



HAYMAN
CAPITAL MANAGEMENT, L.P.

UDF's Ponzi-Like Real Estate Scheme Continues to Unravel:

The Precarious Preston Manor

August 2016

"Only when the tide goes out do you discover who's been swimming naked."

– Warren Buffett

THE PRECARIOUS PRESTON MANOR

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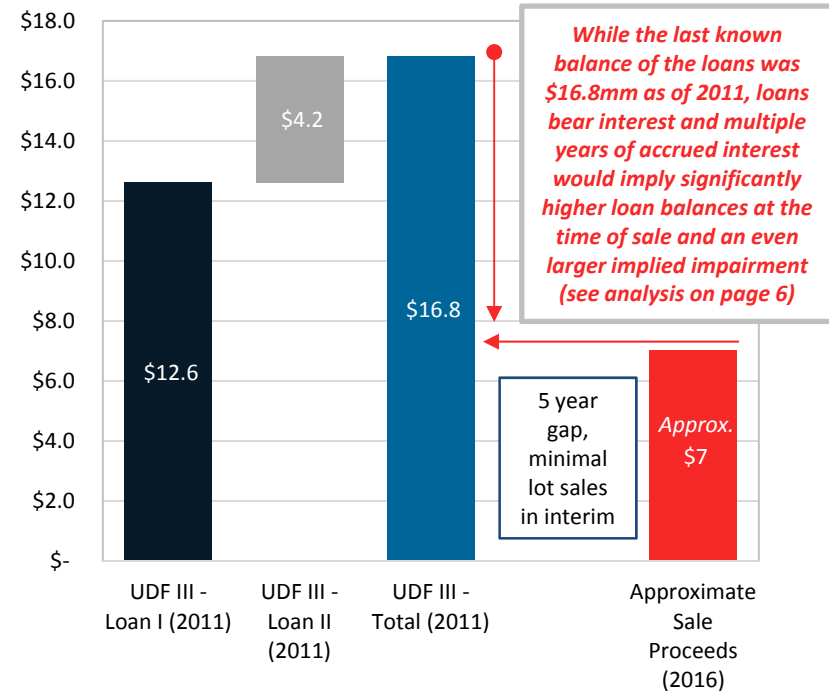
- Overview of Preston Manor: a failed UDF Residential Development Project Life Cycle
- Supporting Detail and Analysis
 - Summary of correspondence between SEC and UDF III regarding a loan related to Preston Manor
 - Disclosures by UDF III and UDF IV regarding loans related to Preston Manor
 - Additional Background on the land / development project securing the UDF III and UDF IV loans related to Preston Manor
 - Analyses of Timeline, Loan Patterns, and Disclosures
 - Debt versus Equity Considerations



PRESTON MANOR – IN SUMMARY

- UDF I, UDF III and UDF IV have all issued loans to a failed development near Lubbock, Texas known as Preston Manor over the course of a decade; Preston Manor is just one of many examples that highlight UDF’s questionable practices and should be considered in context of the many other red flags.
- UDF I foreclosed on a loan related to Preston Manor in 2007 and acquired the underlying land through foreclosure; coinciding with the foreclosure, UDF III lent additional capital to the then struggling and foreclosed development.
- **At the end of 2011, UDF III was owed \$16.8 million** related to the Preston Manor development (aggregate balance of two loans).
- This is the last known combined balance due to the fact that UDF III does not periodically disclose balances of individual loans.
- **In July 2016, UDF sold** the lots which it originally acquired through foreclosure; it is Hayman’s understanding that the **lots sold for approximately \$7 million**, implying significant impairment.
- Despite this example and other evidence that would suggest otherwise, UDF management claims to have “identified the housing bubble and avoided lending in frothy markets.”
- UDF’s disclosures regarding this situation are opaque at best and, in aggregate, misleading. The relevant omissions in disclosures, and the ultimate outcome, lead to questions regarding the intent of the parties in structuring investments and the substantive nature of UDF loans.
- There is a reasonable basis to question whether UDF loans are appropriately characterized as debt; if loans are determined to be mischaracterized, there are potentially significant tax consequences, financial disclosure consequences and REIT qualification consequences.

Summary of UDF III Loans Related to Preston Manor Development (\$ in millions)



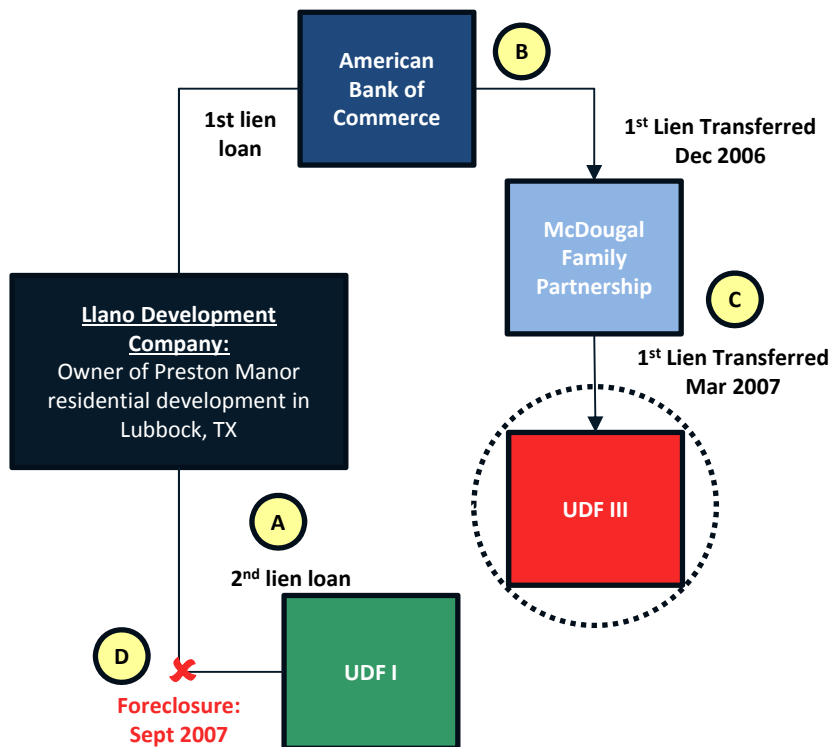
OVERVIEW OF FINANCING OF PRESTON MANOR

A UDF RESIDENTIAL DEVELOPMENT PROJECT LIFE CYCLE: THE EARLY DAYS

Preston Manor is a failed residential development in Lubbock, Texas which UDF financed through various funds for nearly a decade

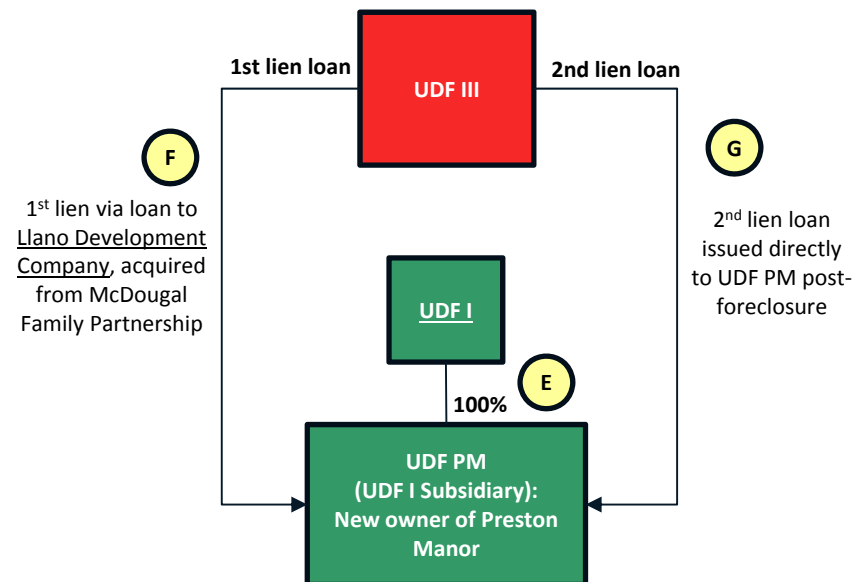
Pre-Foreclosure Lien Summary

- A) UDF I issued a 2nd lien loan to a real estate developer in Lubbock, TX;
- B) The 1st lien lender transferred the lien to a third-party in December 2006;
- C) The third-party, 3 months later, transferred the 1st lien to UDF III in March 2007; therein UDF III acquired and assumed the 1st lien;
- D) The borrower defaulted and UDF I foreclosed on its 2nd Lien in Sept 2007.



Post-Foreclosure Lien Summary

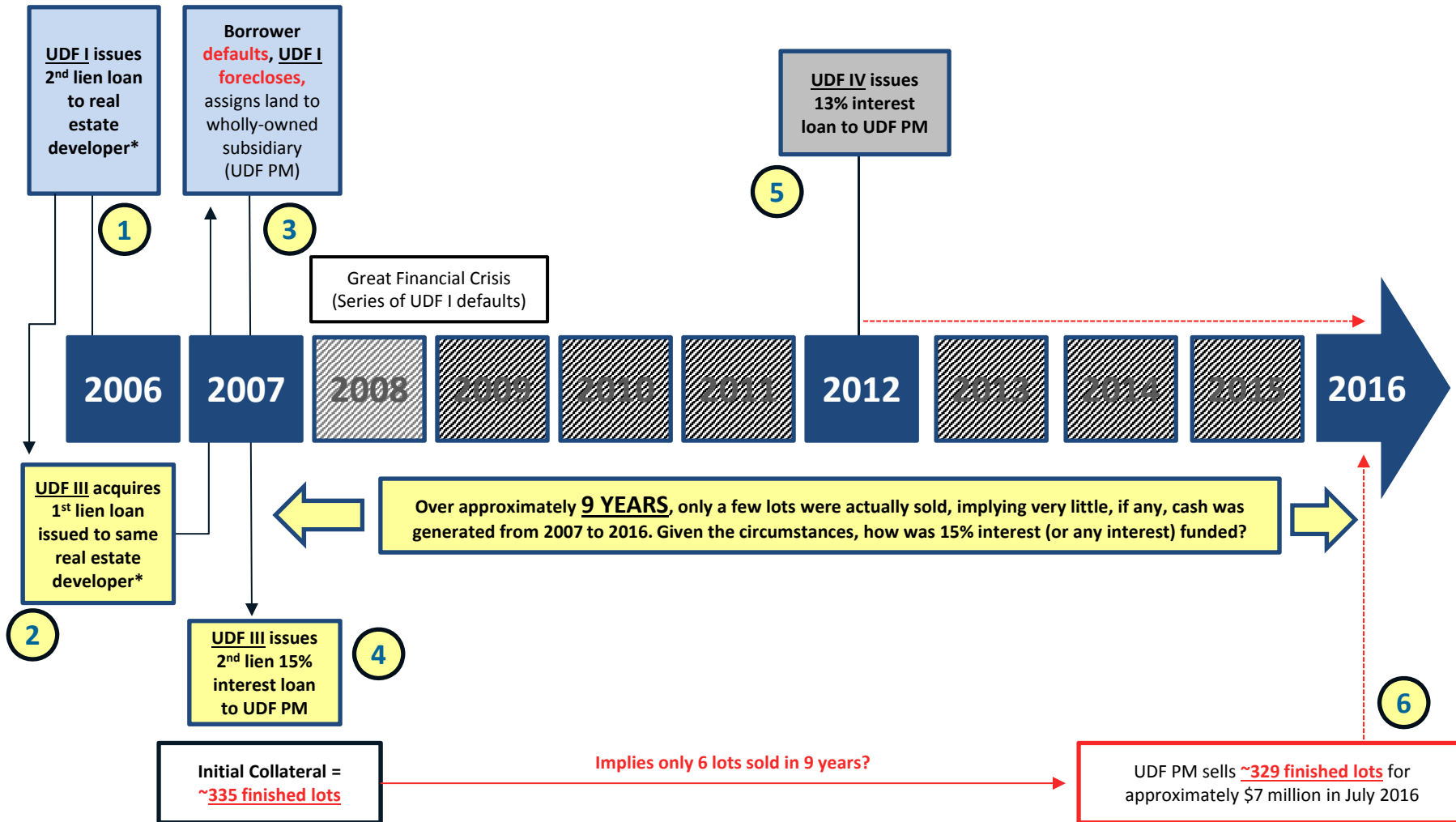
- D) UDF I foreclosed on its 2nd lien, acquiring the land through a foreclosure.
- E) UDF I assigned the land to a subsidiary (UDF PM).
- F) UDF III retained its existing 1st lien (see C, loan to Llano Development Co.)
- G) UDF III issued a new 2nd lien to the UDF I subsidiary. Effectively, UDF III held the 1st lien and 2nd lien on Preston Manor assets.



Source: Lubbock County Deed Records; UDF III and UDF IV SEC filings.

THE PRECARIOUS PRESTON MANOR

SUMMARY TIMELINE: PRESTON MANOR, LUBBOCK, TX A UDF RESIDENTIAL DEVELOPMENT PROJECT LIFE CYCLE



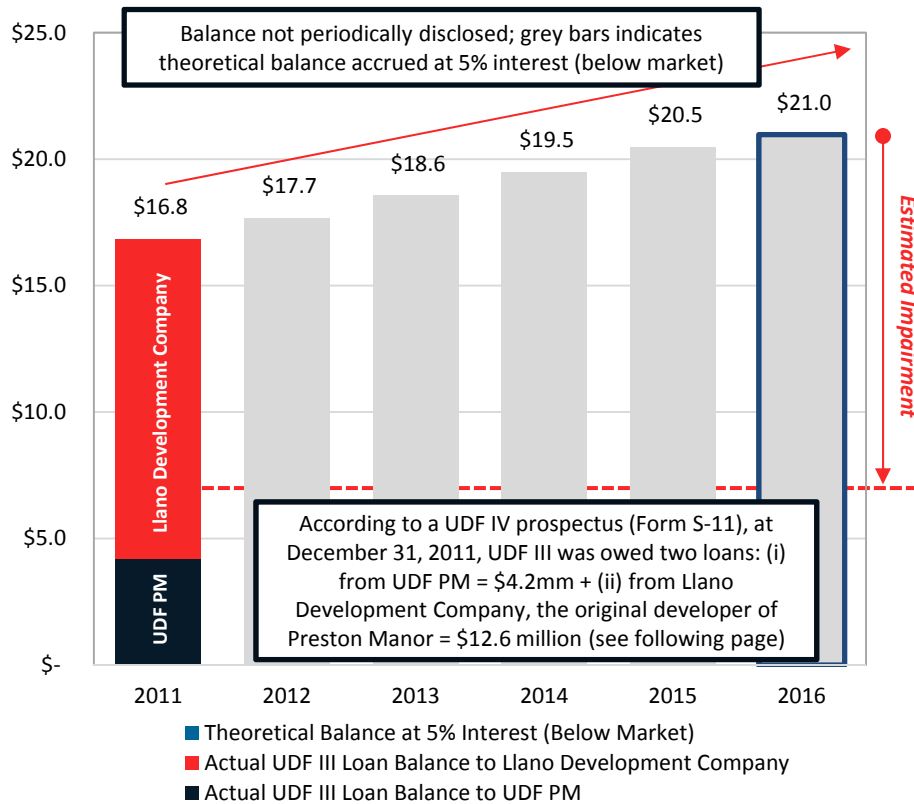
Source: Lubbock County Deed Records; UDF III and UDF IV SEC filings. *Real estate developer = Llano Development Company.
Source: <http://investors.udfiv.com/Cache/1500062253.PDF?Y=&O=PDF&D=&FID=1500062253&T=&IID=4213398>

THE PRECARIOUS PRESTON MANOR

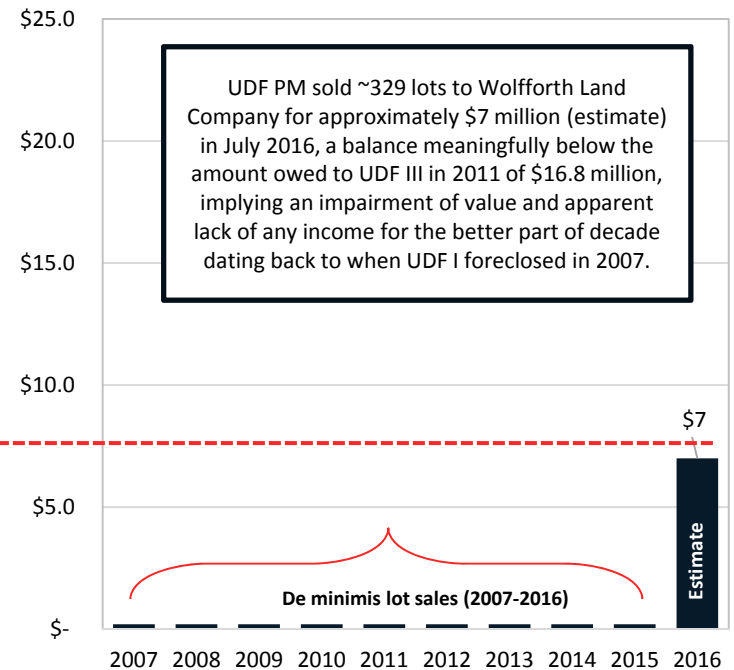
ANALYSIS OF UDF III LOAN(S) TO UDF PM

...AND TO LLANO DEVELOPMENT COMPANY (ORIGINAL DEVELOPER OF PRESTON MANOR)

UDF III Loans Related to Preston Manor (\$mm)



Estimated Cash Generated from Asset (Preston Manor)



While UDF III does not make it expressly clear, UDF IV disclosed (in a prospectus) that UDF III was owed two loans, both secured by lots in Preston Manor, totaling \$16.8 million as of December 31, 2011. UDF finally sold this land in July 2016, for approximately \$7 million (estimate, not officially disclosed), implying significant impairment and raising questions regarding whether these loans were (i) fairly marked over the course of several years or (ii) appropriately characterized as debt from inception.



UDF IV DISCLOSURE ON RELEVANT UDF III LOANS

- UDF IV disclosed various “acquisitions of secured loans and equity investments by prior programs” in its Form S-11 filed with the SEC on October 19, 2012. This document shows that UDF III actually had two loans, both secured by 338 lots in Lubbock, TX: (i) to Llano Development Company, funded March 30 2007 with a balance of \$12.6 million as of 12/31/2011 and (ii) a loan to UDF PM, LLC, funded September 4, 2007 with a balance of \$4.2 million as of 12/31/2011.

UDF IV Form S-11 filed with the SEC on October 19, 2012 (Balances as of December 31, 2011)

ACQUISITIONS OF SECURED LOANS AND EQUITY INVESTMENTS BY PRIOR PROGRAMS							
Name of Investment	Location	# of Acres/Lots or other collateral ⁽¹⁾	Date of Funding	Investment Amount	Cash Expenditures Capitalized	Payments	Balance
Centurion Acquisitions, LP	Denton County, TX	730 Lots	July 14, 2006	\$ 2,498,507	\$ 3,500	\$ (2,502,007)	\$ —
Midlothian Longbranch, LP	Ellis County, TX	124 Lots	August 14, 2006	902,272	3,691	(905,963)	—
CMC Communities, Inc.	Dallas County, TX	78 Lots	August 31, 2006	1,932,384	32,481	(609,738)	1,355,127
Arete Real Estate and Development Company	Houston, TX	16,785 Lots	September 27, 2006	9,044,160	73,100	(2,600,717)	6,516,543
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Obra Land Acquisitions Two, LP	Harris County, TX	100 Acres	January 3, 2007	2,028,136	14,855	(2,042,991)	—
Buffington Hidden Lakes, Ltd	Pflugerville, TX	1,282 Lots	December 19, 2006	8,508,605	14,674	(8,523,279)	—
United Development Funding, LP	Adams County, CO	190 Lots	December 29, 2006	13,415,948	37,573	(831,965)	12,621,556
WC Southern Colony Development, LLC	Fort Bend, TX	65.47 Acres	February 21, 2007	4,227,338	13,998	(178,171)	4,063,164
Buffington JV Fund II, Ltd	Austin, TX	1,718 Lots	March 7, 2007	10,168,227	3,738	(10,171,966)	—
Llano Development Company	Lubbock, TX	338 Lots	March 20, 2007	12,610,580	20,482	—	12,631,062
Oak Island Investments, LLC	Bexar County, TX	344 Acres	March 28, 2007	4,576,719	2,140	(4,578,860)	—
Buffington Zachary Scott, Ltd.	Austin, TX	222.911 Acres	August 17, 2007	\$ 3,807,577	\$ 8,791	\$ (3,816,367)	\$ —
High Desert Land Company, Inc.	Mohave, AZ	18 Acres	August 28, 2007	4,062,185	36,360	—	4,098,545
UDF PM, LLC	Lubbock, TX	338 Lots	September 4, 2007	23,575,219	75,347	(19,428,087)	4,222,480

When UDF III disclosed its 2nd lien loan to UDF PM, LLC issued on September 4, 2007, it did not explain the related loan to Llano Development Company issued on March 20, 2007 which it acquired from a third-party prior to a foreclosure sale.




MARKETING CLAIMS INCONSISTENT WITH REALITY

ISN'T IT IRONIC, DON'T YOU THINK: UDF IV MANAGEMENT TEAM IDENTIFIED THE HOUSING BUBBLE!

- Despite numerous red flags regarding loan patterns, disclosure practices and marketing claims that Hayman has documented at length, UDF's former auditor appears to have either missed the signs or may have failed to sufficiently escalate the issues.
- In a UDF IV investor presentation from June 2014, UDF made the representation that its management team *"identified the housing bubble and avoided lending in frothy markets."*
- Note that the UDF affiliated funds are all managed by the same group of principal individuals.
- As the Preston Manor example illustrates, as do other similar examples which Hayman has documented at length, evidence seems to suggest that management claims would be inconsistent with reality.

UDF IV Overview



- United Development Funding IV ("UDF IV") was first to market in 2009 with a program designed to take the place of the banks in the single-family residential development space.
- UDF IV concentrates on healthy markets with affordable and stable home prices, balanced supply, resilient economies and strong demand fundamentals. UDF IV management team identified the housing bubble and avoided lending in frothy markets.
- Management forecasted shortages of homes and finished lots in desirable markets due to sustained demand and a shortage of development financing, and identified an opportunity for our clients to capture market share.
- UDF IV listed on the NASDAQ on June 4, 2014 (ticker "UDF") to facilitate future growth, value creation and liquidity for shareholders.
- UDF IV currently provides a base annual distribution of \$1.64 per share (paid monthly), and the Board of Trustees has historically declared special distributions in addition to the base distribution rate

Capital Solutions for Homebuilders and Developers 4

It would be ironic if UDF's management team identified the housing bubble and at the same time, decided to issue loans on residential real estate in tertiary markets entering the housing crisis; there would potentially be a marketing issue if management claimed to have avoided lending in frothy markets when evidence would seem to suggest otherwise. A pattern of disclosure issues and questionable marketing claims would likely inform an auditor as it considered intent and substance of various transactions.



SUMMARY OF KEY POINTS

- **A Summary of Preston Manor:**

- A UDF I borrower defaulted; UDF I foreclosed; the land was assigned to a UDF I subsidiary (UDF PM);
- UDF III caused public shareholder capital to be lent to the UDF I subsidiary (UDF PM);
- UDF I financed foreclosed real estate with 15% interest “debt” from UDF III; lot sales for the following SIX years were de minimis;
- The SEC questioned UDF III regarding the UDF PM loan;
- The UDF III loan balance to UDF PM began to reduce, despite seemingly non-existent cash flow from the asset; a second, larger loan from UDF III related to Preston Manor was also outstanding but UDF III did not connect the dots in its disclosure.
- UDF IV caused public shareholder capital to be lent to the same UDF I subsidiary to finance a public amenity center at Preston Manor with 13% interest “debt” from UDF IV; in the subsequent three and a half years after issuing the loan, lot sales were de minimis;
- The initial UDF IV loan of \$4.8 million increased to \$5.8 million as of September 30, 2015;
- In July 2016, UDF sold the land underlying UDF III’s loan for approx. \$7 million, implying significant impairment.

- Carrying assets at values in excess of market value not only presents potential disclosure issues, it also leads to questions regarding the various fees which UDF charges shareholders related to “mortgage” servicing, operating expense reimbursements and other management-related fees. How and why are fees charged on foreclosed real estate, which largely sat idle for nearly a decade?
- There is a reasonable basis to question whether the intent to create creditor-debtor relationships comport with economic reality given (i) the initial nature of the foreclosure; (ii) the high interest rate on the debt given the situation; (iii) the apparent lack of lot sales by the “debtor” to theoretically service principal and interest and (iv) the multiple extensions of loans upon maturity.
- Given all of these factors, there is also a reasonable basis to question (i) the original intent of the parties; (ii) the expectations regarding the source of purported debt service payments and the ability to pay; (iii) how the “borrower” was initially capitalized (thinly or adequately) and (iv) to what extent future payments were dependent on the future earnings of the business.
- Furthermore, the lenders and borrower are all managed by the same principal group of related individuals; despite the fact that the shareholders of each party are unique and separate, management of the lender controls the management of the borrower and despite what any third party report may say about the “reasonableness” of a “loan” on a loan-by-loan basis (at issuance), a reasonable auditor would likely have to consider all the facts relative to broad red flags and loan-specific red flags when evaluating intent and determining whether loans (in substance, rather than form) are appropriately characterized as debt rather than equity.



WHY IS THIS RELEVANT TO UDF IV?

- The pattern outlined in this presentation, while far from an exhaustive review of accounting red flags, is central to the evaluation and determination of whether a financial investment is debt or equity, as informed by IRS testing guidelines informed predominantly by case law.
- Not only is the economic pattern relevant to the determination but the relationship between, and the intent of, the parties involved is also relevant.
- An audit would likely be deficient if it did not rigorously test all UDF IV loans, collectively and individually, to determine whether loans were appropriately characterized as debt rather than as an equity investment.
- Without a reasonable level of access to the books, records and principal individuals of UDF IV's purported borrowers (including related parties such as UDF PM but also notably Centurion), it would be impracticable to sufficiently test (i) the intent of the parties, (ii) whether the intent to create a debtor-creditor relationship comports with economic reality, (iii) the commercial reasonableness of debt-to-equity ratios, (iv) the source of the purported debt service payments and ability to make debt service payments and (v) the extent of the purported lender's participation in management of the purported borrower.
- There could potentially be significant tax consequences (including potential REIT qualification consequences) and financial disclosure consequences should it be determined that any, if not a material number, of UDF IV's loans are determined to be equity investments rather than debt because the primary underlying business activities would constitute "prohibited transactions" if directly pursued through a REIT.
- Regarding potential REIT qualification consequences, two income tests – 856(c)(2) and 856(c)(3) – ensure that REITs are used predominantly to invest passively in real estate: (1) at least 95 percent of a REIT's income must generally be derived from passive sources such as rents from real property, dividends, interest, and certain capital gains, as opposed to "active" income from business activities; and (2) at least 75 percent of a REIT's income must be derived from real estate sources including rents, mortgage interest, and capital gains on real estate. If either income test is failed for any taxable year, UDF IV's status as a REIT could be in jeopardy.
- Based on the publicly available information, there is a reasonable basis to question the nature of UDF IV's relationship with its related parties and its largest borrower (Centurion), which would inform in these determinations and potentially impact REIT income tests.
- The following pages provide supporting detail regarding the confusing and incomplete nature of disclosures, an inquiry by the SEC involving one of the related loans to Preston Manor and relevant debt versus equity considerations.



SUPPORTING DETAIL:

SUMMARY OF CORRESPONDENCE BETWEEN THE SECURITIES AND EXCHANGE COMMISSION AND UDF III REGARDING A LOAN TO A UDF I SUBSIDIARY

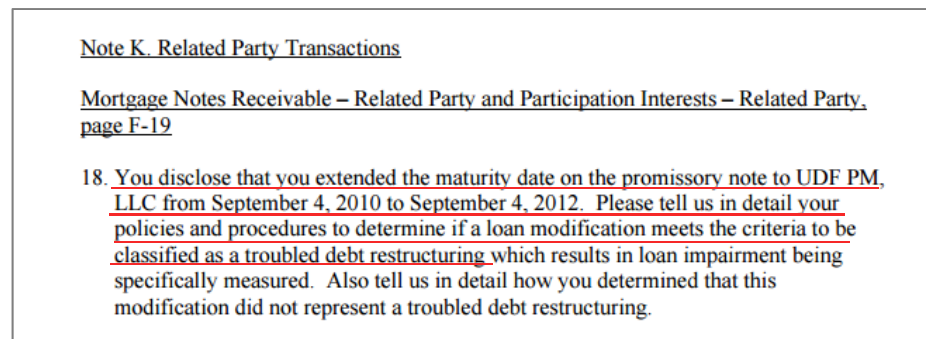
SEC QUESTIONS HOW UDF III DETERMINED THAT A UDF I SUBSIDIARY COULD REPAY A LOAN



SECURITIES AND EXCHANGE COMMISSION

DIVISION OF CORPORATION FINANCE – LETTER TO UDF III (SEPTEMBER 27, 2011)

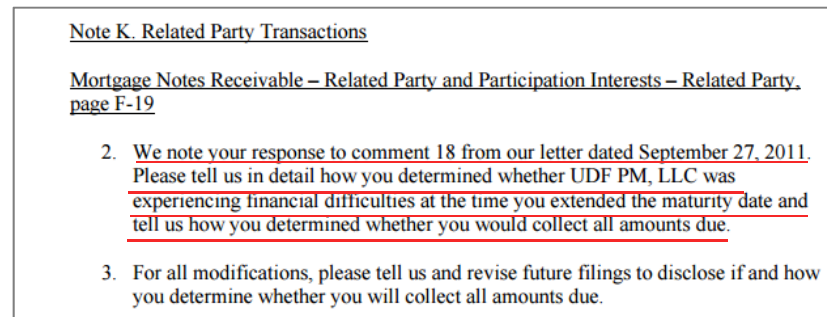
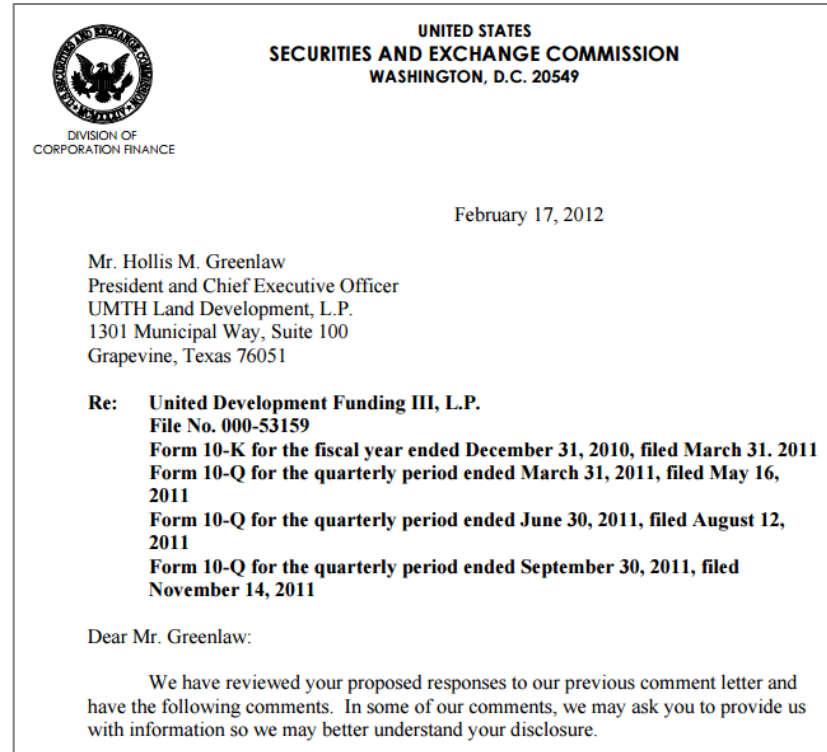
- Beginning with a letter dated September 27, 2011, the SEC’s Division of Corporation Finance engaged in correspondence with UDF III regarding concerns about the company’s financial disclosures in its SEC filings.
- One of those concerns related to a loan issued by UDF III to a UDF I subsidiary (UDF PM).
- Regarding the loan to UDF PM, the letter stated: “You disclose that you extended the maturity date on the promissory note to UDF PM, LLC from September 4, 2010 to September 4, 2012. Please tell us in detail your policies and procedures to determine if a loan modification meets the criteria to be a troubled debt restructuring”.
- The following page details a follow-up exchange regarding the same loan.



SECURITIES AND EXCHANGE COMMISSION

DIVISION OF CORPORATION FINANCE – LETTER TO UDF III (FEBRUARY 17, 2012)

- In a follow-up letter to UDF III dated February 17, 2012, the SEC stated: “We note your response to comment 18 from our letter dated September 27, 2011. Please tell us in detail *how you determined whether UDF PM, LLC was experiencing financial difficulties* at the time you extended the maturity date and tell us *how you determined whether you would collect all amounts due.*”
- The following pages detail UDF III’s public disclosures related to this loan to a UDF I subsidiary and subsequent disclosures by UDF IV regarding a loan to the same UDF I subsidiary.
- The disclosures do not explain how, prior to the issuance of the loan by UDF III, UDF I issued a loan to a third-party in 2006 and subsequently foreclosed on the loan, acquiring the land through foreclosure. The underlying land was part of the ‘development-to-be’ near Lubbock, Texas called Preston Manor.



SUPPORTING DETAIL:

DISCLOSURES BY UDF III AND UDF IV REGARDING LOANS TO THE SAME UDF I SUBSIDIARY

UDF III AND UDF IV EACH LEND TO A SUBSIDIARY OF UDF I (UDF PM) THAT WAS ASSIGNED LAND THROUGH A FORECLOSURE PROCESS



UDF III DISCLOSURE ON LOAN TO UDF PM

- “In **September 2007**, [UDF III] originated a **secured promissory note to UDF PM, LLC**, a Texas limited liability company and **wholly-owned subsidiary of UDF I**”
- “The UDF PM Note, which bore an **interest rate of 15% per annum**, was initially collateralized by a **second lien deed of trust**”
- “The **original maturity date** of the UDF PM Note was **September 4, 2010**”
- “The UDF PM Note was **subsequently extended four times**, resulting in an **amended maturity date** of **September 4, 2015**.”
- “On **October 23, 2014**, the UDF PM Note was **paid in full and terminated**.”

UDF III Form 10-K for the Period Ended December 31, 2014

UDF PM Note

In September 2007, we originated a secured promissory note to UDF PM, LLC, a Texas limited liability company and wholly-owned subsidiary of UDF I (“UDF PM”), in the principal amount of approximately \$6.4 million (the “UDF PM Note”). Our general partner serves as the asset manager for UDF I. The UDF PM Note, which bore an interest rate of 15% per annum, was initially collateralized by a second lien deed of trust on approximately 335 finished lots and 15 acres of land located in Texas. The original maturity date of the UDF PM Note was September 4, 2010. The UDF PM Note was subsequently extended four times, resulting in an amended maturity date of September 4, 2015. In determining whether to modify the UDF PM Note, we evaluated the economic conditions, the estimated value and performance of the underlying collateral, the guarantor, adverse situations that may affect the borrower’s ability to pay or the value of the collateral and other relevant factors. In connection with the UDF PM Note, UDF PM agreed to pay us commitment fees equal to 3% of each advance on the note, or \$187,500. On October 23, 2014, the UDF PM Note was paid in full and terminated. We did not recognize any commitment fee income in connection with the UDF PM Note for years ended December 31, 2014, 2013 or 2012.

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UDF III issued a second lien loan to UDF PM, a UDF I subsidiary, just prior to the onset of the housing crisis and the global financial crisis. This “loan” was amended and extended four times, ultimately resulting in an extension in aggregate of five years. The SEC specifically inquired regarding the treatment of this loan and asked “how [UDF III] determined [UDF III] would collect all amounts due.” This loan was disclosed to be “paid in full” in October 2014.

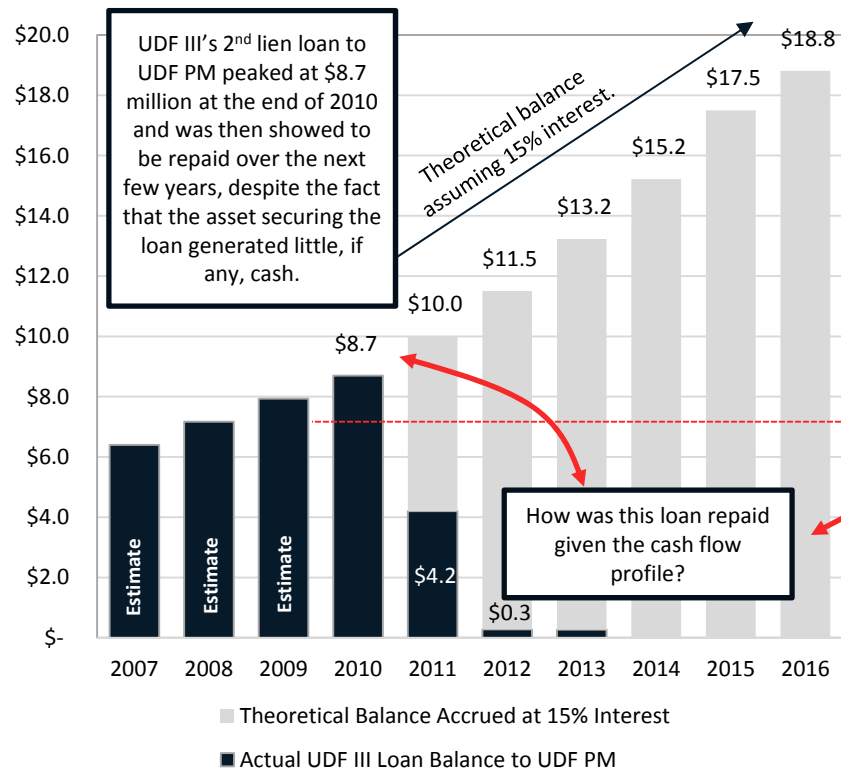
UDF III did not disclose how it was that UDF PM was ultimately able to “repay” the loan given (i) it was a second lien loan and (ii) there was very little, if any, cash generated to repay the loan from the performance of the asset. As part of the disclosure of the loan to UDF PM, UDF III also did not disclose (i) that its affiliate, UDF I, previously foreclosed on the property in September 2007; (ii) that UDF III had actually acquired a senior loan related to the same development in March 2007; or (iii) that UDF IV also issued a loan to UDF PM in October 2012. These could be considered relevant omissions which a reasonable investor would likely rely upon and the omissions may be inconsistent with accounting standards regarding the disclosure of related party activities.



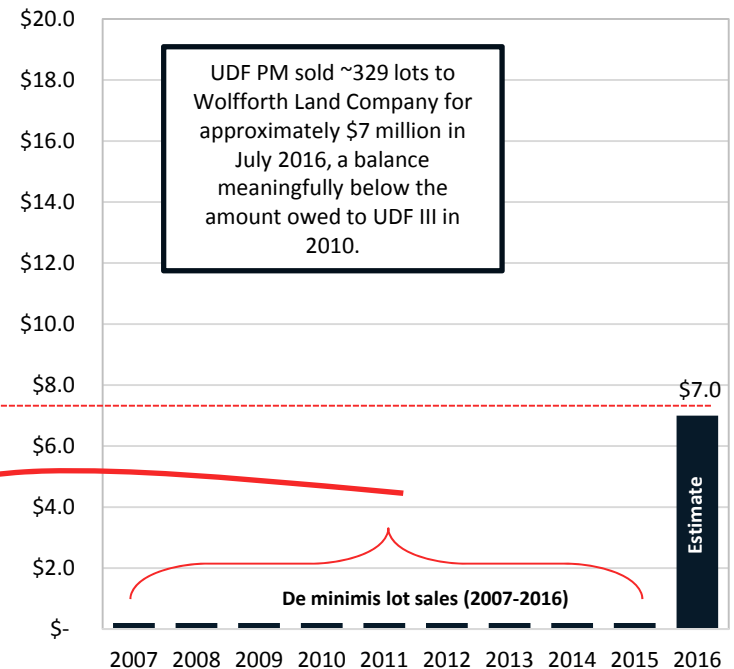
ANALYSIS OF UDF III LOAN TO UDF PM

LOAN "PAYDOWN" DESPITE A LACK OF PROCEEDS

UDF III 2nd Lien Loan to UDF PM (\$mm) – Actual & Projected



Estimated Cash Generated from Asset (Preston Manor)



Despite disclosing that the loan to UDF PM was being paid down from 2010 to 2012, there was little, if any, cash generated by the underlying asset (Preston Manor in Lubbock); UDF I sold the lots in July 2016 for an estimated \$7 million, a balance which would have impaired UDF III's 2nd lien based on the outstanding 2010 balance, even when ignoring the fact that there was a senior lien outstanding – which UDF III also happened to own – implying incremental impairment to the 2nd lien.

UDF III ACQUISITION OF RELATED SENIOR LOAN

- UDF III disclosed a “Note Purchase, Assignment and Assumption Agreement” dated March 20, 2007.
- Through this agreement, UDF III (the assignee) acquired a loan from McDougal Family Partnership, LTD (“McDougal”) to Llano Development Company (“LDC”); McDougal acquired the interest in this loan through a transfer of lien from American Bank of Commerce (note dated October 29, 2004).
- According to the agreement, UDF I executed a guaranty agreement for the benefit of American Bank of Commerce.
- The land securing this loan was the Preston Manor development; Llano Development company was the original owner/developer prior to foreclosure.

Why did UDF III not connect the dots to this loan when it disclosed that it issued a “second lien” loan to UDF PM, a UDF I subsidiary, related to the same foreclosure situation? And, if UDF III’s loan issued in September 2007 was (i) provided subsequent to or in conjunction with a foreclosure sale, (ii) provided subsequent to the acquisition of a related senior loan (iii) issued to a related party, (iv) a second lien, implying the senior loan remained in place and (v) secured by collateral that was mostly finished lots (i.e. development already completed), for what purpose was the 2nd lien loan issued and where did the loan proceeds go? Did UDF I recoup any prior losses via these transactions?

UDF III Disclosure of Note Purchase, Assignment and Assumption Agreement

NOTE PURCHASE, ASSIGNMENT AND ASSUMPTION AGREEMENT

THIS NOTE PURCHASE, ASSIGNMENT AND ASSUMPTION AGREEMENT (this “Agreement”) is dated March 20, 2007 (the “Effective Date”), and is by and between MCDUGAL FAMILY PARTNERSHIP, LTD., a Texas limited partnership (“Assignor”), and UNITED DEVELOPMENT FUNDING III, L.P., a Delaware limited partnership, or its assigns (“Assignee”).

(c) According to Assignor’s records, as of March 20, 2007, the unpaid principal balance of the Loan is \$3,500,000.00 (the “Loan Balance”) and accrued and unpaid interest is \$96,663.41 (the “Accrued Interest”), with a daily per diem of \$996.53 (the “Daily Per Diem”); and

4. Transfer of Liens from ABC to McDougal dated on or about December 12, 2006.

5. Loan Agreement, dated as of October 29, 2004, between Llano Development Company and American Bank of Commerce, such note having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006.

6. Real Estate Lien Note, dated October 29, 2004, in the original principal amount of \$4,000,000, payable by Llano Development Company to the order of American Bank of Commerce, such note having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006, which note evidences a renewal and extension of that certain promissory note in the original principal amount of \$3,250,000.00, payable by Llano Development Company to American Bank of Commerce dated May 21, 2004.

11. Guaranty Agreement, dated October 29, 2004, executed by United Development Funding, L.P. for the benefit of American Bank of Commerce, such agreement having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006.

12. Guaranty Agreement, dated October 29, 2004, executed by Michael Freyburger for the benefit of American Bank of Commerce, such agreement having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006.

13. Deed of Trust, dated May 21, 2004, executed by Llano Development Company to David Harmon, Trustee, for the benefit of American Bank of Commerce and recorded in Vol. 9159 Page 196, of the Official Public Records of Lubbock County, Texas, such deed of trust having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006.

14. Deed of Trust, dated October 29, 2004, executed by Llano Development Company to David Harmon, Trustee, for the benefit of American Bank of Commerce and recorded in Vol. 9486 Page 298, of the Official Public Records of Lubbock County, Texas, such deed of trust having been assigned to McDougal Family Partnership, Ltd. on or about December 12, 2006, which deed of trust extends the instrument described in Item 13 above.



UDF IV DISCLOSURE ON RELEVANT UDF III LOANS

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United Development Funding, LP	Adams County, CO	190 Lots	December 29, 2006	13,415,948	37,573	(831,965)	12,621,556
WC Southern Colony Development, LLC	Fort Bend, TX	65.47 Acres	February 21, 2007	4,227,338	13,998	(178,171)	4,063,164
Buffington JV Fund II, Ltd	Austin, TX	1,718 Lots	March 7, 2007	10,168,227	3,738	(10,171,966)	—
Llano Development Company	Lubbock, TX	338 Lots	March 20, 2007	12,610,580	20,482	—	12,631,062
Oak Island Investments, LLC	Bexar County, TX	344 Acres	March 28, 2007	4,576,719	2,140	(4,578,860)	—
Buffington Zachary Scott, Ltd.	Austin, TX	222.911 Acres	August 17, 2007	\$ 3,807,577	\$ 8,791	\$ (3,816,367)	\$ —
High Desert Land Company, Inc.	Mohave, AZ	18 Acres	August 28, 2007	4,062,185	36,360	—	4,098,545
UDF PM, LLC	Lubbock, TX	338 Lots	September 4, 2007	23,575,219	75,347	(19,428,087)	4,222,480

When UDF III disclosed its 2nd lien loan to UDF PM, LLC issued on September 4, 2007, it did not explain the related loan to Llano Development Company issued on March 20, 2007 which it acquired from a third-party prior to a foreclosure sale.



UDF IV DISCLOSURE ON LOAN TO UDF PM

- “**Effective October 17, 2012**, [UDF IV] entered into a **\$5.1 million loan** agreement with **UDF PM**”
- “**Effective June 30, 2015**, [UDF IV] modified the UDF PM Loan to **increase** the loan amount to **\$6.3 million**.”
- “**Effective October 17, 2015**, we **amended** the UDF PM Loan, resulting in the **current maturity** date of October 17, 2016.”
- “The UDF PM Loan provides UDF PM with up to \$4.8 million in **financing for the development of an amenity center and related project amenities**”

UDF IV Form 10-Q for the Period Ended September 30, 2015

UDF PM Loan

Effective October 17, 2012, we entered into a \$5.1 million loan agreement (the “UDF PM Loan”) with UDF PM, LLC (“UDF PM”), an affiliated Texas limited liability company. UDF PM is a wholly-owned subsidiary of UDF I. The general partner of our Advisor is also the general partner of UMTH LD, our asset manager. UMTH LD also serves as the asset manager of UDF I. Effective June 30, 2015, we modified the UDF PM Loan to increase the loan amount to \$6.3 million. In determining whether to modify this loan, we evaluated the economic conditions, the estimated value and performance of the underlying collateral, adverse situations that may affect the borrower’s ability to pay or the value of the collateral and other relevant factors. Effective October 17, 2015, we amended the UDF PM Loan, resulting in a current maturity date of October 17, 2016. In determining whether to extend this loan, we evaluated the economic conditions, the estimated value and performance of the underlying collateral, adverse situations that may affect the borrower’s ability to pay or the value of the collateral and other relevant factors.

UDF IV Form 10-K for the Period Ended December 31, 2012

UDF PM Loan

Effective October 17, 2012, we entered into a \$5.1 million loan agreement (the “UDF PM Loan”) with UDF PM, LLC (“UDF PM”), an affiliated Texas limited liability company. UDF PM is a wholly owned subsidiary of UDF I. The general partner of our Advisor is also the general partner of UMTH LD, our asset manager. UMTH LD also serves as the asset manager of UDF I. The UDF PM Loan provides UDF PM with up to \$4.8 million in financing for the development of an amenity center and related project amenities located in Lubbock County, Texas. The UDF PM Loan is evidenced and secured by a promissory note and the assignment of development reimbursements owing to UDF PM pursuant to (i) an economic development agreement and (ii) a public improvement district reimbursement contract, both of which were entered into between UDF PM and the city of Wolforth, Texas. The interest rate under the UDF PM Loan is the lower of 13% per annum, or the highest rate allowed by law. The UDF PM Loan matures and becomes due and payable in full on October 17, 2015. The UDF PM Loan provides UDF PM with an interest reserve of approximately \$300,000, pursuant to which we will fund UDF PM’s monthly interest payments and add the payments to the outstanding principal balance of the UDF PM Loan.

Despite the fact that UDF III had issued a second lien loan to UDF PM in September 2007 (only after UDF I had foreclosed on a loan of its own), and despite the fact that UDF PM had only sold FIVE lots in nearly SIX years, UDF IV issued a loan in 2012 to finally complete the amenity center, at a cost of 13% interest. There is a reasonable basis to question whether these loans were appropriately characterized as debt, given numerous irregular data points that do not seem to comport with economic reality or general business common sense.



SUPPORTING DETAIL:

BACKGROUND ON THE LAND / DEVELOPMENT PROJECT SECURING UDF III AND UDF IV LOANS

PRESTON MANOR – LUBBOCK, TX: A UDF “RESIDENTIAL DEVELOPMENT PROJECT LIFE CYCLE”



BACKGROUND ON PRESTON MANOR

- The website for Preston Manor discloses that UDF I “had a lien on 332 vacant finished lots *and foreclosed on the borrowers note in September 2007*” (this is not disclosed in UDF III or UDF IV’s SEC filings).
- Also disclosed on the Preston Manor website: “*Centurion American Development Group has been retained* to revive the Preston Manor development” (note that entities affiliated with Centurion American represent 43% and 67% of UDF III and UDF IV outstanding loans, respectively).

Menu

- Home
- Developer
- History
- Future Plans
- Contact Us
- Lot Sale

Welcome to Preston Manor Wolfforth

The Preston Manor subdivision consists of 448 finished lots. United Development Funding, L.P. (“UDF”) had a lien on 332 vacant finished lots and foreclosed on the borrowers note in September 2007. The current owner is UDF PM, LLC a 100% subsidiary of UDF.

The original borrower started an 114,000 square foot amenity center with a \$3.5M vertical construction loan. Within three months of starting construction the borrower came forward with a proposed change order for an additional \$3M. Construction was stopped to allow a thorough review of cost estimates, bids, marketing plan, operations pro forma and market area demographics. The reviews discovered that the cost to finish would be greater than the original loan and the proposed change order. Subsequent to those reviews the vertical lender declined to fund additional construction cost and allowed the borrower additional time to secure a new vertical construction loan. Due to the same conclusions that UDF came

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Contact Us

Allyson Sherrill
Phone: (806) 782-9483
asherrill@wolfforthtx.us

Recent Works Under Development



Our Future Plan

Centurion American Development Group (www.centurionamerican.com) has been retained to revive the Preston Manor development project. “Centurion” is the largest active developer in North Texas, and have been in business developing residential communities since 1990

[Read More](#)



BACKGROUND ON PRESTON MANOR (CONTINUED)

- According to an article from July 2013, *UDF's representative indicated that UDF had only sold FIVE lots. FIVE. FIVE lots sold since foreclosure in September 2007 (nearly SIX years).*
- In the interim, both UDF III and UDF IV issued loans to UDF I's subsidiary at interest rates of 15% and 13%, respectively.
- A *reasonable auditor would likely question* how these financing arrangements comport with economic reality. A *reasonable auditor would also likely question* how UDF I's subsidiary was originally capitalized, how much equity was invested relative to amount of debt issued, how the purported borrower was able to service debt service payments (principal and interest), the extent to which the lender participated in the management of the borrower and the intent of the parties.

Preston Manor rec center aims for September opening

Developers project an opening date of Sept. 1

Posted: July 18, 2013 - 12:02am

Joe Goggans, an asset manager with United Development Funding, was in Wolforth working last week on coordinating deliveries of furnishings for the recreation center.

Residents are not the only people excited about the new facility. Goggans and Virginia Brown, the center's director of operations, said they are both anticipating the opening.

"We're excited to finally get something to come to fruition down here," Goggans said. "We made a lot of promises five or six years ago...." I think people were reluctant to think things would come to fruition. So we're excited that we've done all this. We've made promises and we've carried through."

Subdivision growing

Goggans said UDF has been patient on promoting Preston Manor lots because he and others involved realized that growth would likely only come if the recreation center were finished.

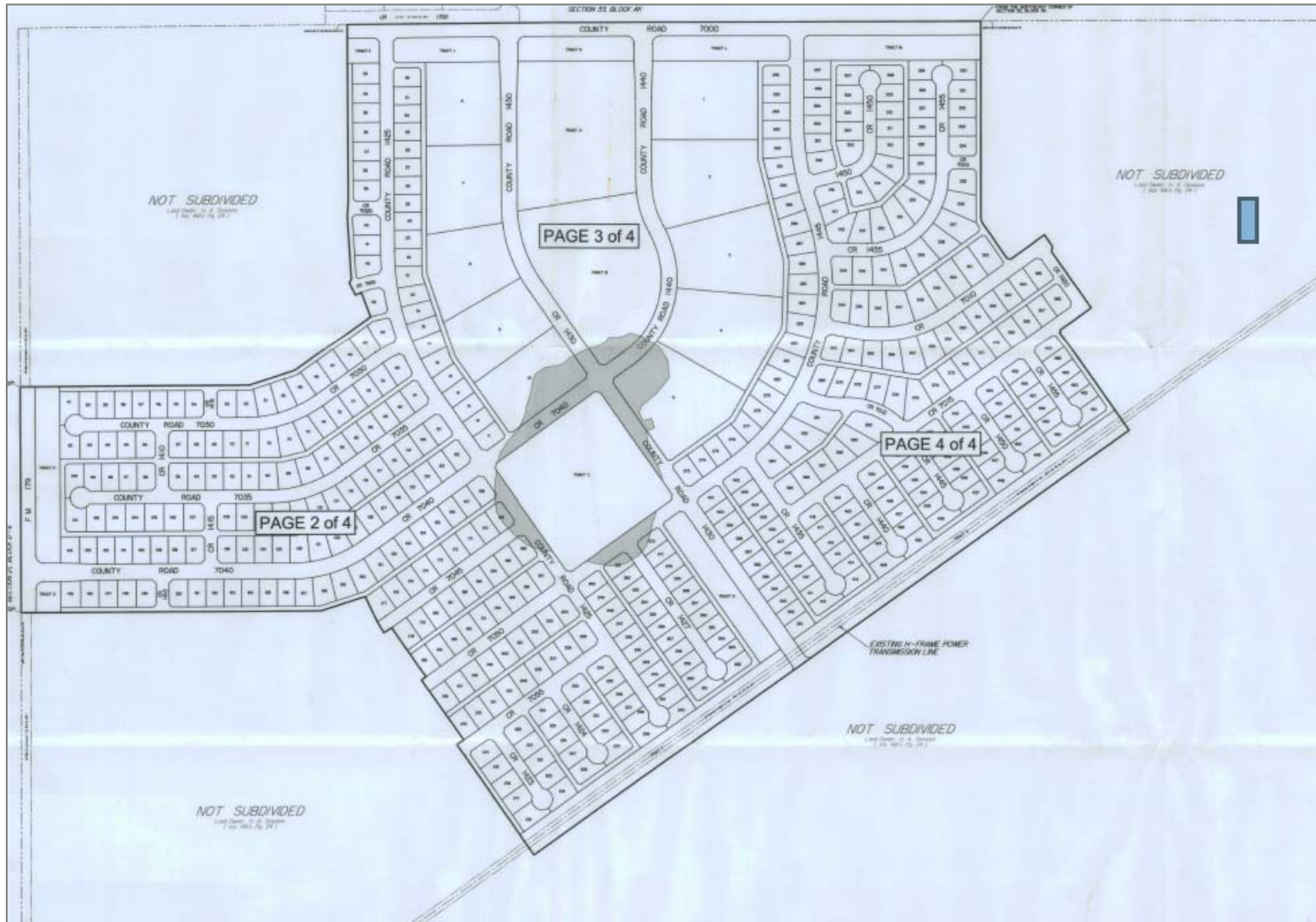
"There were originally 438 lots in here," Goggans said. "There's 32 homes being lived in here now, and I think there's about eight or nine houses that are under construction."

Goggans said UDF owns 332 lots, has sold five lots and has 100 under contract.



BACKGROUND ON PRESTON MANOR (CONTINUED)

PLATTED LOTS = 466 (NOTE A UDF REPRESENTATIVE INDICATED THAT UDF OWNED 332 OF THE LOTS)



BACKGROUND ON PRESTON MANOR (CONTINUED)

LUBBOCK COUNTY DEED RECORDS: INDICATE ONLY ONE LOT SOLD BETWEEN 2007 AND FEBRUARY 2013

You searched for: exact search in GrantorID for UDF PM

25 items found, displaying all items. 1

Description	Summary
DEED OF TRUST 2007036798	RecordingDate: 09/05/2007 04:40:52 PM Grantor: UDF PM LLC Related: , ... Doc#:2013006435, 2013012841, 2013040686, ... Grantee: UNITED DEVELOPMENT FUNDING III LP Legal: 2 TRACTS-SEE INSTRUMENT
DEED OF TRUST 2007044748	RecordingDate: 11/06/2007 10:46:33 AM Grantor: UDF PM LLC Related: Doc#: Grantee: UNITED DEVELOPMENT FUNDING III LP Legal: 2 TRACTS-SEE INSTRUMENT
DEED OF TRUST 2008000319	RecordingDate: 01/04/2008 08:00:00 AM Grantor: UDF PM LLC Related: Doc#:2014012443 Grantee: AMERICAN BANK OF COMMERCE Legal: VARIOUS LOTS- PRESTON MANOR-SEE INSTRUMENT
DEED 2009008436	RecordingDate: 03/13/2009 08:00:00 AM Grantor: UDF PM LLC Related: Doc#: Grantee: BOHN NICHOLAS Legal: Subdivision: PRESTON MANOR Lot: 87
DEED 2013006434	RecordingDate: 02/18/2013 02:09:27 PM Grantor: UDF PM LLC Related: Doc#: Grantee: SINCLAIR TOMMY, SINCLAIR ELIZABETH Legal: Subdivision: PRESTON MANOR Lot: 339

UDF I foreclosed; land assigned to UDF PM in 2007; multiple deeds of trust recorded evidencing loan from UDF III to UDF PM

Likely a deed of trust recorded by original senior lender to UDF PM

4-year gap

There was no deed recording evidencing transfer of land from UDF PM to a third-party between March 2009 and February 2013

Transfers of deeds in public land recordings evidence land being transferred (often sold) from one party to another; from 2007 (when the Preston Manor land was foreclosed on by UDF I and transferred to UDF PM) until February 2013, the deed records indicate that only 1 single family lot (lot 87) was transferred by UDF PM (which was assigned ~332 lots); despite this fact, UDF III had a loan outstanding to UDF PM at 15% interest. The loan had a balance of \$8.7 million at 12/31/10 and was paid down almost entirely by 12/31/12 (~\$280k outstanding). How did UDF PM pay down \$8.4 million on a 2nd lien loan balance when it appears that only 1 residential lot was sold? And how did the economics of a 15% loan make any sense?

SUPPORTING DETAIL:

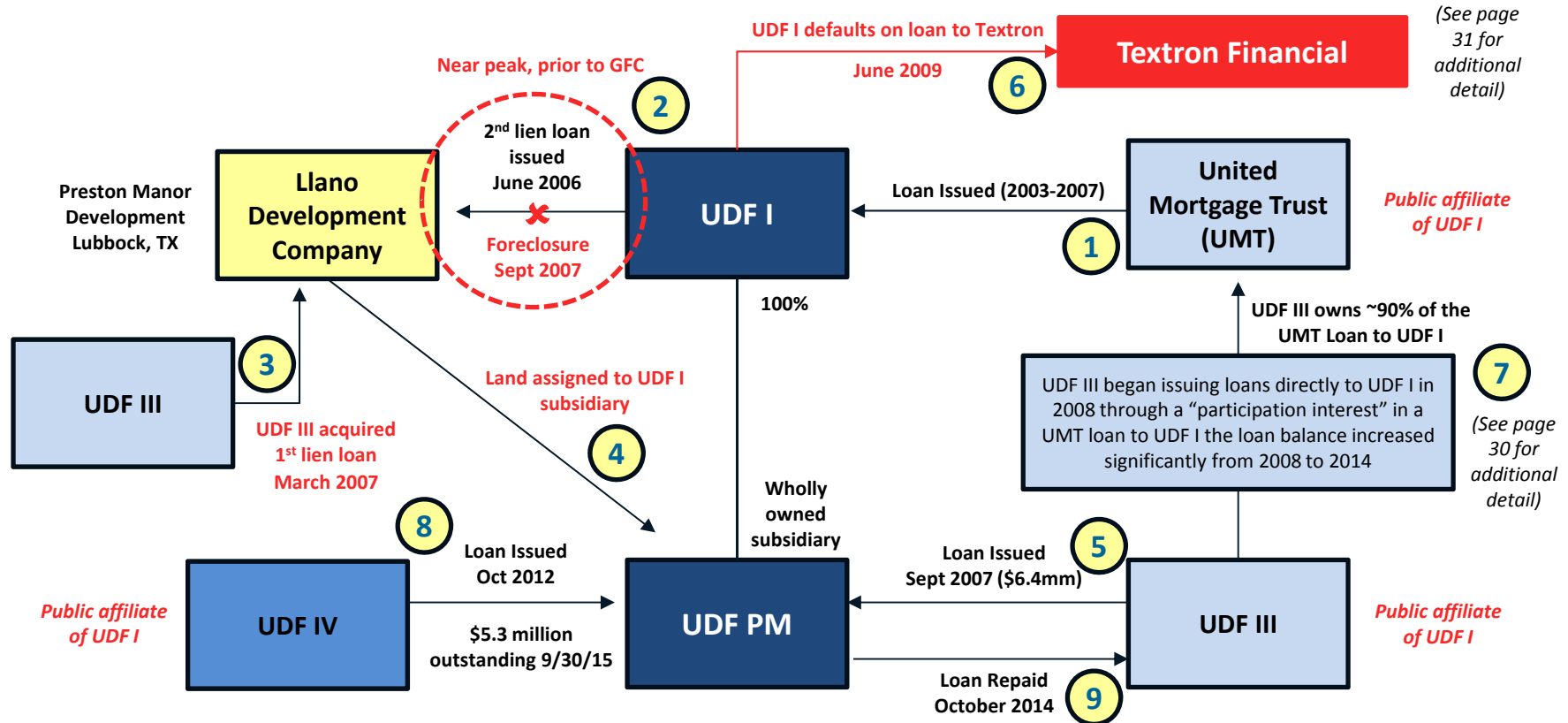
ANALYSES OF TIMELINE, LOAN PATTERNS AND DISCLOSURES

WHEN CONSIDERING THE DEBT VERSUS EQUITY QUESTION, NO ONE FACTOR IS CONTROLLING.



WEB OF LOANS RELATED TO PRESTON MANOR (UDF PM)

THE PONZI-LIKE NATURE OF UDF I, UDF III AND UDF IV “LOANS”



(See page 31 for additional detail)

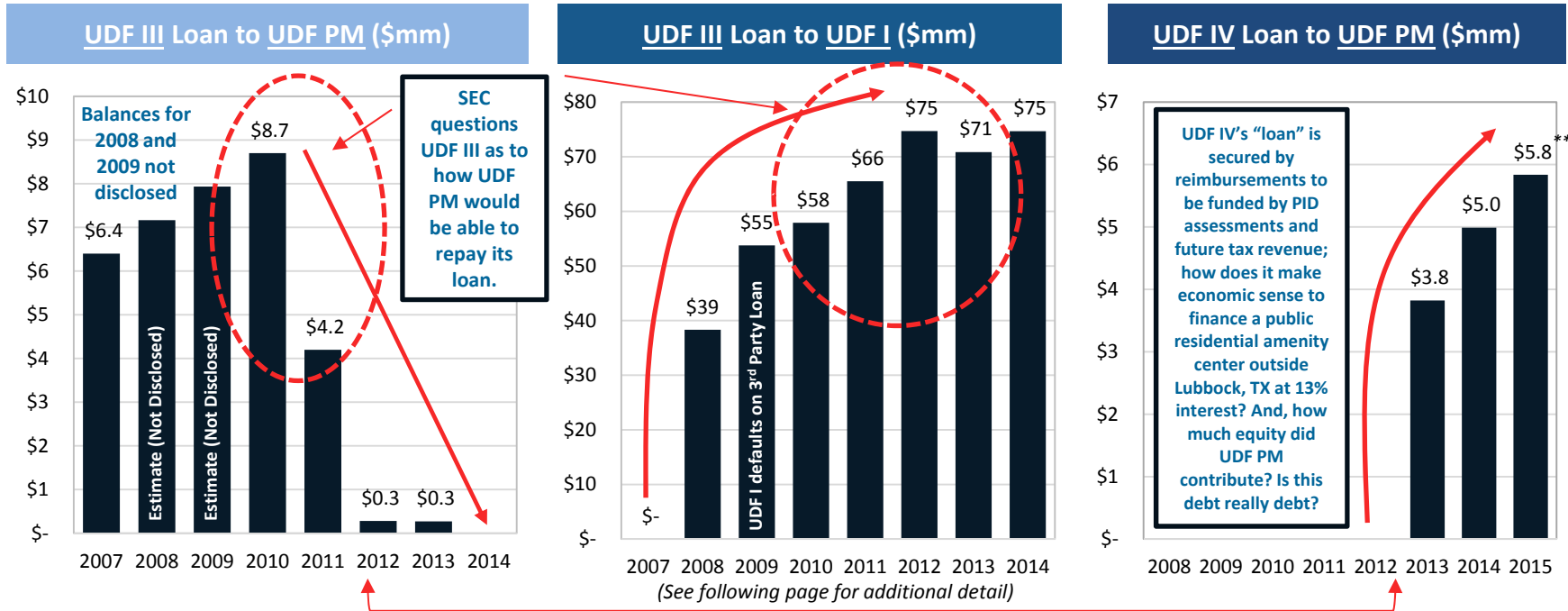
(See page 30 for additional detail)

UDF I foreclosed on real estate, assigned the property to a wholly-owned subsidiary and then, UDF management issued “loans” to the UDF I wholly-owned subsidiary through multiple affiliates with public shareholders (UDF III and UDF IV). When UDF III’s subordinate loan came due, it was amended and extended four times. Coinciding with the period when UDF III’s loan to UDF PM was being repaid, UDF III issued incremental loan proceeds to UDF PM’s parent (UDF I), an affiliate of UDF III, and UDF IV also issued a loan to UDF PM. Not only is there a Ponzi-like element, but there is also a reasonable basis to question whether loans are appropriately characterized as debt rather than equity



RELEVANT UDF III AND UDF IV LOAN BALANCES

The SEC began questioning UDF III as to how it determined UDF PM would be able to repay its loan as early as September 2011; coinciding with this timing, UDF PM's loan balance owed to UDF III began to be reduced dramatically despite the fact that (i) there were only a few lot sales and (ii) that it was a second lien loan. From where did the proceeds come to pay down an \$8.7 million loan (at 15% interest)? Also coinciding with the timing of the SEC's questioning, UDF III's loan to UDF I (the parent of UDF PM) increased from \$58 million to \$75 million. Not only does this raise considerable questions about UDF III and UDF I but UDF IV also issued a loan to UDF PM around the same time, for the purpose of constructing an amenity center that had not been built in the prior six years.



These red flags should be considered in relation to the fact that (i) UDF I acquired the land through the foreclosure of a loan-gone-bad; (ii) UDF I itself defaulted on debt in June 2009; and (iii) the SEC inquired about the loan to UDF PM.

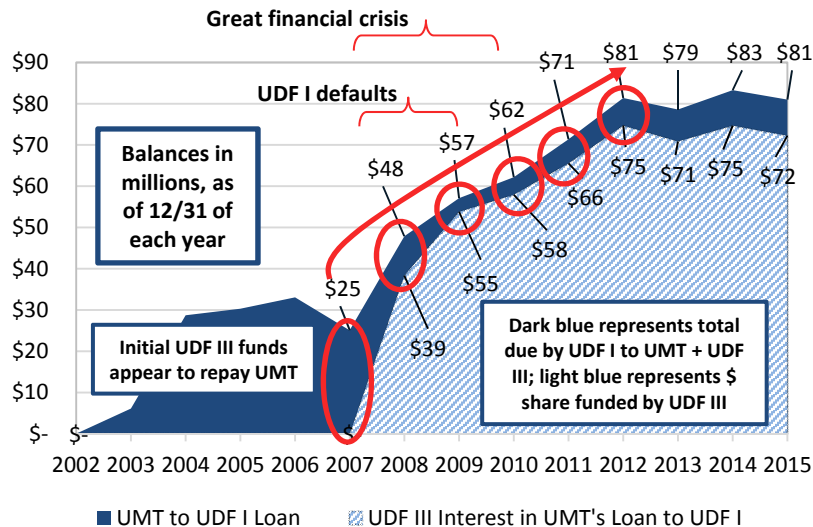
Source: UDF III, UDF IV and UMT Forms 10-Q and Forms 10-K
 **Note: Includes accrued interest balance of \$583k at 9/30/15.

UDF III'S LOAN TO UDF I (VIA UMT)

THE PONZI-LIKE NATURE OF UDF I, UDF III AND UMT "LOANS"

UDF III Form 10-K for Period Ended December 31, 2009

- "In September 2008, [UDF III] entered into an Economic interest participation with UMT pursuant to which UDF III purchased (i) an economic interest in a \$45 million revolving credit facility [...] from UMT to UDF"
- "The UMT Loan is subordinate to UDF I's senior debt, which includes a line of credit provided by Textron."
- "As of December 31, 2009 and 2008, approximately \$55 million and \$39 million, respectively, of the Economic Interest Participation Agreement" was outstanding.
- Despite a UDF I default in June 2009 on the senior Textron loan, UDF I's outstanding balance owed to UDF III on this loan continued to increase (see chart below).



In September 2008, we entered into an Economic Interest Participation Agreement with UMT pursuant to which UDF III purchased (i) an economic interest in a \$45 million revolving credit facility (the "UMT Loan") from UMT to UDF I and (ii) a purchase option to acquire a full ownership participation interest in the UMT Loan (the "Option"). The UMT Loan was subsequently amended to \$60 million as evidenced by a Third Amended and Restated Secured Line of Credit Promissory Note dated as of August 17, 2009 (the "UMT Note"). The UMT Loan matures on December 31, 2010 as evidenced by the Loan Extension Agreement and First Amendment to Third Amended and Restated Secured Line of Credit Promissory Note dated December 31, 2009. The UMT Loan is secured by a security interest in the assets of UDF I including UDF I's land development loans and equity investments pursuant to the First Amended and Restated Security Agreement dated as of September 30, 2004, executed by UDF I in favor of UMT (the "Security Agreement").

Pursuant to the Economic Interest Participation Agreement, each time UDF I requests an advance of principal under the UMT Note, we will fund the required amount to UMT and our economic interest in the UMT Loan increases proportionately. Our economic interest in the UMT Loan gives us the right to receive payment from UMT of principal and accrued interest relating to amounts funded by us to UMT which are applied towards UMT's funding obligations to UDF I under the UMT Loan. We may abate our funding obligations under the Economic Interest Participation Agreement at any time for a period of up to twelve months by giving UMT notice of the abatement.

The Option gives us the right to convert our economic interest into a full ownership participation interest in the UMT Loan at any time by giving written notice to UMT and paying an exercise price of \$100. The participation interest includes all rights incidental to ownership of the UMT Note and the Security Agreement, including participation in the management and control of the UMT Loan. UMT will continue to manage and control the UMT Loan while we own an economic interest in the UMT Loan. If we exercise our Option and acquire a participation interest in the UMT Loan, UMT will serve as the loan administrator but both UMT and we will participate in the control and management of the UMT Loan. Pursuant to the Loan Extension Agreement and First Amendment to Third Amended and Restated Secured Line of Credit Promissory Note, the UMT Note matures on December 31, 2010. The purpose of the UMT Loan is to finance UDF I's investments in real estate development projects. The UMT Loan interest rate is the lower of 14% or the highest rate allowed by law. UDF I may use the UMT Loan proceeds to finance indebtedness associated with the acquisition of any assets and to seek income that qualifies under the Real Estate Investment Trust provisions of the Internal Revenue Code to the extent such indebtedness, including indebtedness financed by funds advanced under the UMT Loan and indebtedness financed by funds advanced from any other source, including senior debt, is no less than 68% of the appraised value of all subordinate loans and equity interests for land development and/or land acquisition owned by UDF I and 75% for first lien secured loans for land development and/or acquisitions owned by UDF I. During 2009 and 2008, we recognized approximately \$6.5 million and \$1.2 million, respectively, of interest income - related party related to this note, of which approximately \$1.9 million and \$508,000, respectively, is included in accrued interest receivable - related party.

The UMT Loan is subordinate to UDF I's senior debt, which includes a line of credit provided by Textron Financial Corporation ("Textron") in the amount of \$30 million, and all other indebtedness of UDF I to any national or state chartered banking association or other institutional lender that is approved by UMT in writing. As of December 31, 2009 and 2008, approximately \$55 million and \$39 million, respectively, of the Economic Interest Participation Agreement is included in participation interest - related party.

On June 14, 2009, the Textron Loan Agreement matured and became due and payable in full. The Textron Loan Agreement is in default and as of December 31, 2009, the outstanding balance owing to Textron under the Textron Loan Agreement is approximately \$26.2 million. Effective August 15, 2009, Textron and UDF I entered into a Forbearance Agreement pursuant to which Textron agreed to forbear in exercising its rights and remedies under the Textron Loan Agreement until November 15, 2009, which forbearance date was extended to February 28, 2010 pursuant to an amendment to the Forbearance Agreement dated effective November 15, 2009. Pursuant to a second amendment to the Forbearance Agreement, effective March 1, 2010, the forbearance period has been extended to June 30, 2010; provided, that the forbearance period will end earlier if UDF I defaults under the Forbearance Agreement. The interest rate payable on the loan is 7.5% as of December 31, 2009. In consideration of Textron entering into the Forbearance Agreement and extending the forbearance period, UDF I agreed to pay Textron a forbearance fee in the amount of \$284,480 and an amendment fee in the amount of \$259,000. Textron has publicly announced that it is exiting its commercial financing business through a combination of orderly liquidation and selected sales which are expected to be substantially complete over the next two to three years. We understand that UDF I intends to continue to make payments on the loan and management does not believe that the repayment of the Textron debt will have a material adverse effect on UDF III's participation in the UMT subordinate loan to UDF I.



DISCLOSURE REGARDING UDF I DEFAULT

UDF III'S LOAN TO UDF I CONTINUED TO INCREASE DRAMATICALLY DESPITE UDF I'S DEFAULT(S)

“On June 14, 2009, the Textron Loan Agreement matured and became due and payable in full. The loan is in default”

The UMT Loan is subordinate to UDF I's senior debt, which includes a revolving loan in the maximum amount of up to \$30 million from Textron Financial Corporation (“Textron”) to UDF I, which is evidenced by the Loan and Security Agreement between Textron and UDF I dated June 14, 2006 (the “Textron Loan Agreement”), and all other indebtedness of UDF I to any national or state chartered banking association or other institutional lender that is approved by UMT in writing. As of September 30, 2009 and December 31, 2008, approximately \$52.5 million and \$39.3 million, respectively, of the Economic Interest Participation Agreement is included in participation interest – related party.

On June 14, 2009, the Textron Loan Agreement matured and became due and payable in full. The loan is in default and as of September 30, 2009, the outstanding balance owing to Textron under the Textron Loan Agreement is approximately \$27.7 million. Effective August 15, 2009, Textron and UDF I entered into a Forbearance Agreement pursuant to which Textron agreed to forbear in exercising its rights and remedies under the Textron Loan Agreement until November 15, 2009; provided, that the forbearance period will end earlier if UDF I defaults under the Forbearance Agreement. Textron and UDF I are currently engaged in discussions which management believes will result in an agreement between UDF I and Textron to extend the current Forbearance Agreement for an additional forbearance period. The interest rate payable on the loan is 5.5% as of September 30, 2009. In consideration of Textron entering into the Forbearance Agreement, UDF I agreed to pay Textron a forbearance fee in the amount of \$284,480. Textron has publicly announced that it is exiting its commercial financing business through a combination of orderly liquidation and selected sales which are expected to be substantially complete over the next two to four years. We understand that UDF I intends to continue to make payments on the loan and management does not believe that the repayment of the Textron debt will have a material adverse effect on UDF III's participation in the UMT subordinate loan to UDF I.

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Despite the number of red flags, including (i) the foreclosure related to UDF I's loan on Preston Manor; (ii) the UDF I default on loans related to its Williamsburg development (see *udfexposed.com*, “Where Public Shareholder Capital Went”); and (iii) the UDF I default on its Textron loan, UDF III first extended “credit” to a UDF I subsidiary and then continued to extend “credit” to UDF I through its “economic participation agreement” with UMT, another public affiliate (see prior page). Notably, of these credit events, only UDF I's default on its Textron loan was disclosed to UDF III investors. These patterns are highly relevant to the evaluation of broader intent when considering the fact patterns of individual “loans” and the characterization of loans as debt rather than equity, especially considering the related nature and the broader context of the timing in and around the housing crisis and great financial crisis, a global event which UDF clearly did not see coming.




MARKETING CLAIMS INCONSISTENT WITH REALITY

ISN'T IT IRONIC, DON'T YOU THINK: UDF IV MANAGEMENT TEAM IDENTIFIED THE HOUSING BUBBLE!

- Despite numerous red flags regarding loan patterns, disclosure practices and marketing claims that Hayman has documented at length, UDF's former auditor appears to have either missed the signs or may have failed to sufficiently escalate the issues.
- In a UDF IV investor presentation from June 2014, UDF made the representation that its management team *"identified the housing bubble and avoided lending in frothy markets."*
- Note that the UDF affiliated funds are all managed by the same group of principal individuals.
- As the Preston Manor example illustrates, as do other similar examples Hayman has documented at length, evidence seems to suggest that management claims would be inconsistent with reality.

UDF IV Overview



- United Development Funding IV ("UDF IV") was first to market in 2009 with a program designed to take the place of the banks in the single-family residential development space.
- UDF IV concentrates on healthy markets with affordable and stable home prices, balanced supply, resilient economies and strong demand fundamentals. UDF IV management team identified the housing bubble and avoided lending in frothy markets.
- Management forecasted shortages of homes and finished lots in desirable markets due to sustained demand and a shortage of development financing, and identified an opportunity for our clients to capture market share.
- UDF IV listed on the NASDAQ on June 4, 2014 (ticker "UDF") to facilitate future growth, value creation and liquidity for shareholders.
- UDF IV currently provides a base annual distribution of \$1.64 per share (paid monthly), and the Board of Trustees has historically declared special distributions in addition to the base distribution rate

Capital Solutions for Homebuilders and Developers 4

It would be ironic if UDF's management team identified the housing bubble and at the same time, decided to issue loans on residential real estate in tertiary markets entering the housing crisis; there would potentially be a marketing issue if management claimed to have avoided lending in frothy markets when evidence would seem to suggest otherwise. A pattern of disclosure issues and questionable marketing claims would likely inform an auditor as it considered intent and substance of various transactions.



POTENTIAL DISCLOSURE ISSUES

WOULD A REASONABLE INVESTOR WANT TO KNOW

- UDF III did not disclose that UDF I previously issued a loan to the former developer of Preston Manor.
- UDF III did not disclose that UDF I foreclosed on the property after the development failed and that the underlying Preston Manor land was assigned to UDF PM (a UDF I subsidiary) following the foreclosure.
- UDF III did not disclose that only one lot had been sold by UDF PM between the issuance of its 15% interest loan (2007) and February 2013. UDF III also did not disclose how it was that its loan was able to be repaid despite its subordinate nature and the economic reality of the situation (de minimis lot sales and therein de minimis cash generated by the property).
- UDF III did not disclose that Centurion American, its largest borrower, had “been retained to revive the Preston Manor development project” – information disclosed on the Preston Manor website; UDF III also did not disclose how it was that its largest group of related borrower’s (collectively registered affiliates of Centurion American) was also retained by its affiliated borrower to develop real estate and what, if any, financial arrangements there were with its affiliates.
- UDF III did not disclose that UDF IV issued a loan to a mutual affiliate when, at the time, that affiliate (UDF PM) had a loan outstanding from, and due to, UDF III.
- UDF IV did not disclose that it issued a loan to a mutual affiliate of UDF III when, at the time, that affiliate (UDF PM) had a loan outstanding from, and due to, UDF III (a loan that was issued by UDF III following a foreclosure by UDF I).
- UDF IV did not disclose that UDF I previously issued a loan to the former developer of Preston Manor.
- UDF IV did not disclose that UDF I foreclosed on the property after the development failed and that the underlying Preston Manor land was assigned to UDF PM (a UDF I subsidiary) following the foreclosure.
- UDF IV did not disclose that only one lot had been sold by UDF PM between the foreclosure by UDF I (2007) and February 2013.



A REASONABLE BASIS TO QUESTION WHETHER UDF IV DEBT IS ACTUALLY DEBT – IN SUMMARY

DEBT VERSUS EQUITY CONSIDERATIONS.



DEBT VERSUS EQUITY CONSIDERATIONS

IRS GUIDELINES TO DETERMINE WHETHER DEBT IS REALLY DEBT – UDF III “LOAN” TO UDF PM

- Considerations that would provide a reasonable basis to question whether debt is really debt:
 - Lenders participation in management of the borrower – *related management*.
 - Source of debt payments (principal and interest) dependent on future earnings of the business – *15% interest, largely on sale of finished residential lots*.
 - Status of the contribution in relation to corporate creditors – *2nd lien loan*.
 - Thin or adequate capitalization – *to be determined, would need to review UDF I and UDF PM financials*.
 - Failure of debtor to repay on the due date – *amended and extended four times*.
 - The intent of the parties – *no one factor is controlling*.

Excerpt from opinion in Estate of Mixon v. United States , 464 F.2d 394, 402 (5th Cir. 1972):

Guidelines for determining the "debt versus equity" question have developed by the courts in a number of cases. ¹¹ Decisions in this Circuit have stressed at least thirteen factors which merit consideration in determining this issue. They are:

- ((1)) the names given to the certificates evidencing the indebtedness;
- ((2)) the presence or absence of a fixed maturity date;
- ((3)) the source of payments;
- ((4)) the right to enforce payment of principal and interest;
- ((5)) participation in management flowing as a result;
- ((6)) the status of the contribution in relation to regular corporate creditors;
- ((7)) the intent of the parties;
- ((8)) "thin" or adequate capitalization;
- ((9)) identity of interest between creditor and stockholder;
- ((10)) source of interest payments;
- ((11)) the ability of the corporation to obtain loans from outside lending institutions;
- ((12)) the extent to which the advance was used to acquire capital assets; and
- ((13)) the failure of the debtor to repay on the due date or to seek a postponement.

“The approach of this Court has been to consider all the factors and weigh the evidence favoring characterization of the advance as debt or equity, while realizing that the various factors are not of equal significance and that no one factor is controlling.” – U.S. Court of Appeals, Fifth Circuit (Mixon opinion, 464 F.2d at 402.)



DEBT VERSUS EQUITY CONSIDERATIONS

IRS GUIDELINES TO DETERMINE WHETHER DEBT IS REALLY DEBT – UDF IV “LOAN” TO UDF PM

- Considerations that would provide a reasonable basis to question whether debt is really debt:
 - Lenders participation in management of the borrower – *related management*.
 - Source of debt payments (principal and interest) dependent on future earnings of the business – *13% interest, largely on PID assessments and future increase in tax revenue base and lot absorption*.
 - Status of the contribution in relation to corporate creditors – *1st lien “loan” but loan balance has increased significantly in excess of original balance (including interest reserve)*.
 - Thin or adequate capitalization – *to be determined, would need to review UDF I and UDF PM financials*.
 - Failure of debtor to repay on the due date – *amended and extended upon maturity*.
 - The intent of the parties – *no one factor is controlling*.

Excerpt from opinion in Estate of Mixon v. United States , 464 F.2d 394, 402 (5th Cir. 1972):

Guidelines for determining the "debt versus equity" question have developed by the courts in a number of cases. ¹¹ Decisions in this Circuit have stressed at least thirteen factors which merit consideration in determining this issue. They are:

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- ((3)) the source of payments;
- ((4)) the right to enforce payment of principal and interest;
- ((5)) participation in management flowing as a result;
- ((6)) the status of the contribution in relation to regular corporate creditors;
- ((7)) the intent of the parties;
- ((8)) "thin" or adequate capitalization;
- ((9)) identity of interest between creditor and stockholder;
- ((10)) source of interest payments;
- ((11)) the ability of the corporation to obtain loans from outside lending institutions;
- ((12)) the extent to which the advance was used to acquire capital assets; and
- ((13)) the failure of the debtor to repay on the due date or to seek a postponement.

“The approach of this Court has been to consider all the factors and weigh the evidence favoring characterization of the advance as debt or equity, while realizing that the various factors are not of equal significance and that no one factor is controlling.” – U.S. Court of Appeals, Fifth Circuit (Mixon opinion, 464 F.2d at 402.)



SUMMARY OF KEY POINTS

- **A Summary of Preston Manor:**

- A UDF I borrower defaulted; UDF I foreclosed; the land was assigned to a UDF I subsidiary (UDF PM);
- UDF III caused public shareholder capital to be lent to the UDF I subsidiary (UDF PM);
- UDF I financed foreclosed real estate with 15% interest “debt” from UDF III; lot sales for the following SIX years were de minimis;
- The SEC questioned UDF III regarding the UDF PM loan;
- The UDF III loan balance to UDF PM began to reduce, despite seemingly non-existent cash flow from the asset; a second, larger loan from UDF III related to Preston Manor was also outstanding but UDF III did not connect the dots in its disclosure.
- UDF IV caused public shareholder capital to be lent to the same UDF I subsidiary to finance a public amenity center at Preston Manor with 13% interest “debt” from UDF IV; in the subsequent three and a half years after issuing the loan, lot sales were de minimis;
- The initial UDF IV loan of \$4.8 million increased to \$5.8 million as of September 30, 2015;
- In July 2016, UDF sold the land underlying UDF III’s loan for approx. \$7 million, implying significant impairment.

- Carrying assets at values in excess of market value not only presents potential disclosure issues, it also leads to questions regarding the various fees which UDF charges shareholders related to “mortgage” servicing, operating expense reimbursements and other management-related fees. How and why are fees charged on foreclosed real estate, which largely sat idle for nearly a decade?
- There is a reasonable basis to question whether the intent to create creditor-debtor relationships comport with economic reality given (i) the initial nature of the foreclosure; (ii) the high interest rate on the debt given the situation; (iii) the apparent lack of lot sales by the “debtor” to theoretically service principal and interest and (iv) the multiple extensions of loans upon maturity.
- Given all of these factors, there is also a reasonable basis to question (i) the original intent of the parties; (ii) the expectations regarding the source of purported debt service payments and the ability to pay; (iii) how the “borrower” was initially capitalized (thinly or adequately) and (iv) to what extent future payments were dependent on the future earnings of the business.
- Furthermore, the lenders and borrower are all managed by the same principal group of related individuals; despite the fact that the shareholders of each party are unique and separate, management of the lender controls the management of the borrower and despite what any third party report may say about the “reasonableness” of a “loan” on a loan-by-loan basis (at issuance), a reasonable auditor would likely have to consider all the facts relative to broad red flags and loan-specific red flags when evaluating intent and determining whether loans (in substance, rather than form) are appropriately characterized as debt rather than equity.

