investments and other assets, a \$1,453,000 increase in insurance premiums and other considerations, a \$1,058,000 increase in net investment income, a \$449,000 increase in other revenues, and a \$52,000 decrease in other than temporary impairments on investments. This increase in total revenues was partially offset by a \$13,515,000 decrease in mortgage fee income, and a \$126,000 decrease in net mortuary and cemetery sales.

Insurance premiums and other considerations increased by \$1,453,000, or 8.4%, to \$18,810,000 for the three months ended March 31, 2018, from \$17,357,000 for the comparable period in 2017. 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 \$1,058,000, or 11.7%, to \$10,074,000 for the three months ended March 31, 2018, from \$9,016,000 for the comparable period in 2017. This increase was primarily attributable to a \$1,121,000 increase in mortgage loan interest, a \$496,000 increase in insurance assignment income, a \$105,000 increase in fixed maturity securities income, an \$46,000 increase interest on cash and cash equivalents, a \$46,000 increase in income from other investments, and a \$4,000 increase in equity securities income. This increase was partially offset by a \$522,000 increase in investment expenses, a \$224,000 decrease in rental income from real estate owned, and a \$14,000 decrease in policy loan income.

Net mortuary and cemetery sales decreased by \$126,000, or 3.8%, to \$3,233,000 for the three months ended March 31, 2018, from \$3,359,000 for the comparable period in 2017. This decrease was primarily due to a decrease in preneed sales and at-need sales of the cemetery operations.

Gains on investments and other assets increased by \$21,876,000, or 15,052.4%, to \$22,021,000 in gains for the three months ended March 31, 2018, from \$145,000 in gains for the comparable period in 2017. This increase in realized gains on investments and other assets was primarily attributable to a gain of \$22,252,000 realized on the sale of Dry Creek at East Village Apartments, and a \$274,000 increase in gains on other assets due to the sale of various other residential real estate properties. This increase was partially offset by a \$283,000 increase in realized losses on fixed maturity securities, and a \$367,000 increase in losses on equity securities mostly attributable to decreases in the fair value of these securities. Due to the adoption of Accounting Standards Update ("ASU") 2016-01, these changes in fair value are now recognized in earnings instead of other comprehensive income. See the discussion of the adoption of this ASU in Note 2 of the notes to condensed consolidated financial statements.

Mortgage fee income decreased by \$13,515,000, or 34.7%, to \$25,460,000, for the three months ended March 31, 2018, from \$38,975,000 for the comparable period in 2017. 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.

48

Other revenues increased by \$449,000, or 22.1%, to \$2,477,000 for the three months ended March 31, 2018, from \$2,028,000 for the comparable period in 2017. This increase was due to an increase in mortgage servicing fees.

Total benefits and expenses were \$60,889,000, or 74.2% of total revenues, for the three months ended March 31, 2018, as compared to \$67,932,000, or 95.9% of total revenues, for the comparable period in 2017.

Death benefits, surrenders and other policy benefits, and future policy benefits increased by an aggregate of \$783,000 or 5.1%, to \$16,003,000 for the three months ended March 31, 2018, from \$15,220,000 for the comparable period in 2017. This increase was primarily the result of a \$813,000 increase in death benefits and a \$17,000 increase in future policy benefits. This increase was partially offset by a \$47,000 decrease in surrender and other policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired increased by \$846,000, or 37.4%, to \$3,110,000 for the three months ended March 31, 2018, from \$2,264,000 for the comparable period in 2017. This increase was primarily due to an increase in insurance sales expenses.

Selling, general and administrative expenses decreased by \$9,172,000, or 18.8%, to \$39,499,000 for the three months ended March 31, 2018, from \$48,671,000 for the comparable period in 2017. This decrease was primarily the result of a \$5,072,000 decrease in commissions due to the decline in mortgage loan originations, a \$2,023,000 decrease in personnel expenses, a \$850,000 decrease in costs related to funding mortgage loans, a \$536,000 decrease in other expenses, a \$281,000 decrease in advertising, a \$261,000 decrease in rent and rent related expenses, and a \$149,000 decrease in depreciation on property and equipment.

Interest expense increased by \$508,000, or 40.5%, to \$1,762,000 for the three months ended March 31, 2018, from \$1,254,000 for the comparable period in 2017. 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.

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 held for sale that are 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, and debt service, and to meet current operating expenses.

During the three months March 31, 2018 and 2017, the Company's operations provided cash of \$8,713,000 and \$30,431,000, respectively. This decrease was due primarily to a decline in cash collected on loans held for sale.

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 having to liquidate 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 \$230,850,000 and \$227,774,000 as of March 31, 2018 and December 31, 2017, respectively. This represents 38.7% and 35.1% of the total investments as of March 31, 2018 and December 31, 2017, 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 March 31, 2018, 5.2% (or \$12,031,000) and at December 31, 2017, 5.4% (or \$12,293,000) of the Company's total bond investments were invested in bonds in rating categories three through six, which were considered non investment grade.

49

The Company has classified its fixed income securities 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 March 31, 2018 and December 31, 2017, 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 \$317,356,000 as of March 31, 2018, as compared to \$306,019,000 as of December 31, 2017. Stockholders' equity as a percent of total capitalization was 52.3% and 48.5% as of March 31, 2018 and December 31, 2017, respectively.

Lapse rates measure the amount of insurance terminated during a particular period. The Company's lapse rate for life insurance in 2017 was 10.6% as compared to a rate of 9.6% for 2016. The 2018 lapse rate to date has been approximately the same as 2017.

At March 31, 2018, the statutory capital and surplus of the Company's life insurance subsidiaries was \$56,375,000. 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 March 31, 2018, 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 executive officers have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2018, 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

There have been no changes in the Company's internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II - Other Information

Item 1. Legal Proceedings.

For a description of the litigation involving SecurityNational Mortgage Company ("Security National 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.

50

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

Sale of Dry Creek at East Village Apartments

On March 29, 2018, the Company through its wholly owned subsidiary, Security National Life Insurance Company ("Security National Life"), completed the sale of the Dry Creek at East Village ("Dry Creek") apartments to a subsidiary of Dinapoli Capital Partners, LLC ("Dinapoli Capital") pursuant to the terms of the Purchase and Sale Agreement, dated February 14, 2018, between Security National Life and Dinapoli Capital. The purchase price paid for the Dry Creek apartments was \$57,000,000. From the proceeds that Security National Life received from the sale of the apartment complex, \$26,802,904 was used to pay off an existing loan at Zions First National Bank, N.A., which was secured by a security interest in the apartment complex. A brokerage commission of \$285,000 and legal fees and related costs were also paid from the purchase proceeds. The Company's book basis in Dry Creek was approximately \$34,400,000, and the Company has recognized the gain net of tax effects from the sale in the first quarter of 2018.

The Dry Creek apartments consist of 282 units, with a mixture of one, two, and three-bedroom units. The construction of Dry Creek was completed in December 2015. As of December 31, 2017, the apartments were 95% leased. Also, rental rates in the market had increased by 9.8% over pro forma rents, and effective (achieved) rates net of concessions increased. The Company had owned the land for the development since 1991, when the Company purchased the land, along with the cemetery and mortuary that are adjacent to the property. The Company continues to operate the cemetery and mortuary. The Company may use the net proceeds from the sale of the Dry Creek apartments to invest in residential and commercial real estate projects. This may include the possible use of a Section 1031 real property exchange transaction.

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.

51

(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 Articles of Amendment and Restatement to Articles of Incorporation (9)
- 3.2 Amended and Restated Bylaws (11)
- 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 Letter from Eide Bailly, LLP (10)
- 10.1 Amended and Restated Employee Stock Ownership Plan (ESOP) and Trust Agreement (1)
- 10.2 2003 Stock Option Plan (2)
- 10.3 2006 Director Stock Option Plan (3)
- 10.4 2013 Amended and Restated Stock Option and Other Equity Incentive Awards Plan (8)
- 10.5 2014 Director Stock Option Plan (4)
- 10.6 Employment agreement with Scott M. Quist (6)
- 10.7 Purchase Agreement among Security National Financial Corporation, SNFC Subsidiary, LLC, American Funeral Financial, LLC, and Hypershop, LLC (5)
- 10.8 Stock Purchase Agreement among Security National Financial Corporation, and Reppond Holding Company, to purchase First Guaranty Insurance Company (8)
- 21 Subsidiaries of the Registrant (11)
- 23.1 Consent of Eide Bailly LLP (7)
- 23.2 Consent of Mackey Price & Mecham (7)
- 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-K, as filed on April 2, 2018

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: May 15, 2018 /s/ Scott M. Quist
Scott M. Quist
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Dated: May 15, 2018 /s/ Garrett S. Sill
Garrett S. Sill
Chief Financial Officer and Treasurer
(Principal Financial Officer and Principal Accounting Officer)