# HOLLY MORTGAGE TRUST

# FINANCIAL STATEMENTS

# DECEMBER 31, 2004 AND 2003

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FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003

C O N T E N T S

UHY Mann Frankfort Stein & Lipp
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# Independent Auditors' Report

To the Board of Trustees of
Holly Mortgage Trust
Houston, Texas

We have audited the accompanying balance sheets of Holly Mortgage Trust (the "Trust") as of December 31, 2004 and 2003, and the related statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note C to the financial statements, the Trust reports its investment in A. R. Goldrick Company, Inc. ("Goldrick"), its wholly-owned subsidiary, under the cost method of accounting. In our opinion, accounting principles generally accepted in the United States of America require that this investment be accounted for as a consolidated subsidiary. The effects of this departure from generally accepted accounting principles cannot be reasonably estimated.

In our opinion, except for the effects of not consolidating Goldrick, as discussed in the preceding paragraph, the financial statements referred to the in the first paragraph present fairly, in all material respects, the financial position of Holly Mortgage Trust as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

UHY Mann Frankfort Stein & Lipp CPAs, LLP

Houston, Texas
May 11, 2005

HOLLY MORTGAGE TRUST
BALANCE SHEETS

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| ASSETS | | |
| MORTGAGE NOTES RECEIVABLE | | |
| Mortgage notes receivable | $ 5,160,593 | $ 4,183,682 |
| Mortgage participations | (4,091,364) | (3,507,619) |
| Allowance for loan losses | (400,775) | (316,063) |
| MORTGAGE NOTES RECEIVABLE, net | 668,454 | 360,000 |
| Cash and cash equivalents | 583,953 | 75,260 |
| Accrued interest receivable, net of allowance of $919,006 at December 31, 2004 and 2003 | 15,842 | 13,702 |
| Other current assets | 2,900 | - |
| Investment in subsidiary | - | - |
| Investment in affiliate | 53,241 | 55,362 |
| TOTAL ASSETS | $ 1,324,390 | $ 504,324 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Accrued expenses | $ 23,617 | $ 52,428 |
| Accounts payable - subsidiary | 184,000 | 84,000 |
| Accounts payable - affiliate | 100,000 | - |
| Notes payable | 110,313 | 71,518 |
| Long-term debt - affiliate | 43,496 | 230,000 |
| TOTAL LIABILITIES | 461,426 | 437,946 |
| SHAREHOLDERS' EQUITY | | |
| Preferential 9% cumulative convertible shares of beneficial interest, no par value, 950,000 shares authorized, 815,000 and 0 shares issued and outstanding at December 31, 2004 and 2003, respectively | 815,000 | - |
| Shares of beneficial interest, no par value, unlimited shares authorized, 1,404,732 shares issued and outstanding at December 31, 2004 and 2003, respectively | 1,336,119 | 1,336,119 |
| Accumulated deficit | (1,288,155) | (1,269,741) |
| TOTAL SHAREHOLDERS' EQUITY | 862,964 | 66,378 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 1,324,390 | $ 504,324 |

See accompany notes to financial statements.

HOLLY MORTGAGE TRUST
STATEMENTS OF OPERATIONS

| | Year Ended December 31, | |
|---|---|---|
| | 2004 | 2003 |
| REVENUES | | |
| Interest income | $ 70,630 | $ 72,325 |
| Other income | 100,067 | 22,862 |
| TOTAL REVENUES | 170,697 | 95,187 |
| COSTS AND EXPENSES | | |
| General and administrative | 85,083 | 51,391 |
| Bad debt expense | 84,712 | 13,109 |
| Interest expense | 19,316 | 28,896 |
| TOTAL COSTS AND EXPENSES | 189,111 | 93,396 |
| NET INCOME (LOSS) | $ (18,414) | $ 1,791 |
| NET LOSS PER SHARE, basic and diluted | $ (.01) | $ .00 |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 1,404,732 | 1,404,732 |

See accompany notes to financial statements.

HOLLY MORTGAGE TRUST
STATEMENTS OF SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2004 AND 2003

| | Preferential Shares of Beneficial Interest | | Shares of Beneficial Interest | | Accumulated | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Number | Amount | Number | Amount | Deficit | Equity |
| Balance at January 1, 2003 | - | $ - | 1,404,732 | $ 1,336,119 | $ (1,271,532) | $ 64,587 |
| Net income | - | - | - | - | 1,791 | 1,791 |
| Balance at December 31, 2003 | - | - | 1,404,732 | 1,336,119 | (1,269,741) | 66,378 |
| Issuance of preferential shares | 815,000 | 815,000 | - | - | - | 815,000 |
| Net loss | - | - | - | - | (18,414) | (18,414) |
| Balance at December 31, 2004 | 815,000 | $ 815,000 | 1,404,732 | $ 1,336,119 | $ (1,288,155) | $ 862,964 |

See accompany notes to financial statements.

HOLLY MORTGAGE TRUST
STATEMENTS OF CASH FLOWS

| | Year Ended December 31, 2004 | Year Ended December 31, 2003 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | $ (18,414) | $ 1,791 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Bad debt expense | 84,712 | 13,109 |
| Income from equity method investments | (5,698) | (7,862) |
| Changes in operating assets and liabilities: | | |
| Accrued interest receivable | (2,140) | (14,165) |
| Other receivables | (2,900) | 5,400 |
| Accounts payable and accrued expenses | 171,189 | 15,906 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 226,749 | 14,179 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Mortgage notes originated | (2,559,880) | (162,037) |
| Mortgage note participations sold | 1,823,797 | 138,481 |
| Principal collected on mortgage notes receivable, net of participation | 342,917 | (39,623) |
| Distributions from equity method investments | 7,819 | 2,500 |
| NET CASH USED IN INVESTING ACTIVITIES | (385,347) | (60,679) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from long-term debt - affiliate | 142,500 | - |
| Payments on long-term debt - affiliate | (329,004) | (170,000) |
| Proceeds from note payable | 121,000 | 90,000 |
| Payments on note payable | (82,205) | (88,467) |
| Proceeds from issuance of preferred shares | 815,000 | - |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 667,291 | (168,467) |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 508,693 | (214,967) |
| CASH AND CASH EQUIVALENTS, beginning of period | 75,260 | 290,227 |
| CASH AND CASH EQUIVALENTS, end of period | $ 583,953 | $ 75,260 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Cash paid for interest | $ 50,471 | $ 4,041 |
| Mortgage note receivable originated and funded by participation holder | $ - | $ 400,000 |

See accompany notes to financial statements.

## NOTE A - ORGANIZATION AND ACCOUNTING POLICIES

Holly Mortgage Trust (the "Trust") was organized as a Massachusetts business trust on January 2, 1998. The Trust is engaged primarily in the business of investing in second mortgages and equity participation mortgages. First Commonwealth Holdings Corporation ("FCHC"), whose principal shareholder is a trustee and a shareholder of the Trust, is the Trust's compensated manager and advisor.

Cash Equivalents: For purposes of the Statements of Cash Flows, the Trust considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Mortgage Notes Receivable: Mortgage notes receivable are carried at unpaid principal balance since generally it is management's intention to hold the mortgage notes to maturity. Commitment and origination fees collected from prospective borrowers are deferred and recognized as income using a method approximating the interest method over the life of those loans.

A loan is considered impaired when it is probable that the scheduled principal or interest will not be collected when due. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or collateral fair value, if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, an impairment loss is recognized through a valuation allowance and a corresponding charge to operations.

Allowance for Losses: The allowance for losses is based on management's estimate of the amount required to maintain an allowance adequate to reflect the risks inherent in the loan portfolio after giving consideration to existing economic conditions, loss experience in relation to outstanding loans, changes in the loan portfolio, borrowers' performance in reducing loan principal, adequacy of loan collateral and other relevant factors.

Interest Income: Interest income on loans is accrued based upon the principal amount outstanding. If a loan is placed on nonaccrual status, interest previously recognized but uncollected is reversed and charged against current income. Subsequent interest collected on such a loan is credited to principal if, in the opinion of management, collectibility of principal is doubtful; otherwise, the interest collected is recognized as revenue.

Concentration of Credit Risk: The Trust's primary business activity is investing in loans collateralized by mortgages on real estate projects. These loans are principally collateralized by real estate in Florida and California.

The Trust maintains cash balances in a bank that at times, exceeds federal insured limits. The Trust monitors the financial condition of the bank and has experienced no losses associated with this account.

Net Income (Loss) Per Share: Net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares of beneficial interest outstanding during the year. Earnings per share, both basic and diluted, are the same.

## NOTE A - ORGANIZATION AND ACCOUNTING POLICIES (Continued)

Management Estimates: The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

## NOTE B - MORTGAGE NOTES RECEIVABLE AND COMMITMENTS

Notes receivable from funding mortgage loans are principally collateralized by second mortgage loans on commercial or residential property and are due at various dates, with the latest maturity due in October 2010. Notes receivable bear interest at rates ranging from 9.5% to 15%.

Commitments to lend additional funds at December 31, 2004 were approximately $639,000.

## NOTE C - NOTES PAYABLE

Notes payable consisted of the following:

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Note payable to an individual, bearing interest at 8%, principal and interest due monthly, maturing October 2005. | $ 85,313 | $ - |
| Note payable to an individual, bearing interest at 8%, principal and interest payments due monthly, maturing October 2005. | 25,000 | - |
| Note payable to an individual, bearing interest at 8%, principal and interest payments due monthly. This note matured September 2004. | - | 41,026 |
| Note payable to an individual, bearing interest at 8%, principal and interest payments due monthly. This note matured September 2004. | - | 30,492 |
| | $ 110,313 | $ 71,518 |

## NOTE D - LONG-TERM DEBT - AFFILIATE

The Trust has a note payable to an affiliate totaling $43,496 and $230,000 at December 31, 2004 and 2003, respectively. This note was repaid subsequent to December 31, 2004. Interest expense related to this affiliate debt totaled approximately $14,000 and $24,800 for the years ended December 31, 2004 and 2003, respectively.

## NOTE E - FEDERAL INCOME TAXES

The Trust operates in such a manner to qualify as a "real estate investment trust" under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder. Under those sections, the Trust will not be taxed on that portion of its qualifying income distributed to shareholders so long as at least 90% of the Trust's otherwise taxable income is distributed to shareholders each year and other requirements of a qualified real estate investment trust are met. The Trust satisfied the income distribution requirement for the periods ended December 31, 2004 and 2003. Management believes that all other requirements of a qualified real estate investment trust have been met.

## NOTE F - SHAREHOLDERS' EQUITY

Except for the rights and preferences in payment of dividends and in liquidations, the Preferential Shares of Beneficial Interest ("Preferential Shares") will have the same voting and other rights as the Shares of Beneficial Interest ("Common Shares"). The Preferential Shares are entitled to receive cumulative preferential dividends at the annual rate of nine cents ($0.09) per share before any dividends are paid on the Common Shares.

In the event of liquidation of the Trust, the assets available for distribution will be distributed first to the holders of the Preferential Shares up to one dollar ($1) per share plus any deferred dividends, then second to the holders of Common Shares up to one dollar ($1) per share and then equally on all of the shares of Preferential and Common Shares.

The Preferential Shares are subject to redemption at any time after January 1, 2009 upon not less than thirty days' prior written notice, in whole or in part, at the election of the Trust at the redemption price of one dollar ($1) per share plus all unpaid dividends accrued to the redemption date. Any Preferential Shares outstanding on September 30, 2014 will be redeemed on that date.

In May 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 150, "*Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,*" which is effective for mandatorily redeemable financial instruments of non-public entities for the fiscal period beginning after December 15, 2003. SFAS No. 150 aims to eliminate diversity in practice by requiring that certain types of mandatorily redeemable financial instruments be reported as liabilities by their issuers. Among the types listed as mandatorily redeemable instruments are shares that conditionally or unconditionally obligate the issuer to redeem the shares for cash or by transferring other assets. The Company is in the process of evaluating the impact of this standard on its Preferred Stock.

## NOTE G - ADVISORY AGREEMENT AND RELATED PARTY TRANSACTIONS

The Trust is managed and advised by FCHC, whose principal shareholder is a trustee and shareholder of the Trust. An advisory fee is incurred based on approximately 1% of the book value of the assets of the Trust at the end of each fiscal year. The advisory fees for the years ended December 31, 2004 and 2003 were approximately $20,000.

At December 31, 2004, the Trust had accounts payable to an affiliated business trust of $100,000.

## NOTE G - ADVISORY AGREEMENT AND RELATED PARTY TRANSACTIONS (Continued)

During the year 2004, the Trust engaged in eight mortgage participation payables with various affiliated business trusts. At December 31, 2004, the Trust had six outstanding mortgage participation payables that totaled $2,130,364 and are included in Mortgage Notes Receivable, net on the Balance Sheet. The participations incur interest at rates ranging from 3.5% to 14% (excluding possible contingent interest rates up to 8.5%) and maturity dates ranging from August 2005 to August 2014. Interest on such participations paid to the affiliates amounted to approximately $442,400 for the year ended December 31, 2004.

During the year 2003, the Trust engaged in six mortgage participation payables with various affiliated business trusts. At December 31, 2003, the Trust had four outstanding mortgage participation payables that totaled $1,137,619 and are included in Mortgage Notes Receivable, net on the Balance Sheet. The participations incur interest at rates ranging from 11.5% to 14% (excluding possible contingent interest rates up to 8.5%) and maturity dates ranging from August 2005 to July 2010. Interest on such participations paid to the affiliates amounted to approximately $112,600 for the year ended December 31, 2003.

## NOTE H - MAJOR LOANS

During the year ended December 31, 2004, the Trust derived approximately 71% of its interest income from three mortgage notes. These notes comprised approximately 15% of the mortgage notes receivable, net of participation at December 31, 2004.

During the period ended December 31, 2003, the Trust derived approximately 69% of its interest income from three mortgage notes. These notes comprised approximately 29% of the mortgage notes receivable, net of participation at December 31, 2003.

## NOTE I - INVESTMENT IN SUBSIDIARY

The Trust owns 100% of the common stock of A. R. Goldrick (a C Corporation). A. R. Goldrick is the general partner of Wilco Building Partners, Ltd., a limited partnership which owns and operates an office building in Midland, Texas. The financial statements of A. R. Goldrick have not been consolidated with those of the Trust.