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## **PRIVATE OFFERING CIRCULAR**

Maximum Offering: \$1,500,000,000  
1,500,000 Membership Interests (“Shares”)  
\$1,000 per Share  
Minimum Investment per Subscriber: \$250,000 (250 Shares)

**The date of this Offering Circular is January 1, 2022**

LONE OAK FUND, LLC (the “**Fund**”), is a California limited liability company whose sole manager is Lone Oak Industries Inc., a California corporation (the “**Manager**”). The Fund has been in operation since 2003, and its sole business is to originate loans secured by first deeds of trust on commercial, industrial, multi-family residential, one-to-four-unit non-owner occupied residential and special-use properties in California (“**Mortgage Loans**”). All Mortgage Loans are arranged by the Manager, which is a real estate broker licensed by the Department of Real Estate of the State of California. The Fund is licensed as a California Finance Lender by the Department of Financial Protection and Innovation of the State of California. Loans are serviced by the Manager. On July 1, 2018, the Fund elected to qualify as a real estate investment trust (a “**REIT**”) under the Internal Revenue Code (the “**Code**”)

The Fund currently has total capital of \$1,243,200,000, of which \$118,375,000 has been invested by the Manager’s principals. The Fund is seeking to raise up to an additional \$256,800,000 in this offering (the “**Offering**”) of Shares, for a subscription price of \$1,000 per Share, pursuant to the terms and conditions described in this Private Offering Circular, as it may be amended from time to time by the Fund (the “**Offering Circular**”). The Fund has never actively solicited new investors, but the Fund has received and continues, from time to time, to receive unsolicited offers to purchase Shares of the Fund, typically from friends and family of existing investors in the Fund, as well as from wealth managers who designate a portion of their clients’ assets for investment in the Fund. The Fund intends to continue accepting new investors through these existing relationships until such time as the Board of Managers determines to cease accepting new capital in the Fund. All investors in the Fund must be “**accredited investors**” as further described in the Offering Circular under the heading “**TERMS OF THE OFFERING – Investor Qualifications**”. Investors will become non-managing members in the Fund (“**Members**”) having the rights and obligations set forth in the Fund’s Operating Agreement, a copy of which is attached as Exhibit A to this Offering Circular.

**THIS OFFERING INVOLVES SIGNIFICANT RISKS, DESCRIBED IN DETAIL HEREIN. (SEE “RISKS AND OTHER IMPORTANT FACTORS.”) PROSPECTIVE PURCHASERS OF SHARES SHOULD READ THIS OFFERING CIRCULAR IN ITS ENTIRETY.**

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**THE SALE OF THE SHARES COVERED BY THIS OFFERING CIRCULAR HAS NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “ACT”), NOR WITH THE SECURITIES REGULATORY AGENCY OF ANY STATE IN RELIANCE UPON THE EXEMPTIONS FROM**



**SUCH REGISTRATION REQUIREMENTS PROVIDED FOR UNDER THE ACT AND UNDER APPLICABLE STATE SECURITIES LAWS.**

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**THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY WITH RESPECT TO ANY INVESTOR EXCEPT THOSE PARTICULAR INVESTORS WHO SATISFY THE QUALIFICATION REQUIREMENTS DESCRIBED HEREIN. (SEE "INVESTOR QUALIFICATION STANDARDS.")**

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**THERE IS NO MARKET FOR THE SHARES AND NONE IS EXPECTED TO DEVELOP IN THE FUTURE. SUMS INVESTED IN THE FUND ARE ALSO SUBJECT TO SUBSTANTIAL RESTRICTIONS ON WITHDRAWAL OR REPURCHASE, AND THE SHARES OFFERED HEREBY SHOULD BE PURCHASED ONLY BY INVESTORS WHO HAVE NO NEED FOR LIQUIDITY IN THEIR INVESTMENT.**

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**THE SHARES ARE SUBJECT TO LIMITATIONS ON OWNERSHIP AND TRANSFER, INCLUDING AN OWNERSHIP LIMIT OF 9.8% OF THE OUTSTANDING SHARES, INTENDED TO ASSIST THE FUND TO QUALIFY AS A REIT. (SEE "TERMS OF THE OFFERING – RESTRICTIONS ON OWNERSHIP AND TRANSFER OF SHARES.")**

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**NO PERSON HAS BEEN AUTHORIZED IN CONNECTION WITH THIS OFFERING TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THIS OFFERING CIRCULAR, AND ANY SUCH INFORMATION OR REPRESENTATIONS SHOULD NOT BE RELIED UPON. NEITHER THE DELIVERY OF THIS OFFERING CIRCULAR NOR ANY SALES HEREUNDER SHALL UNDER ANY CIRCUMSTANCES CREATE AN IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE FUND SINCE THE DATE HEREOF.**

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**PROSPECTIVE PURCHASERS SHOULD NOT REGARD THE CONTENTS OF THIS OFFERING CIRCULAR OR ANY OTHER COMMUNICATION FROM THE FUND AS A SUBSTITUTE FOR CAREFUL AND INDEPENDENT TAX AND FINANCIAL PLANNING. EACH POTENTIAL INVESTOR IS ENCOURAGED TO CONSULT WITH THEIR OWN INDEPENDENT LEGAL COUNSEL, ACCOUNTANT AND OTHER PROFESSIONALS WITH RESPECT TO THE LEGAL AND TAX ASPECTS OF THIS INVESTMENT AND WITH**



**SPECIFIC REFERENCE TO THEIR OWN TAX SITUATION, PRIOR TO SUBSCRIBING TO PURCHASE SHARES.**

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**THE PURCHASE OF SHARES BY A QUALIFIED PENSION OR PROFIT-SHARING PLAN, INDIVIDUAL RETIREMENT ACCOUNTS (“IRA”), KEOGH PLAN OR OTHER QUALIFIED RETIREMENT PLAN INVOLVES SPECIAL TAX RISKS AND OTHER CONSIDERATIONS THAT SHOULD BE CAREFULLY CONSIDERED. (SEE “FEDERAL INCOME TAX CONSEQUENCES” AND “ERISA CONSIDERATIONS.”)**

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## TERMS OF THE OFFERING

The Fund is offering to accept new investments up to an additional 256,800 Shares for purchase by qualified investors upon the terms and conditions described in this Offering Circular. The minimum purchase is \$250,000 (250 Shares at \$1,000 per Share), provided that investors may purchase fewer than the stated minimum at the discretion of the Board of Managers. The maximum may be increased by the Manager at any time. This offering may also be terminated at the option of the Board of Managers at any time.

The Fund has never actively solicited new investors, but the Fund has received and continues, from time to time, to receive unsolicited offers to purchase Shares of the Fund, typically from friends and family of existing investors in the Fund, as well as from wealth managers who designate a portion of their clients' assets for investment in the Fund. The Fund intends to continue accepting new investors through these existing relationships until such time as the Board of Managers determines to cease accepting new capital in the Fund. The Manager has paid all expenses incident to the organization of the Fund, all prior offerings of Shares, and this Offering, at the Manager's own expense without reimbursement by the Fund. No commissions will be paid by the Fund to any third party in connection with this Offering.

As of the date of this Offering Circular, the Fund has issued 1,243,200 outstanding Shares, representing total capital investments of \$1,243,200,000 and there are 1,523 Members of the Fund. The Manager's two principals own approximately 9.52% of the outstanding Shares, which have been purchased by them in cash, at par value, for a total of \$118,375,000.

### Investor Qualifications

The Shares are being offered and sold without registration under the Securities Act of 1933, as amended (the "**Securities Act**") under an exemption provided by Section 4(2) of the Securities Act and Securities and Exchange Commission Regulation D ("**Regulation D**"), and other exemptions of similar import in the laws of the states or jurisdictions where the Offering is made. Each investor will be required to represent that it is an "**accredited investor**" as defined in Regulation D, and that such investor is acquiring the Shares for investment and not with a view to resale or distribution.

The Fund will not be registered as an investment company pursuant to the exemption provided by Section 3(c)(5) of the Investment Company Act of 1940, as amended (the "**Investment Company Act**").

Further information concerning investor qualifications and representations made by investors are contained in the Subscription Agreement attached as Exhibit B to this Offering Circular.

## **Subscription Agreements; Admission to the Fund**

By executing a Subscription Agreement, an investor unconditionally and irrevocably agrees to purchase the Shares in the amount shown thereon and makes a commitment to contribute capital in accordance with the terms set forth in the Subscription Agreement and the Operating Agreement. Subscription Agreements from prospective investors will be accepted or rejected by the Fund. The Fund reserves the right to reject any subscription submitted for any reason. If the Fund rejects the subscription of any subscriber, the Subscription Agreement and subscription funds will be returned promptly to the subscriber. If accepted, such investor's entire investment shall be held in escrow by the Fund and deposited into an interest-bearing Subscription Account pursuant to the terms of the investor's Subscription Agreement. Shares will be issued to such investor, and such investor shall become a Member without any further action, when such investor's funds are transferred from the Subscription Account into the Fund's account as described in the Operating Agreement. Such transfers occur only on the first day of any calendar month, or, if the first calendar day of a calendar month is not a business day, on the first business day of such calendar month, provided that Subscriber shall become a member of the Fund, and the purchased Shares shall be credited to Subscriber, as of the first calendar day of such calendar month.

## **Temporary Investment of Subscription Funds Pending Use in Lending Business**

Each subscriber's capital contributions to the Fund will be temporarily deposited and held by the Fund in escrow in an interest-bearing account of the Fund referred to as the "**Escrow Subscription Account**," until such time as the Fund first makes use of the investor's subscription amount. While the investor's subscription funds are on deposit in the Escrow Subscription Account, the investor shall not be a Member nor be entitled to distributions from the Fund with respect to amounts held in the Subscription Account. Rather, the investor shall receive any interest the funds may earn in said account pursuant to the terms of the Subscription Agreement. The investor's subscription amount will be transferred from the Subscription Account into the Fund's general operating account on a first in, first out basis, as capital is needed by the Fund. Commencing on the date of the transfer of the investor's capital from the Subscription Account to the operating account, the investor will be issued Shares and become a Member. Such transfers occur only on the first day of any calendar month, or, if the first calendar day of a calendar month is not a business day, on the first business day of such calendar month, provided that Subscriber shall become a member of the Fund, and the purchased Shares shall be credited to Subscriber, as of the first calendar day of such calendar month. Funds on deposit in the Subscription Account will not be transferred to the Fund's operating account until all other available cash in the Fund's operating account, except net income available for distribution to Members, has been expended, except at the discretion of the Board of Managers where, in its opinion, the interests of Members will not be significantly diluted.

## **Transferability of Shares**

Shares are freely transferrable, subject to certain limited exceptions. The Board of Managers may impose restrictions on the transfer of Shares, to the extent it determines such restrictions are appropriate, to:

- Ensure the Fund remains exempt from registration as an “investment company” under the Investment Company Act of 1940, as amended;
- Avoid Fund assets being deemed “plan assets” under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”);
- Ensure the Fund complies with applicable securities laws or any applicable exemption therefrom; and
- Avoid causing the Fund to fail to qualify as a REIT.

A transferee of Shares will be admitted as a Member upon his execution of an instrument signifying his agreement to be bound by the Operating Agreement.

### **Restrictions on Ownership and Transfer of Shares**

The Operating Agreement contains restrictions on the number of Shares that a person may own. Beginning January 30, 2019, no person may acquire or hold, directly or indirectly, in excess of 9.8% of the aggregate outstanding Shares (in value or number of Shares, whichever is more restrictive). The Operating Agreement also prohibits (a) any person from owning Shares that would result in the Fund being “closely held” under Section 856(h) of the Code or otherwise cause the Fund to fail to qualify as a REIT and (b) any person from transferring Shares if the transfer would result in Shares being owned by fewer than 100 persons.

Any person who acquires or intends to acquire Shares that may violate any of these restrictions, or who is the intended transferee of Shares which are transferred to the Trust, as explained below, must give the Fund immediate notice in writing and provide the Fund with such information as it may request in order to determine the effect of the transfer on its status as a REIT.

The Board of Managers, in its sole discretion, may exempt a person from these limits. Before granting any exemption, the Board of Managers may require a ruling from the Internal Revenue Service or an opinion of counsel in order to determine or ensure the Fund’s status as a REIT.

Any attempted transfer of Shares that, if effective, would result in Shares being owned by fewer than 100 persons will be void. Any attempted transfer of Shares which, if effective, would result in violation of the 9.8% ownership limit discussed above or in the Fund being “closely held” under Section 856(h) of the Code or otherwise failing to qualify as a REIT will cause the number of Shares causing the violation (rounded up to the nearest whole Share) to be automatically transferred to a trust (the “Trust”) for the exclusive benefit of one or more charitable beneficiaries, effective as of the close of business on the business day before the date of the prohibited transfer. The proposed transferee will not acquire any rights in, benefit economically from the ownership of, any Shares held in the Trust, will have no rights to distributions and no rights to vote or other rights attributable to any Shares held in the Trust. Any distribution paid before the Fund discovers that Shares have been transferred to the Trust must be paid by

the recipient to the Trustee upon demand. The Trustee may (i) rescind as void any vote cast by the proposed transferee before the Fund discovered that the Shares have been transferred to the Trust and (ii) to recast the vote in accordance with the desires of the Trustee acting for the benefit of the Charitable Beneficiary.

Within 20 days of receiving notice from the Fund that Shares have been transferred to the Trust, the Trustee must sell the Shares and pay to the proposed transferee the lesser of (i) the price paid by the proposed transferee for the Shares or, if the event causing the Shares to be held in the Trust did not involve a purchase of such Shares at market price, the market price of the Shares on the day of the event causing the Shares to be held in the Trust and (ii) the price received by the Trustee from the sale or other disposition of the Shares. If, before the Fund discovers that Shares have been transferred to the Trust, the Shares are sold by the proposed transferee, then (i) the Shares will be deemed to have been sold on behalf of the Trust and (ii) to the extent that the proposed transferee received an amount for the Shares that exceeds the amount he was entitled to receive, the excess must be paid to the Trustee upon demand. Until the Trustee has sold the Shares held in the Trust as described above, the Fund, or its designee, may purchase the Shares at a price per share equal to the lesser of (i) the price per Share in the transaction that resulted in the transfer to the Trust (or, if the event causing the Shares to be held in Trust did not involve a purchase of such Shares at market price, the market price of the Shares on the day of the event causing the Shares to be held in the Trust) and (ii) the market price on the date the Fund, or its designee, accept the offer.

Members may not require the Fund to redeem their Shares or request that the Fund repurchase their Shares if, at the time of such redemption or repurchase request, the redemption or repurchase would cause any person to violate the restrictions on ownership and transfer discussed above.

## **THE FUND**

Lone Oak Fund, LLC is a limited liability company formed under the laws of the State of California. The Fund has been engaged in business since 2003. The Fund is managed by a Board of Managers, comprised of a single member, the Manager. The Manager is Lone Oak Industries Inc., a California corporation. The Board of Managers has exclusive control over the business of the Fund. Upon admission to the Fund, each investor shall become a Member. With certain exceptions, Members shall take no part in the conduct or control of the Fund's business. (See "**SUMMARY OF THE OPERATING AGREEMENT.**")

The rights and obligations of the Board of Managers and the Members in the Fund are governed by the Operating Agreement of Lone Oak Fund, LLC (the "**Operating Agreement**"), a copy of which is attached as Exhibit A to this Offering Circular, which must be read in conjunction with this Offering Circular. By execution of a Subscription Agreement, each Member agrees to be bound by the terms of the Operating Agreement. Upon acceptance of a Member by the Fund, the Fund will deliver to the Member a copy of the Operating Agreement reflecting the investment of the Member, and the Member's initial percentage interest in the Fund.

## **BUSINESS STRATEGY OF THE FUND**

### **Market Positioning**

The Fund is known as a direct mortgage lender providing short-term bridge financing for owners of real property. As a bridge lender, the Fund provides interim financing to borrowers until they qualify for and obtain permanent financing from an institutional lender or sell a property to a third party. The need for short-term financing is ubiquitous in the mortgage market, across loan sizes, borrower profiles, property types, geographies, and throughout different market cycles. Yet, the underwriting length of time required by traditional mortgage lenders such as commercial banks, thrifts and life insurance companies result in some potential borrowers being unable to obtain such financing in a timely manner. The Manager is experienced and equipped to underwrite and originate Mortgage Loans more quickly than traditional mortgage lenders.

The Fund originates short-term loans with maturities typically ranging from six to twenty-four months, secured by improved commercial, industrial, multi-family residential, non-owner occupied one to four unit residential and special-use properties in California. The Fund will not originate construction loans, loans on un-entitled vacant land or loans secured by property outside of California. The Fund's loans will be first position senior loans with current targeted loan to value ratios of 50.00% to 60.00% depending upon the location and the type of real property. Lone Oak's rates will be generally higher than institutional lenders and lower than most private lenders. The Fund currently charges annual interest rates of 5.90% to 7.90%, but interest rates may change from time to time depending on changes in market conditions. Repayment of the Fund's loans generally depends on the borrowers' ability to obtain permanent financing from institutional or other asset-based lenders or to sell their properties to third parties.

The Fund currently targets loan originations with principal amounts ranging from \$1,000,000 to \$25,000,000, but in no event, will a loan exceed 5.00% of the Fund's capitalization.

### **Lending Philosophy and Strategy**

The Fund's lending business is asset-driven, as opposed to the credit-driven approach commonly used by banking institutions. Although the Fund conducts reasonable credit and background checks on the borrower, the Fund mainly focuses on each loan's underlying collateral, and the borrower's serious cash and/or time investment in the property. The Fund attempts to limit its exposure to loan defaults by requiring a "**co-investment**" from the borrower of approximately 40 to 50 percent, consisting of the borrower's own capital invested in the property or junior financing. Significant appreciation of the property over the period of time that the borrower has owned the property is treated as equity. The Fund currently limits the amount of its loans to 50.00% to 60.00% of the LTV of the real property securing the Fund's Mortgage Loans, depending upon the type of property. The Fund's portfolio LTVs are lower than the industry average of senior bank loans. The Fund also follows the other lending standards established by

the Board of Managers as described in detail under the heading “**LENDING STANDARDS AND POLICIES.**”

The Fund seeks to hold a diversified loan portfolio by limiting the maximum loan to 5.00% of the Fund’s capitalization; however, the Fund generally originates loans from \$1 million to \$15 million. The Fund seeks to diversify across property types and limit its maximum exposure on each property type, depending on market conditions.

The Fund attempts to reduce the interest rate risk and the market cycle risk of potential declines in property values by making short-term loans with average maturities ranging from twelve to twenty-four months. The Fund also seeks to reduce risk by NOT utilizing leverage.

Notwithstanding the loan policies that the Fund follows to reduce the risks of its lending business, there can be no assurance that the Fund will not experience loan losses, particularly because the Fund relies more on the value of the real property in making its lending decisions than upon the ability of a borrower to repay the loan without refinancing or selling the property.

### **Property Evaluation**

Although the Manager may obtain a third party limited scope appraisal or broker price opinion (“**BPO**”) to provide some third-party analysis in the Fund’s property evaluation process, the Fund primarily relies upon internal evaluations and upon the many years of experience of the Manager’s principals in evaluating real property. Real estate is a highly localized business. The value and marketing time of a property can be grossly impacted by intangibles in the submarket that are often overlooked by a third-party appraisal. The Manager conducts an internal evaluation of the real property securing each of the Fund’s loans before the loan is made, based on the current income from the property, sales and leasing comparables, the prevailing capitalization rate in the immediate market, the general local market condition, and other tangible and intangible parameters. Inspections of all commercial and multifamily residential properties are required before Mortgage Loans are originated. The Manager makes the final decision of the value of each property based on the Manager’s evaluation of all of the data reviewed by the Manager.

### **Borrower Profile**

The Fund’s typical borrower is a real estate investor who is acquiring property to hold, rehabilitate or sell for a profit, or an owner-user of commercial property. Frequently, the timing of the transaction is so critical that the borrower cannot rely on an institutional lender, with its time-consuming application process, to fund in a timely manner. Other potential borrowers are expected to be those who have cash for a significant down payment or whose existing property has a large amount of equity, but for a variety of reasons, do not reflect profits on their tax returns. These typical borrowers are long on real estate assets but short on cash.

## **MARKET PRESENCE**

Since 2003, the Fund has established a market niche in the private commercial mortgage financing arena in California. The Lone Oak brand is now equated with value, expertise, speed, and integrity. The Fund's loan interest rates of 4.90% to 7.90% are currently positioned below many private lenders' interest rates, which are typically higher. This has been a conscious and effective branding strategy of the Fund and will be continued by the Fund. Combined with the Manager's operational efficiency, and the reputation of the Fund as an ethical and responsible lender, the Fund has developed a market presence with mortgage brokers and real estate professionals in California. As a result, the Fund is actively sought out by borrowers, mortgage brokers and other real estate professionals.

The market presence of the Fund is reinforced by its market specialization and expertise. The Fund specializes only in bridge financing and only in California. Because of this specialization, it is able to develop market-specific knowledge, to closely follow market trends, and achieve operational efficiency. As real estate is a highly localized business, the Fund focuses on the primary markets in California. The Fund has utilized the Manager's principals' sixty-plus years of combined experience in real estate investment, development and finance in California.

## **LACK OF LEVERAGE**

The Fund is not, and will not be, leveraged. All Members of the Fund have and will have a 100% equity position in their pro rata share of the Fund's assets. In the event that the Fund does foreclose on a property, because the Fund's deeds of trust always have first priority, the Fund will acquire the property free and clear of any other loans.

## **OPERATING HISTORY OF THE FUND**

The Fund is in its nineteenth year of operating history. Since inception, the Fund has made 6,769 loans totaling \$7,660,713,500. The Fund's loan portfolio as of December 31, 2021, contained 270 loans totaling \$1,093,804,000.

The Fund's weighted average LTV ratio since inception has been 51.98% and was 51.45% for the period ending December 31, 2021. The current average loan term is 11 months. The Fund's average loan amount from inception has been \$1,131,735 and was \$4,051,126 as of December 31, 2021. The current average loan amount in the Fund's loan portfolio as of December 31, 2021, represents approximately 0.37% of the Fund's total loan portfolio as of that date.

From 2003 to December 31, 2021, there were twenty-four (24) foreclosure sales on defaulted loans. The properties were either sold to third-party buyers at the trustee's sale or reverted to the Fund as real estate owned ("REO"). The Fund sold all of the REO's. The total amount of the twenty-four (24) sales of the foreclosed properties was \$60,983,500. The total of the original loan amounts of those properties was \$49,292,500. After taking into account costs of sale and maintenance of the properties, the

Fund netted a profit of \$6,664,500. There were no losses on any individual property. If there were a loss, however, the amount of the loss would be recouped through a reduction in the monthly interest distribution or from interest reserves, thereby enabling the Members' capital accounts to remain at par.

The Fund sustained a loss on one loan made in 2015 due to a defect in Borrower's title to the property securing the loan. The Fund then commenced litigation against the title company that insured the Fund's security interest in the property. In 2016 the Fund settled the lawsuit following mediation for approximately 80% of the original loan amount rather than proceeding with a costly trial. The Fund's Members suffered no loss of invested capital in this matter because their capital accounts were credited with the net loss amount from undistributed interest income held in reserve by the Fund pursuant to the Operating Agreement.

From time to time the Fund records notices of default against the properties of delinquent borrowers in order to enforce the terms of the loan. In almost all cases the defaults are cured. It is anticipated, however, that in the future the Fund may foreclose on some of these delinquent loans.

The Manager has occasionally advanced accrued interest on non-performing loans and may continue to do so from time to time as circumstances warrant, but the Manager has no obligation to make such advances.

In the past, the Manager and Related Investors have purchased Mortgage Loans, but the Manager has determined that it will not, as a general rule, purchase problem Mortgage Loans from the Fund in the future. There is no guaranty that buyers will be found for future problem loans. As of the date of this Offering Circular, twenty-eight loans have been sold to avoid interruption of debt service. Nine of the loans were sold to junior lien holders, thirteen loans were sold to third parties, and six loans were sold to Related Investors.

The Fund returned distributions of net profits (not including distributions of capital) to its Members during its first 19 years of operations equal to net annualized yields of 8.60% in 2003, 8.75% in 2004, 8.85% in 2005, 9.56% in 2006, 9.73% in 2007, 9.56% in 2008, 8.65% in 2009, 8.16% in 2010, 8.03% in 2011, 7.64% in 2012, 7.81% in 2013, 7.62% in 2014, 7.45% in 2015, 7.34% in 2016, 7.35% in 2017, 7.12% in 2018, 6.70% in 2019, 6.16% in 2020 and 5.83% as of December 31, 2021. There is no assurance that in the future the Fund will not experience a declining or uneven return as a result of potential higher delinquency and default rates or other factors.

## **LENDING STANDARDS AND POLICIES**

### **General Standards for Mortgage Loans**

The Fund will engage in the business of making or purchasing Mortgage Loans, which may be whole loans or fractionalized interests in loans (but only loans managed by the Manager or its Affiliates), secured by first deeds of trust on improved commercial, industrial, multi-family residential,

one to four unit residential, and special use properties located in California. The Fund does not make loans on owner occupied homes. The Fund's Mortgage Loans will not be insured or guaranteed by any governmental agency or private mortgage insurance company. Mortgage Loans will be selected for investment by the Fund pursuant to the lending standards set forth below regarding the quality of the real property security given for the loans and the terms and provisions of the loans. All Mortgage Loans made by the Fund will be negotiated and arranged by the Manager, a real estate broker licensed by the State of California, or an Affiliate of the Manager that holds a real estate broker license

1. **Priority of Deeds of Trust.** All Fund loans will be secured only by first deeds of trust. A first deed of trust is by its very nature the senior monetary lien against the real property identified in the deed of trust. At the time of loan origination, the liens created by the Fund's deeds of trust will generally be subject to certain exceptions to title, such as property taxes not yet due, water rights, covenants, conditions, restrictions, rights of way, easements, and reservations of record, but only such exceptions deemed acceptable to the Manager.

2. **Geographic Area of Lending Activity.** The Fund may originate loans secured only by properties located in California. The vast majority of the loans will be secured by properties primarily located in the coastal counties from San Diego to San Francisco.

3. **Loan-to-Value Ratios.** The amount that the Fund will loan on any given property is determined by an evaluation of a number of factors, including, but not limited to, the type of property, general or special use, owner or tenant occupied, location, and purpose of the loan (acquisition or refinance). When the amount of the loan is fixed, it is expressed as a percentage of the value of the property known as the "**loan-to-value ratio**" or "**LTV.**" The Manager has currently targeted the LTV ratios set forth in the table below in the column labeled "**Current Targeted LTV Ratios**" for the categories of Mortgage Loans that will be made by the Fund. These targeted LTV ratios take into account the reduction in values of real property over the past few years. The Manager may, if conditions improve, or if, in the judgment of the Manager, the loan is supported by the desirability and quality of the property and the credit worthiness of the borrower, accept higher LTV ratios than those currently targeted. However, in general the Fund will not accept Mortgage Loans at LTV ratios exceeding the amounts set forth below in the column labeled "**Maximum LTV Ratios.**"

<u>Type of Property/Loan</u>	<u>Current Targeted LTV Ratios</u>	<u>Maximum LTV Ratios</u>
One to Four Unit Non-Owner-Occupied Residential Property.	60%	60%
Multi-Family Residential Property (Apartments).	60%	60%
Commercial Property (including but not limited to office buildings, industrial and warehouse facilities, retail stores, shopping centers, mobile home parks).	50%	60%
Specialized Commercial Property (including but not limited to hotels/motels, schools, churches and synagogues, retirement and care facilities; property must be capable of an alternative or general use).	50%	50%
Vacant Land – Properly zoned lot or parcel which has installed offsite improvements including drainage, curbs, gutters, paved roads and utilities mandated by the political subdivision having jurisdiction over the lot or parcel.	50%	60% (depending on location)

The foregoing LTV ratios will not apply to purchase-money financing offered by the Fund to sell any real estate owned through foreclosure (“**REO**”). In such cases, the Manager may accept any reasonable financing terms that it deems to be in the best interests of the Fund, in its sole discretion, subject to the supervision and direction of the Board of Managers.

4. Appraisals. Although the Manager may obtain a third party limited scope appraisal or broker price opinion (“**BPO**”) to provide independent analysis in the Manager’s property evaluation process, the Fund will primarily rely upon internal evaluations and upon the many years of experience of the Manager’s principals in real property evaluation. Real estate is a highly localized business. The value and marketing time of a property can be grossly impacted by intangibles that are often overlooked by a third-party appraisal. The Manager will conduct an internal evaluation based on the current income from the property, sales and leasing comparables, the prevailing capitalization rate in the immediate market, the general local market conditions, and other tangible and intangible parameters. The Manager also performs an inspection of all commercial and multifamily residential properties, and single-family residences as required, before Mortgage Loans are originated. The Manager will make the final decision of the value of each property based on the Manager’s evaluation of all of the data reviewed by the Manager.

5. Terms of Loans and Interest Rates. Being primarily a short term, bridge lender, the Fund's Mortgage Loans will generally have a term of between 6 to 24 months. The Fund may, from time to time, make a Mortgage Loan with a longer term. The Fund may occasionally make a Mortgage Loan that has a shorter maturity if the Manager believes in its sole discretion, subject to the supervision and direction of the Board of Managers, that such loan represents a sound investment opportunity. The term of the Mortgage Loan offered will depend on the amount of the loan, the loan-to-value ratio, the purpose of the loan, the type and condition of the property, location and the borrower's credit and experience. The current initial interest rates offered by the Fund are from 5.90% to 7.90%. The interest rate following an extension may be based upon the greater of the initial rate or 500 to 700 basis points over Wall Street Journal Prime Rate, depending on the interest rate risk at the time and the supply and demand in the real estate financing market. The Manager in its sole discretion, subject to the supervision and direction of the Board of Managers, shall determine interest rates based on its evaluation of market conditions. All Mortgage Loans will require payments of interest only during the loan term, and the borrower will have to make a substantial "**balloon payment**" at the end of the term. Many borrowers do not have funds sufficient to make this balloon payment and, consequently, must refinance or sell the underlying property. (See "**RISKS AND OTHER IMPORTANT FACTORS – Loan Defaults and Foreclosures.**")

6. Extensions to Term of Loan. There is no standing provision in the Company's loan documents to extend the term of the Mortgage Loan beyond its maturity. Requests by borrowers for extensions will be evaluated by the Manager on a case-by-case basis, but extensions will only be granted if a Mortgage Loan is current in all interest payments, property taxes, insurance, and other amounts owed on the Mortgage Loan at the time of extension, and only in the amount up to the LTV ratios then accepted on new Mortgage Loans. The Manager may charge a fee to the borrower for negotiating and arranging an extension of the loan ranging from 0.25% to 2.00% of the then-outstanding principal balance. (See "**Compensation to Manager**"). In addition, the Manager may increase the interest rate on the loan during any extension period.

7. Escrow Conditions. Mortgage Loans will be funded through an escrow account handled by either a qualified title insurance or escrow company. The escrow agent will be instructed not to disburse any of the Fund's proceeds out of the escrow for purposes of funding the Mortgage Loan until:

(a) Satisfactory title insurance coverage has been obtained naming the Fund as the insured and providing title insurance in an amount equal to or greater than the principal amount of the loan. Title insurance insures only the validity and priority of the Fund's deed of trust, and does not insure the Fund against loss by reason of other causes, such as diminution in the value of the property, over-appraisals, borrower's defaults, etc.

(b) Satisfactory fire and casualty insurance has been obtained naming the Fund as loss payee in an amount equal to the replacement value of the building on the property. Fire insurance will not be required where a loan is secured by unimproved land. Any requirement for earthquake insurance will be made on a case-by-case basis. (See "**Risk Factors – Uninsured Losses.**")

(c) The borrower has on deposit in escrow all funds required of the borrower, inclusive of sums to pay all costs, including title, escrow, fire and casualty insurance, recording, tax service, appraisal, delivery, commissions and any other fee or charge. The Fund will not incur costs in connection with the initial origination of any Mortgage Loan that are not reimbursed by the borrower upon initial loan funding.

8. Construction Loans. The Fund will not make loans to fund ground-up, new construction. Loans may be made on property with a construction component, such as remodeling, rehabilitation or completion of new construction. In such cases the property will be evaluated on an “as-is” basis in determining the loan-to-value, and the finished product value will not be considered.

9. No Leasehold Loans. The Fund will not make loans secured by leasehold interests.

10. Recourse. Mortgage Loans will be full recourse to the borrower except under rare circumstances at the discretion of the Manager. A loan may also be secured by additional real property owned by the borrower or its affiliates, at the discretion of the Manager.

11. Prepayment Penalties. Prepayment penalties, that is, payments due from borrowers as a penalty for repaying their Mortgage Loans prior to their maturities, will not be charged or collected.

12. Due on Sale. The Fund’s loan documents will contain provisions accelerating the maturity of a Mortgage Loan, and thereby requiring a borrower to repay the loan, in the event of the sale or transfer of a significant interest in the mortgaged property, without the prior written consent of the Manager.

13. Junior Financing. The Fund’s loan documents contain provisions restricting the borrower from placing a junior lien (a second trust deed) on the property without the prior written consent of the Manager. However, as part of the Fund’s business strategy in maximizing the security of its investments, the Manager, at its discretion, may, from time-to-time, permit junior loans by third party lenders, sellers carrying back financing, and Related Investors.

14. Late Charges. The terms of the Fund’s note secured by the deed of trust set the first day of the month as the due date for payments. The borrower, however, is granted a ten-day grace period before the imposition of a late charge. The Manager, in its discretion, may not enforce the late charge provision if the borrower’s payment history is satisfactory. Late charges will be imposed on late borrowers and will be payable to the Manager.

15. Absence of Mortgage Insurance. The Manager does not intend to arrange for mortgage insurance, which would afford some protection against loss if the Fund foreclosed on a loan and there was insufficient equity in the property to repay all sums owed.

16. Fund as Payee. All loan documents (notes, deeds of trust, etc.) and insurance policies will name the Fund as payee and beneficiary. Loans will not be written in the name of the

Manager or any other nominee, although loans that the Fund purchases (as described below) will originally be written in the name of the original lender or investor. Such loans will be assigned to the Fund when they are purchased, and the assignments will be recorded and receive title insurance coverage.

17. No Loans to Manager or Members. No loans shall be made by the Fund to the Manager, to any of its Affiliates or to Members.

18. Loan Participations. The Fund may originate fractional interests in Mortgage Loans with Related Investors, so long as the Mortgage Loans otherwise meets the Fund's lending criteria, including the criteria for purchase of Mortgage Loans from third parties, as described below, and the Manager or one of its Affiliates is the servicer of such Mortgage Loans. With respect to new Mortgage Loans, the Fund may fund such loans by itself or it may participate in the funding of such loans with a Related Investor. Subject to the Fund's loan limits, Related Investors shall hold fractional interests equal to the relative amounts that they have funded. To date, the Fund has not made such loans.

19. Purchase of Loans from Third Parties. Preexisting Mortgage Loans that meet the Fund's lending criteria may be purchased from third parties, provided that any such loan is not in default as of the date of purchase by the Fund and has not been in default at any time during its term. The purchase price paid by the Fund for any such purchased Mortgage Loan shall be not more than the then-outstanding principal balance of the loan, together with any accrued but unpaid interest (the "**Loan Balance**"). However, the Fund shall not purchase pre-existing Mortgage Loans from the Manager, any of its Affiliates or Related Investors. Upon any purchase of a Mortgage Loan by the Fund, the seller of the loan shall execute appropriate assignments of all of the seller's rights in the loan, and the Fund's interest in the loan and deed of trust shall be recorded and insured by a title insurer. To date, the Fund has never purchased an existing loan from a third party.

20. Reserve Fund. The Fund may retain a contingency reserve fund for the purpose of covering unexpected cash needs of the Fund. The amount of this reserve fund is established by the Manager, and is typically held in cash, bank accounts, certificates of deposit, money market accounts, short-term bankers' acceptances, treasury bonds or other liquid assets. The yield from investments of reserve funds may not be as high as the yield that would result if such reserve funds were invested in loans. The principal purpose of the reserve fund is for unexpected cash flow needs, such as REO expenses or loss of principal.

## **Loan Repayment**

All of the Fund's Mortgage Loans require monthly payments of interest only; there is no amortization of the principal balance during the term of the loan. Therefore, at maturity a substantial balloon payment (usually the full original principal balance of the loan) will be due from the borrower. Generally, the borrower will have to sell or refinance the property in order to make the balloon payment. There is a risk that the borrower may not be able to sell or refinance the property to pay off the Mortgage Loan upon maturity. See "**RISKS AND OTHER IMPORTANT FACTORS.**"

## Credit Evaluations

The Manager considers the income level and general creditworthiness of a borrower to determine a borrower's ability to repay a Mortgage Loan according to its terms, but such considerations are subordinate to a determination that the appraised value of the property is sufficient to satisfy the LTV ratios described above. In addition, the Manager examines the actual capital investment of the borrower in the property, and the length of time that the borrower has held the property, to establish that the borrower has **"skin in the game,"** which the borrower would stand to lose if the borrower fails to repay the loan. The principal source of repayment of any Mortgage Loan will generally be from the sale or refinancing of the property, not from the borrower's own resources or from a guarantor, if any.

If a borrower is unable to repay its loan at maturity (e.g., if the sale or refinance of the property does not generate sufficient proceeds to repay the loan, or if the borrower defaults under the loan, the Fund forecloses on and subsequently sells the property and the sales proceeds are inadequate to repay the loan and costs of foreclosure), the Fund may be precluded from seeking a deficiency judgment from the borrower under applicable California laws. If the loan is guaranteed, the guarantor may be able to raise legal defenses that may be available to guarantors generally that would impair the Fund's ability to seek a deficiency from the guarantor. (See **"RISKS AND OTHER IMPORTANT FACTORS – Loan Defaults and Foreclosures"** - **"Risks of Underwriting Standards and Procedures"** and **"Certain Legal Aspects of Loans Secured by Real Estate."**)

## Environmental Issues

The Manager makes reasonable investigations into whether the properties that secure Mortgage Loans contain toxic or hazardous substances. Depending on the type of property securing a Mortgage Loan and its location, the Manager may require a preliminary environmental investigation report (Phase I) as a condition to making the loan. In addition, the Manager may require an environmental indemnity from the borrower and/or its principals. However, if the Fund acquires ownership of a property as a result of a foreclosure, the Fund may, in limited circumstances, become liable for any environmental contamination that exists on the property, even if the Fund was not responsible for the contamination. (See **"RISKS AND OTHER IMPORTANT FACTORS – Environmental Liabilities."**)

## REO Held by the Fund

The Fund establishes special purpose entities for the purposes of acquiring, holding, managing and selling REO acquired upon foreclosure of loans made by the Fund. By establishing separate entities to acquire, hold and sell REO, the Fund seeks to limit the liability exposure of the Fund from ownership of REO pending sale to third parties. Lone Oak Fund, LLC will be the sole Member. This means that whatever percentage interest each Member has in the Fund, that Member will have the same pro rata interest in the property LLC. If a Member's investment increases or decreases in the Fund, then that Member will have a corresponding percentage interest change in the property LLC.

Lone Oak Industries, Inc., the Manager of Lone Oak Fund, will also act as the manager of the property LLCs but will not have any ownership or profit participation in them. The principals of Lone Oak Industries, Inc. will not receive any promotional consideration typical of real estate syndications. Their ownership interest will be based upon their investment in the Fund.

### **Sale of Loans**

The Fund invests in Mortgage Loans for investment and does not engage in real estate operations in the ordinary course of business (except as may be required if the Fund forecloses on a property securing a Mortgage Loan and takes over ownership and management of the REO). The Fund does not presently intend to invest in Mortgage Loans primarily for the purpose of reselling such loans in the ordinary course of business, however, the Fund may occasionally sell Mortgage Loans (or fractional interests therein) when the Manager determines that it appears to be advantageous for the Fund to do so, based upon then current interest rates, the length of time that the loan has been held by the Fund, the current condition of the borrower's credit, and the overall investment objectives of the Fund.

### **Loan Servicing**

The Manager "services" all Fund loans (i.e., the Manager manages the collection of loan payments, loan enforcement and other loan administrative services). The Manager is compensated for such loan servicing activities in accordance with the terms of the Operating Agreement, and the Manager pays the costs associated with servicing all Mortgage Loans owned by the Fund, except for certain expenses related to foreclosure and REOs. (See "**COMPENSATION TO MANAGER.**")

Borrowers make loan payments in arrears with respect to the preceding 30-day period. Payments are collected by electronic funds transfer (EFT) and deposited directly in the Fund's account, maintained at a financial institution selected by the Manager. Payment by EFT is a condition of all loans.

If a Mortgage Loan goes into default, the range of responses that the Manager may take with respect to the default will vary depending on the nature of the default and the circumstances existing at the time of the default. These responses can include, without limitation, granting additional cure periods to the borrower, selling the loan, appointing a receiver to collect rents and manage the property, foreclosing non-judicially under the deed of trust or taking such other loan enforcement actions as are typically undertaken by commercial lenders, negotiating and accepting a deed in lieu of foreclosure, and/or commencing legal action against the borrowers or against any guarantors of the loan if the Manager determines that such actions are prudent under the circumstances. The Manager also may modify the economic terms of the loan (e.g., altering the rate of interest, extending the maturity date or altering the payment obligations) if it believes such actions are advisable under the circumstances. There is no assurance that the Fund will not incur loan losses in the event one or more of the Fund's loans go into default and the Fund exercises one or more of its remedies.

Any REO acquired by the Fund through foreclosure will usually be held in one or more special purpose wholly owned subsidiaries of the Fund. By holding REO in separate entities, the Fund will seek to minimize potential risks to the Fund that may arise from the ownership and management of REO pending sale of the REO.

### **OPERATIONAL TECHNOLOGY**

The Manager and its affiliates have invested in technology to improve the Fund's operational efficiency, including software that tracks loan information, investors' information and provides web-based access to Members.

The loan software contains all parameters of the loan and borrower information. It also automatically generates mortgage statements for monthly invoicing. The loan software is capable of creating reports to facilitate portfolio construction and management.

The investor software calculates distributions to Members, creates reports on contributions, distributions, repurchases and redemptions. It also produces statements and sends electronic fund transfer authorizations to disburse funds on a monthly basis.

Members will have access to various reports, statements, notices and tax information regarding the Fund and its loan portfolio via a web-based platform.

### **THE MANAGER AND ITS AFFILIATES**

The Board of Managers will manage and direct the affairs of the Fund and all Mortgage Loans will be underwritten, arranged, and serviced by the Manager.

#### **Manager**

Lone Oak Industries, Inc., a California corporation and licensed real estate broker, serves as the Manager of the Fund. The Directors and shareholders of the Manager are James A. Rothstein and Gerald A. Ducot.

#### **Managing Directors of the Manager**

**Gerald A. Ducot** is a co-founder of Lone Oak Fund, LLC and the Secretary of Lone Oak Industries Inc., the Manager of the Fund. He is also a founder and owner of Lazar-Ducot Associates, Inc., a real estate development firm established in 1981. With over 50 years of experience in all phases of real estate, Mr. Ducot's real estate career began in 1966 at Helmsley-Spear, a large national real estate firm. During the seven years that Mr. Ducot was at Helmsley-Spear, his responsibilities included managing and leasing numerous downtown Los Angeles office buildings and managing and converting high rise apartment buildings into condominiums. His most notable achievement was the successful conversion of a

1906, nine story, Los Angeles office building at 6th and Hill Street into the California Jewelry Mart in the late sixties and early seventies. With the formation of Lazar-Ducot in 1981, Mr. Ducot developed or acquired numerous income properties, including apartments and a mobile home park, industrial, commercial office buildings, medical office buildings and retail centers primarily in Los Angeles and Orange Counties. Many of these properties are still owned or co-owned by him. From 1995 through 2002, Mr. Ducot was involved in building single family homes in Los Angeles.

In addition to the above, Mr. Ducot built, owned and operated a small chain of early childhood education schools commencing in 1969. The majority of the schools were sold to Gerber Products in the 1970s. One school built in 1971 is still owned. From 1975 through 1981, Mr. Ducot was the President of three Section 502 Local Development Companies, which were part of a Small Business Administration program that provided real estate and equipment financing to small business. From 1978 through 1981, Mr. Ducot co-owned a small chain of restaurants. From 1999 through 2001, he provided seed capital to start up high tech companies. In 1998, Mr. Ducot founded and co-owned a national home furnishings company. He sold his interest in 2007.

**James A. Rothstein** is a co-founder of Lone Oak Fund, LLC and the President of Lone Oak Industries Inc., the manager of the Fund. Mr. Rothstein has been an active lender and developer of residential, commercial and industrial properties since 1989. He has owned and developed residential, commercial and industrial projects in California and Nevada. He received his B.A. from the University of California, Los Angeles in 1968 and a J.D. from the University of California, Berkeley in 1971 and was a practicing attorney until 1990. He is a current member of The State Bar of California.

### **COMPENSATION TO MANAGER**

The following discussion summarizes the forms of compensation to be received by the Manager. All of the amounts described below will be received regardless of the success or profitability of the Fund. None of the following compensation was determined by arm's-length negotiations.

<u>Form of Compensation</u>	<u>Method of Compensation</u>
Loan Servicing Fee paid by the Fund.	0.30 of 1.00% of the aggregate loan balances of all Mortgage Loans owned by the Fund (not including REO or cash held by the Fund), payable monthly (i.e., .025%), on the 15th day of each calendar month with respect to Mortgage Loans as of the last day of the immediately preceding month.
Loan origination and extension fees paid by borrowers to Manager.	From .50% to 2.00% of the principal amount of each Mortgage Loan (historically, approximately 1.50%) at origination and from 0.50% to 2.00% of the then-outstanding principal balance at extension. The amount of origination and extension fees are established based on the size and term of each loan. Loan origination fees are paid by borrowers out of loan proceeds upon funding and out-of-pocket upon extension and are not included in revenues of the Fund.
Miscellaneous fees paid by borrowers to Manager.	All fees payable by borrowers on Mortgage Loans, including statutory reconveyance fees, late fees and beneficiary statement fees paid by borrowers when their loans are paid off.
No profits of the Fund to Manager; No part of Cash Available for Distribution.	The Manager has no interest in distributions of the Fund, other than its interest in distributions as a Member of the Fund. The Manager receives no other fees or compensation from the Fund except as described in this table.

### **ALLOCATION OF EXPENSES**

At no cost to the Fund, all general day-to-day, ordinary and necessary operating and administrative expenses of the Fund and loan servicing expenses are billed directly to and paid by the Manager from the Manager's own funds. General operating and administrative expenses include, but are not limited to, general office expenses, rent, supplies, equipment, salaries, marketing and travel expenses.

The Fund is required to pay loan servicing fees to the Manager, in the amount described under the heading "**COMPENSATION TO MANAGER**" as well as REO expenses for payment of any

taxes, insurance, property repair, maintenance costs, and foreclosure and legal expenses not otherwise paid by revenue generated by the REO. The Fund also pays property management fees and real estate broker fees to unaffiliated third parties who may be hired by the Manager as necessary for the management or sale of REO. In addition, the Fund is required to pay the California franchise tax and fee.

### **FIDUCIARY RESPONSIBILITY OF THE MANAGER**

The fiduciary duties of a manager to a limited liability company and to its members are those of a partner to a partnership and to the partners of a partnership. Accordingly, a manager is accountable to a limited liability company as a fiduciary, which means that a manager is required to exercise good faith and integrity with respect to company affairs. This fiduciary duty is in addition to those other duties and obligations of, and limitations on, the Manager which are set forth in the Operating Agreement.

The Manager and other Members are not prohibited from engaging in outside businesses, including businesses that may compete with the Fund. The Manager and its affiliates currently have no intention to establish any other funds that would compete for the same loan opportunities as the Fund, but they may do so in the future in their sole discretion.

The Operating Agreement provides that the Manager shall have no liability to the Fund for losses resulting from errors in judgment or other acts or omissions, unless the Manager is guilty of misconduct or fraud. The Operating Agreement also provides that the Fund shall indemnify the Manager against liability and related expenses (including reasonable attorneys' fees and costs) incurred in dealing with the Fund, Members or third parties, so long as no misconduct or fraud on the part of the Manager is involved. Members, therefore, may have a more limited right of action than they would have absent these provisions in the Operating Agreement. A successful indemnification of the Manager or any litigation that may arise in connection with the Manager's indemnification could deplete the assets of the Fund. Members who believe that a breach of the Manager's fiduciary duty has occurred should consult with their own counsel.

### **TRANSPARENCY AND ACCOUNTABILITY**

The Fund is committed to the policy of full transparency and accountability. It has checks and balances in place to ensure transparency. The first level of the Fund's transparency lies with its monthly statement. The statement contains a record of each Member's capital investment, monthly earnings and a summary of the Fund's cash and asset position as of the last day of each calendar month. Additionally, Members receive a monthly report of Current Loan Activity which shows details of new loans, loans paid off, modifications to existing loans, loan workouts, loans serviced by others and REO properties. Members receive a complete accounting of all of the Fund's transactions for that month. In addition, Members will have access to the Fund's website, which will contain all of the historical and current information regarding the Fund's lending business.

The next level of transparency is the quarterly independent accountants' report. The purpose of this report is to verify the existence of the Fund's assets as reported at the end of each calendar quarter. This is accomplished by the auditor's examination of each recorded deed of trust, promissory note and title policy for each loan made by the Fund.

Finally, an annual certified audit of the Fund's financial statements is performed by an independent certified public accountant on the cash basis of accounting used for federal income tax purposes, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. As part of that audit, selected Members are contacted to confirm the amount of each Member's capital investment. The accountants retained by the Fund for the annual certified audit do not prepare the Fund's tax returns or maintain the Fund's books.

In addition to the policies for independent review described herein, each Member of the Fund is entitled to perform an examination of the Fund's books and records at any time upon reasonable prior notice during business hours.

### **CONFLICTS OF INTEREST**

The Manager has certain conflicts of interest with the Fund and the Members, including the following:

#### **Fees Payable to Manager are Not Based on Profits Earned by the Fund**

The compensation payable to the Manager, including loan origination fees, loan extension fees and loan servicing fees, is to be paid regardless of whether the borrowers on Mortgage Loans make their required loan payments, and whether or not the Fund makes a profit or incurs a loss on its Mortgage Loans. The Manager may therefore have a short-term incentive to originate more Mortgage Loans for the Fund, even if those Mortgage Loans could cause losses to the Fund, in order to increase the fees payable to the Manager. Over the longer term, however, if the Fund does not return positive yields to the Members, the Fund will not be able to attract and retain Members, so the Manager has a long-term incentive to generate positive yields to the Members.

#### **Other Funds or Businesses; Loan Participations**

The Manager does not presently intend to establish any new funds or entities that would compete for the same loan opportunities as the Fund, but the Manager reserves the right to do so in the future. All investors in the Fund will be required to acknowledge and agree that conflicts of interest may exist, and that the Fund will have no priority over any other entity that may be managed by the Manager or its Affiliates in connection with the allocation of loan opportunities.

The Manager and its Affiliates may also engage, for their own account, or for the account of others, in other business ventures, similar to that of the Fund or otherwise, and neither the Fund nor any Member shall be entitled to any interest therein.

The Fund will not have independent management and will rely on the Manager for the operation of the Fund. The Manager will devote only so much time to the business of the Fund as the Manager determines is reasonably required to manage the business of the Fund. The Manager will have conflicts of interest in allocating management time, services and functions between its existing business interests other than the Fund, and any future businesses which it may organize or engage in. The Manager believes it has sufficient staff available to be fully capable of discharging its responsibilities to all such entities.

### **Lack of Independent Legal Representation**

The Fund has not been represented by independent legal counsel in connection with its organization or this Offering. The terms of this Offering and the Operating Agreement have not been negotiated on an arm's length basis and have been established solely by the Manager. The Manager and the Fund have been jointly represented by Jeffer, Mangels, Butler & Mitchell LLP (“**JMBM**”) in connection with this Offering, and Venable LLP (“**Venable**”) has represented the Fund with respect to its election to be taxed as a REIT.

## **RISKS AND OTHER IMPORTANT FACTORS**

Any investment in the Shares offered hereby involves a significant degree of risk and is suitable only for investors who have no need for liquidity in their investments. When analyzing this offering, prospective investors should carefully consider the following risks and other factors, in addition to those discussed herein under the captions “**COMPENSATION TO MANAGER AND ITS AFFILIATES,**” “**CONFLICTS OF INTEREST,**” AND “**FEDERAL INCOME TAX CONSEQUENCES.**”

### **No Market for Shares; Restrictions on Redemptions and Repurchases**

There is no public market for the Shares and none is expected to develop in the future. In addition, the transferability of Shares is restricted by the provisions of the Securities Act of 1933, as amended, applicable state securities laws, the regulations thereunder and by the provisions of the Operating Agreement. Although investors will have the right to require the Fund to redeem their Shares for \$1,000 per Share after twelve months from the date the Shares were issued, those rights are subject to conditions, including the availability of funds, a notice requirement and a maximum quarterly redemption amount of \$100,000 or 25.00% of a Member's total Shares, whichever amount is greater. (See “**SUMMARY OF OPERATING AGREEMENT – Withdrawal from the Fund**”). Investors may also request that the Fund repurchase their shares after twelve months from the date the Shares were issued, but all repurchases will be made in the sole discretion of the Board of Managers, investors will have no right to require that the

Fund repurchase any Shares, and requests for repurchase are subject to conditions, including the availability of funds. (See “**SHARE REPURCHASE PROGRAM**”). Therefore, all purchasers of Shares must be capable of bearing the economic risks of this investment for an indefinite period of time. (see “**SUMMARY OF OPERATING AGREEMENT – Redemption of Shares**”).

### **Risks of Loan Underwriting Standards and Procedures**

As an asset-based lender, the Fund’s underwriting standards and procedures are different from conventional lenders such as banks. The Fund may invest in loans to borrowers who may not meet the credit standards of conventional lenders, so long as the Manager determines that the real property pledged as security has the requisite LTV ratio and that the borrower has sufficient invested capital in the property, or length of ownership of the property, to be motivated to repay the loan. In addition, the Manager approves Mortgage Loans more expeditiously than conventional mortgage lenders, generally not spending more than ten days, and sometimes less, assessing the creditworthiness of potential borrowers and the value of the property. The Manager believes that its underwriting criteria and loan review process, including a personal visit to every real property proposed as security for a loan, provide appropriate support for the Manager’s lending decisions, although no underwriting criteria or loan review process can completely eliminate credit risks of mortgage loans.

### **Loan Defaults and Foreclosures**

The Fund is in the business of lending money and, as such, takes the risk of defaults by borrowers and other risks faced by lenders. All Mortgage Loans will require payments of interest only during the loan term. Thus, the borrower will have to make a large “**balloon**” payment of principal due at the end of the term. Most borrowers are unable to repay such loans out of their own funds and are compelled to refinance or sell. Fluctuations in interest rates, the unavailability of mortgage funds, or a weak real estate market could adversely affect the ability of borrowers to refinance their loans at maturity or sell their property.

Since the Fund is primarily an “**asset**” rather than a “**credit**” lender, the Fund is relying principally on the real property securing the loans to protect its investment. The Manager may obtain guaranties on certain loans but will not always require a guaranty as a condition to making a loan. There are a number of factors which could adversely affect the value of such real property security, including, among other things, the following:

1. Because the Fund makes its loans on an expedited basis, the Fund may obtain a third party limited scope appraisal or a BPO consisting of a review of the property by a local real estate broker familiar with the local real estate market and an estimate of value based on comparable properties in the area. Whether the Fund obtains an independent appraisal or a BPO, no assurance can be given that the appraisal or BPO will be accurate. The Manager will make the final decision of the value of each property based on the Manager’s evaluation of all of the data reviewed by the Manager. Since an appraisal fixes the value of real property at a given point in time, subsequent events could adversely affect the value of real property used to secure a loan. Such “**subsequent events**” may include war, riots, and terrorism,

nationwide, statewide or local economic, demographic, property, or other trends, or may include specific local events such as freeway construction, adverse weather conditions, or earthquakes. Neither the appraiser nor the Manager will be able to predict with any certainty whether these events will occur after a loan is made. An overall decline in the real estate market could adversely affect the value of the property securing the loans such that the aggregate outstanding balance of the loan made by the Fund exceeds the value of the property.

2. If the borrower defaults, the Fund may be forced to acquire the property at a foreclosure sale. If the Fund cannot quickly sell such property, and the property does not produce any significant income, the Fund's profitability will be adversely affected.

3. To the extent that Mortgage Loans are secured by improved real property, the improvements will constitute a significant portion of the value of the real property security for such loans. In the event that such improvements are destroyed or damaged, the value of the real property security will be correspondingly diminished to the extent not covered by insurance. (See "**Uninsured Losses**," below). In addition, if the Fund acquires REO as a result of foreclosure, the Fund will incur legal, property tax and insurance costs in connection with the foreclosure and will also be required to repair and maintain the REO, which may require the Fund to advance additional expenses. In addition, the Fund will need to hire a property manager to manage the REO, and a real estate agent to sell the REO, and these expenses will be paid by the Fund. The Fund will seek to recover its expenses from the resale proceeds of the property, but there can be no assurance that the Fund will be able to recover these additional expenses.

4. In California, if the real property security proves insufficient to repay amounts owing to a lender, under certain circumstances the lender may not have the right to recover any deficiency from the borrower or it may be more costly and time-consuming to recover a deficiency from the borrower than by a non-judicial foreclosure. (See "**CERTAIN LEGAL ASPECTS OF LOANS SECURED BY REAL ESTATE**.")

5. The recovery of sums advanced by the Fund in making or investing in Mortgage Loans may also be delayed or impaired by the operation of the federal bankruptcy laws or by irregularities in the manner in which the loan was made. Any borrower has the ability to delay a foreclosure sale by the Fund for a period ranging from several weeks to months simply by filing a petition in bankruptcy, which automatically stays any actions to enforce the terms of the loan. The length of this delay and the costs associated therewith may have an adverse impact on the Fund's profitability.

6. The property securing Fund loans could be adversely affected by earthquakes, floods, mud slides, similar events, and acts of nature that may not be insured against. (See "**Uninsured Losses**" in this Section below.)

## **Unspecified Loans; Reliance on Key Personnel**

Requests for loans are received on an ongoing basis. Accordingly, such loans cannot be specified at this time, and Members will have no opportunity to review potential Mortgage Loans before the Fund invests in these loans. The Manager makes all decisions with respect to the management of the Fund's lending business, including the determination as to which Mortgage Loans to make or purchase, and the Fund is dependent to a substantial degree on the services of the managing directors of the Manager, who are James A. Rothstein and Gerald A. Ducot (See "**The Manager and Its Affiliates**"). The loss of either of these managing directors could have a material adverse effect on the business of the Fund. In the event of the loss of both of the managing directors of the Manager, the Operating Agreement provides that the Fund will be liquidated.

## **Competition**

Due to the nature of the Fund's business, its profitability depends to a large degree upon the ability of the Fund to invest in quality Mortgage Loans. The Fund competes with institutional lenders and others engaged in the mortgage lending business, some of whom have greater financial, technical and other resources than the Fund. Mortgage lending is a highly competitive business and institutional or other lenders may have other advantages over the Fund in conducting business and providing certain services to potential borrowers.

## **Manager Not Required to Devote Full Time to the Business of the Fund**

The Manager is not required to devote full time to the Fund's affairs, but only such time as the affairs of the Fund may reasonably require.

## **Fund Not Independently Represented**

The Fund has not been represented by independent counsel in connection with this Offering. (See "**CONFLICTS OF INTEREST.**") The Manager and the Fund have been jointly represented by JMBM in connection with this Offering, and Venable has represented the Fund with respect to its election to be taxed as a REIT.

## **Investment Delays; Cash Reserves**

There will be a delay between the time that capital contributions are made by Members and the time the funds from those contributions are invested in Mortgage Loans. In addition, Mortgage Loans held by the Fund will from time to time be repaid by borrowers, and delays will inevitably occur in reinvesting those funds in new Mortgage Loans. During these periods, such proceeds will be invested in short-term certificates of deposit, money-market funds or other liquid assets which will not yield a return as high as the anticipated return to be earned on Mortgage Loans. The length of these interim investments may adversely affect the overall investment return to Members. Additionally, the Manager may retain a

contingency reserve fund to cover unexpected cash needs of the Fund. The contingency reserve fund may be invested in assets whose yield will not be as high as the yield that would result if such reserve funds were invested in Mortgage Loans. This lesser yield may adversely affect the investment return to the Members.

### **Uninsured Losses**

The Manager requires borrowers to obtain comprehensive title, fire and casualty insurance on improved properties securing Mortgage Loans. Additionally, the Manager carries, on behalf of the Fund, mortgage impairment insurance. The Manager may also on a case-by-case basis require borrowers to obtain earthquake insurance. There are, however, certain types of losses (generally of a catastrophic nature) which are either uninsurable or not economically insurable, such as losses due to war, terrorism, floods, mudslides or other acts of nature. Should any such disaster occur, or should the insurance coverage lapse and the Manager be unable to obtain replacement coverage in a timely manner, the Fund could suffer a loss of principal and interest on the Mortgage Loan secured by the uninsured property.

### **Lack of Regulation**

The management and investment practices of the Fund are not supervised or regulated by any federal or state authority, except that certain aspects of the Fund, its operations and/or its Affiliates and their operations are subject to supervision or regulation by the California Bureau of Real Estate and the Bureau of Business Oversight.

### **Conflicts of Interest**

There are several areas in which the interests of the Manager will conflict with those of the Fund, which should be carefully considered (See “**CONFLICTS OF INTEREST.**”).

### **Environmental Liabilities**

Properties that secure Mortgage Loans may contain, or may become contaminated with, toxic or hazardous substances. While the Manager will make reasonable investigations into whether the properties contain toxic or hazardous substances and will require an environmental indemnity from the borrower or its principals, these investigations will not guarantee that a property is free of toxic or hazardous substances, nor can they ensure that a property does not become contaminated with toxic or hazardous substances subsequent to the closing of the loan. This liability may, under rare circumstances, extend to a lender that has, pre-foreclosure, undertaken certain roles in managing the property or the activities of the borrower such that the lender could be characterized as an “owner” or “operator” under applicable environmental laws, or to a lender post-foreclosure.

Under current federal and state law, the owner and operator of real property contaminated with toxic or hazardous substances is, in most situations, liable for all costs associated with any remedial action necessary to bring the property into compliance with applicable environmental laws and regulations. This liability may arise regardless of who caused the contamination or when it was caused. In general, under California law, a mortgage lender who has acquired title through foreclosure is statutorily exempt from such liability. However, the Fund could become liable for environmental contamination on REO under certain federal laws unless the Fund complies with certain conditions and sells the REO as quickly as possible. The Manager will use its best efforts to comply with the requirements necessary to maintain the Fund's exemption from liability for environmental contamination of REO.

If any property that secures a Fund loan is found to be contaminated, this could adversely impair the value of the property (e.g., decreased desirability of the property, which could lead to slower absorption, declining sales prices, lower rental rates or decreased occupancy) or the ability of the borrower to repay the loan (since the borrower might have to pay for the cost to remove or clean up the contamination and might also be liable to purchasers or tenants of the property or owners or occupants of adjoining property for property damage, bodily injury, lost profits or other consequential damages). If the borrower fails to remove or clean up contaminated property, it is possible that federal, state and/or local environmental agencies could perform the removal or cleanup, then impose liens upon and subsequently foreclose on the property to pay for the costs of such removal or cleanup. These factors can significantly decrease the value of the property as security for the loan. Furthermore, even if the Fund does not foreclose on contaminated property security, the mere existence of hazardous substances on such real property security may depress the market of such real property security such that the loan is no longer adequately secured.

The Fund generally will not participate in the on-site management of any facility on property that secures a Fund loan in order to minimize the potential for liability for cleanup of any environmental contamination under applicable federal, state, or local laws. However, where the Fund has taken title to contaminated property due to foreclosure or otherwise, the Manager may determine that it is in the best interests of the Fund to cause the property to be cleaned up. There can be no assurance that the Fund would not incur full recourse liability for the entire cost of any such removal and cleanup, or that the cost of such removal and cleanup would not exceed the value of the property. In addition, the Fund could incur liability to tenants and other users of the affected property, or users of neighboring property, including liability for consequential damages. The Fund would also be exposed to risk of lost revenues during any cleanup and to the risk of lower lease rates or decreased occupancy if the existence of such substances or sources on the property becomes known. If the Fund fails to remove the substances or sources and clean up the property, it is possible that federal, state, and/or local environmental agencies could perform such removal and cleanup and impose and subsequently impose liens on the property for the cost thereof. The Fund may find it difficult or impossible to sell the property prior to or following any such cleanup. The Fund could be liable to the purchaser thereof if the Manager knew or had reason to know that such substances or sources existed. In such case, the Fund could also be subject to the costs described above.

## **Reliance on Information Provided by Others**

The success of a loan will depend, among other things, on an accurate assessment of the creditworthiness of the borrower and the underlying value of the real property securing the loan. While the Manager will make an investigation regarding all property proposed as security, and each borrower, it will rely to some extent on third parties such as credit agencies, appraisers, and the borrower itself to provide the information upon which the Manager will base its decision to make a loan. There is no guarantee that this information will be accurate.

## **Risks of Ownership of Real Property**

When the Fund acquires ownership of REO by foreclosure or otherwise, the Fund is exposed to the risks of liability incident to real property ownership. Owners of real property may be subject to liability for injury to persons and property occurring on the real property or in connection with the activity conducted thereon, and liability for non-compliance with governmental regulations. These risks may also include, but are not limited to, the marketing and absorption risk of marketing and selling commercial properties to prospective purchasers or renters, the risks for environmental clean-up costs and related environmental liabilities described in the “**Environmental Liabilities**” section above, and, in the case of a rental project, the economic risks of managing and operating a rental project. The impact of any of these or other factors described in this Offering Circular can adversely impact the ability of the Fund to recover the full value of amounts invested in the Mortgage Loan originally secured by the REO.

## **Enforcement Against and Solvency of Guarantors**

In connection with some of its loans, the Fund may obtain guaranties from the principals or affiliates of borrowers. Upon a borrowing default, the Fund may seek to recover repayment of some or all of the Fund’s loan by enforcing the guaranty against the guarantors. A guarantor may have defenses that would impair the ability of the Fund to enforce on or recover from the guarantor. Additionally, the net worth of a guarantor may decline between the date that the loan was funded, and the guaranty was given and the date that the Fund seeks to enforce a guaranty. This may impair the Fund’s ability to recover the full amount of a delinquent loan.

## **Reliance on Management**

Except as otherwise set forth in the Operating Agreement, the Manager will have the sole right to make all decisions with respect to the management of the Fund, subject to the supervision and direction of the Board of Managers. The Members will not have an opportunity to evaluate the specific properties that will be financed with the proceeds of this offering. No person should purchase Shares unless they are willing to entrust all aspects of the management of the Fund to the Manager.

## **Geographic Concentration of Loans in California**

The Fund will make loans secured by properties located only in California. The Manager will seek to diversify the Fund's loan portfolio within California among different property types and regions. However, a downturn in the economy across the state would more greatly affect the Fund than if its lending business were more geographically diversified.

## **Portfolio Diversification**

The Fund will seek to diversify its loan portfolio to the extent reasonably possible. There can be no assurance, however, that the Fund will have loan opportunities consistent with its targeted diversification goals.

## **Fluctuations in Interest Rates and Market Variables**

The operating results of the Fund will be affected primarily by the following factors: (i) the amount of capital available to invest in Mortgage Loans, (ii) the level of real estate financing activity in California, (iii) the Manager's ability to identify and originate suitable Mortgage Loans, (iv) the interest rates the Fund is able to charge on its loans, and (v) any foreclosures and related loan losses experienced.

Mortgage interest rates are subject to abrupt and substantial fluctuations. The purchase of Shares is an illiquid investment. (See above, "**No Market for Shares.**") If prevailing interest rates rise above the average interest rate being earned by the Fund's loan portfolio, returns earned by investors in the Fund may be less than the returns that could be earned in other investments.

## **Performance Record**

The Fund has been in operation since 2003, but significant changes have occurred in real estate markets in recent years and there is no assurance that the past performance of the Fund will be an indicator of future results of the Fund.

## **Real Estate is Illiquid and its Value May Decrease**

Real estate investments are relatively illiquid. The ability of the Fund to vary its portfolio in response to changes in economic and other conditions will be limited.

## **Adverse Changes in General Economic Conditions**

The Fund's success is dependent upon the general economic conditions in the geographic areas in which a substantial number of the properties that secure its Mortgage Loans are located. Adverse changes in national economic conditions or in the economic conditions of the regions in which a

substantial number of the properties that secure the Fund's Mortgage Loans likely would have an adverse effect on real estate values, interest rates and, accordingly, the Fund's loan portfolio.

### **Liability of Members**

Under California law, a member of a limited liability company is not personally liable for any contract, tort or other obligation of the company by virtue of being a member, other than liability for distributions made by the company to members that cause the company to become unable to meet its liabilities, as provided by California law. The Members will not be liable to the Fund for amounts in excess of their capital commitments.

### **Tax Risks**

Before making a decision to invest in the Fund, each investor should assess the tax risks and its willingness and ability to comply with ongoing federal income tax filing and compliance requirements described under "**FEDERAL INCOME TAX CONSEQUENCES.**" In particular, the investors will be allocated income but may not receive cash distributions in connection therewith with which to pay any associated income taxes.

## **CERTAIN LEGAL ASPECTS OF LOANS SECURED BY REAL ESTATE**

Repayment of Mortgage Loans will be secured by deeds of trust on California real property. A deed of trust has three parties: a borrower-grantor called the "trustor," a third-party grantee called the "trustee," and a lender-creditor called the "beneficiary." The trustor grants the property, irrevocably until the debt is paid, "in trust, with power of sale" to the trustee to secure payment of the obligation. The trustee's authority is governed by law, the express provisions of the deed of trust and the directions of the beneficiary. The Manager will act as the trustee of the Fund's deeds of trust. The Fund will always be the beneficiary of the deeds of trust securing loans made by the Fund.

### **Foreclosure**

The manner in which the Manager will enforce the Fund's rights under a deed of trust is governed by California law. A lender may be able to enforce its deed of trust by judicial foreclosure or by non-judicial foreclosure through the exercise of a power of sale. Statutes dictate, among other things, the amount of time and costs associated with a judicial or non-judicial foreclosure sale, whether or not a lender would be entitled to recover a deficiency judgment (i.e., the resulting shortfall if the proceeds from the sale of the property are not sufficient to pay the debt) from the borrower, concurrently with a judicial sale, whether there are limits as to the amount of this deficiency judgment, and whether the borrower would have a right to redeem the property following a judicial sale.

A judicial foreclosure is a public sale of the property conducted under an order of the Superior Court with the sales proceeds being applied to satisfy the underlying debt. A judicial foreclosure is subject to most of the delays and expenses of other lawsuits and can take up to several years to complete, depending on how busy the local courts are.

In contrast, a non-judicial foreclosure is a private sale of the property conducted directly by the trustee following the giving of appropriate notice and the expiration of appropriate cure periods. It is generally cheaper and quicker to conduct a non-judicial foreclosure than to conduct a judicial foreclosure.

In California, a lender is not entitled to recover a deficiency judgment if the lender forecloses non-judicially on a deed of trust. The lender must instead foreclose judicially if it seeks to recover a deficiency judgment against the borrower. The amount of deficiency that can be recovered from a borrower following a judicial foreclosure sale is limited to the difference between the amount of the debt owing to the lender and the higher of (i) the successful sales price bid at the foreclosure sale, or (ii) the fair market value of the property at the time of foreclosure (a so-called “fair value limitation”). A borrower has the right to redeem the property for a period of time following a judicial foreclosure sale by paying to the successful bidder an amount equal to the successful sales price bid at the foreclosure sale and the costs of the foreclosure sale. This right of redemption can depress the amount bid at a judicial foreclosure sale because the successful bidder would have to take the property subject to the borrower’s right of redemption.

If a borrower were to default under a Mortgage Loan, the Manager, as the loan servicer, would evaluate the applicable laws, and consider the enforcement practices typically undertaken by lenders before commencing enforcement actions.

### **Other Loan Enforcement Issues**

Other matters, such as litigation instituted by a defaulting borrower or the operation of the federal bankruptcy laws, may have the effect of delaying enforcement of the lien of a defaulted loan and may in certain circumstances reduce the amount realizable from sale of REO.

In some instances, a loan may not only be secured by real property security but also guaranteed by a third-party guarantor. Investors should be aware that a guarantor may have defenses that would impair the ability of the lender to enforce its guaranty. For example, if a loan obligation is modified without the guarantor’s consent, the guarantor may be exonerated from part or all of its obligations under the guaranty.

## ERISA CONSIDERATIONS

### General

ERISA contains strict fiduciary responsibility rules governing the actions of “**fiduciaries**” of employee benefit plans. It is anticipated that some Members will be corporate pension or profit-sharing plans and Individual Retirement Accounts, or other employee benefit plans that are subject to ERISA. In any such case, the person making the investment decision concerning the purchase of Shares will be a “**fiduciary**” of such plan and will be required to conform to ERISA’s fiduciary responsibility rules. Persons making investment decisions for employee benefit plans (i.e., “**fiduciaries**”) must discharge their duties with the care, skill and prudence which a prudent person familiar with such matters would exercise in like circumstances. In evaluating whether the purchase of Shares is a “**prudent**” investment under this rule, fiduciaries should consider all of the risk factors set forth above. Fiduciaries should also carefully consider the possibility and consequences of unrelated business taxable income (see “**FEDERAL INCOME TAX CONSEQUENCES**”), as well as the percentage of plan assets which will be invested in the Fund insofar as the diversification requirements of ERISA are concerned. An investment in the Fund is relatively illiquid, and fiduciaries must not rely on an ability to convert an investment in the Fund into cash in order to meet liabilities to plan participants who may be entitled to distributions. DUE TO THE COMPLEX NATURE OF ERISA, EACH PROSPECTIVE INVESTOR IS URGED TO CONSULT WITH AND RELY SOLELY UPON HIS OWN TAX ADVISOR OR PENSION CONSULTANT TO DETERMINE THE INCOME TAX CONSEQUENCES AND THE APPLICATION OF ERISA TO HIS OR HER PROSPECTIVE INVESTMENT.

### Plan Asset Regulations

The Manager of the Fund has determined that the Fund will not accept capital contributions from Members who are corporate pension or profit sharing plans, individual retirement accounts, and other employee benefit plans (collectively, “**Plan Investors**”), that equal or exceed 25% of the total capital contributions in the Fund. By limiting the Investors of the Fund to less than 25% of the total capital contributions in Lone Oak, the assets of the Fund will not be deemed “plan assets” under ERISA, the Manager’s activities will not be subject to the general fiduciary requirements of Section 404 of ERISA and will not be subject to the prohibited transaction rules of Section 406 of ERISA and Section 4975 of the Internal Revenue Code. Although the Manager believes that it would be unlikely that a prohibited transaction would occur, the Manager has determined that it is in the best interests of the Fund to avoid the application of the plan assets rule by limiting the amount of capital accepted from Plan Investors.

In order to avoid application of the U.S. Department of Labor’s plan asset regulations (29 C.F.R. §2510.101), the Fund will limit subscriptions for Shares from ERISA plan investors such that, immediately after each sale of Shares, ERISA plan investors will in aggregate hold less than twenty-five percent (25%) of the total outstanding membership interests in the Fund.

## **Annual Valuation**

Fiduciaries of plans subject to ERISA are required to determine annually the fair market value of the assets of such plans as of the close of any such plan's fiscal year. Although the Manager will provide annually upon the written request of a Member an estimate of the value of the Shares based upon, among other things, outstanding mortgage investments, it may not be possible to value the Shares adequately from year to year, because there will be no market for them.

## **FEDERAL INCOME TAX CONSEQUENCES**

### **General**

The following is a summary of the material U.S. federal income tax consequences of The Fund's election to qualify as a REIT and an investment in Shares. This summary is based upon the Code, the regulations promulgated by the U.S. Treasury, rulings and other administrative pronouncements issued by the Internal Revenue Service (the "IRS"), and judicial decisions, all as currently in effect, and all of which are subject to differing interpretations or to change, possibly with retroactive effect. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax consequences described below. No advance ruling has been or will be sought from the IRS regarding any matter discussed in this section. This summary is also based upon the assumption that the Fund will continue to operate in accordance with the Operating Agreement. This summary is for general information only, and does not purport to discuss all aspects of U.S. federal income taxation that may be important to a particular Member in light of its investment or tax circumstances, or to Members subject to special tax rules, such as:

- depository institutions;
- insurance companies;
- broker dealers;
- regulated investment companies;
- holders who receive Shares through the exercise of employee share options or otherwise as compensation;
- persons holding Shares as part of a "straddle," "hedge," "conversion transaction," "synthetic security" or other integrated investment;
- persons subject to the alternative minimum tax;
- partnerships and trusts;
- persons who hold Shares on behalf of another person as nominee;

- non-U.S. Members

and, except to the extent discussed below:

- tax-exempt organizations.

This summary assumes that Members will hold Shares as a capital asset, which generally means as property held for investment.

If a partnership, including for this purpose any entity that is treated as a partnership for U.S. federal income tax purposes, holds Shares, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A Member that is a partnership and the partners in such partnership should consult their tax advisors about the U.S. federal income tax consequences of the acquisition, ownership and disposition of Shares.

The U.S. federal income tax treatment of holders of Shares depends in some instances on determinations of fact and interpretations of complex provisions of U.S. federal income tax law for which no clear precedent or authority may be available. In addition, the tax consequences to any particular Member holding Shares will depend on the Member's particular tax circumstances. You are urged to consult your tax advisor regarding the U.S. federal, state, local and foreign income and other tax consequences to you in light of your particular investment or tax circumstances of acquiring, holding, exchanging or otherwise disposing of Shares.

## **Taxation of Members**

### ***Taxation of Taxable Domestic Members***

*Distributions.* Provided that the Fund qualifies as a REIT, distributions made to taxable domestic Members out of current or accumulated earnings and profits, and not designated as capital gain dividends, will generally be taken into account by them as ordinary income and will not be eligible for the dividends received deduction for C corporations. For non-corporate taxable domestic Members, such Members may deduct up to 20% of such dividends (other than capital gains dividends and dividends treated as qualified dividend income) for taxable years beginning after December 31, 2017 and before January 1, 2026. With certain exceptions, dividends received from REITs are not eligible for taxation at the preferential income tax rates (20% maximum U.S. federal income tax rate) for qualified dividends received by domestic shareholders that are individuals, trusts and estates from taxable C corporations. Such shareholders, however, are taxed at the preferential rates on dividends designated by and received from REITs to the extent that certain holding requirements are met and the dividends are attributable to (i) income retained by the REIT in the prior taxable year on which the REIT was subject to corporate level income tax (less the amount of tax), (ii) dividends received by the REIT from TRSs or other taxable C corporations, or (iii) income in the prior taxable year from the sales of "built in gain" property acquired by the REIT from C corporations in carryover basis transactions (less the amount of corporate tax on such income).

Distributions that are designated as capital gain dividends will generally be taxed to Members as long-term capital gains, to the extent that they do not exceed actual net capital gain for the taxable year, without regard to the period for which the Member has held its Shares. A similar treatment will apply to long-term capital gains retained by the Fund, to the extent that the Fund elects the application of provisions of the Code that treat shareholders of a REIT as having received, for U.S. federal income tax purposes, undistributed capital gains of the REIT, while passing through to Members a corresponding credit for taxes paid by the REIT on such retained capital gains. See “—Taxation of the Fund—Annual Distribution Requirements.” Corporate Members may be required to treat up to 20% of some capital gain dividends as ordinary income. Long-term capital gains are generally taxable at maximum U.S. federal rates of 20% in the case of Members who are individuals, trusts and estates, not including the 3.8% Medicare tax described below, and 21% in the case of Members that are C corporations.

Distributions in excess of current and accumulated earnings and profits will generally represent a return of capital and will not be taxable to a Member to the extent that they do not exceed the adjusted basis of the Member's Shares in respect of which the distributions were made, but rather, will reduce the adjusted basis of these Shares. To the extent that such distributions exceed the adjusted basis of a Member's Shares, they will be included in income as long-term capital gain, or short-term capital gain if the Shares have been held for one year or less. In addition, any dividend declared by the Fund in October, November or December of any year and payable to a Member of record on a specified date in any such month will be treated as both paid by the Fund and received by the Member on December 31 of such year, provided that the dividend is actually paid before the end of January of the following calendar year.

*Dispositions of Shares.* In general, a Member must treat any gain or loss recognized upon a sale or other disposition of Shares as capital gain or loss. Any capital gains recognized by individuals, trusts and estates upon the sale or disposition of Shares generally will be treated as long-term capital gains and will be subject to a maximum U.S. federal income tax rate of 20%, not including the 3.8% Medicare tax described below, if the Shares are held for more than one year, and will be treated as short-term capital gains taxed at substantially higher ordinary income rates (of up to 37%, not including such Medicare tax) if the Shares are held for one year or less. Gains recognized by Members that are C corporations are subject to U.S. federal income tax currently at a maximum rate of 21%, whether or not classified as long-term capital gains. Capital losses recognized by a Member upon the disposition of Shares held for more than one year at the time of disposition will be considered long-term capital losses, and are generally available only to offset capital gain income of the Member but not ordinary income (except in the case of individuals, who may offset up to \$3,000 of ordinary income each year). In addition, any loss upon a sale or exchange of Shares by a Member who has held the Shares for six months or less, after applying holding period rules, will be treated as a long-term capital loss to the extent of distributions received from the Fund that are required to be treated by the Member as long-term capital gain.

*Medicare Contribution Tax on Unearned Income.* Certain Members that are individuals, estates or trusts are required to pay an additional 3.8% Medicare tax on, among other things, dividends on and capital gains from the sale or other disposition of stock. Members should consult their tax advisors regarding the effect, if any, of this tax on their ownership and disposition of Shares.

*Information Reporting and Backup Withholding.* The Fund will report to its Members and to the IRS the amount of distributions paid during each calendar year and the amount of tax withheld, if any. Under the backup withholding rules, you may be subject to backup withholding at a current rate of 24% with respect to distributions unless you:

- (a) are a corporation or come within certain other exempt categories and, when required, demonstrate this fact; or
- (b) provide a taxpayer identification number, certify as to no loss of exemption from backup withholding, and otherwise comply with the applicable requirements of the backup withholding rules.

Any amount paid as backup withholding will be creditable against your income tax liability.

### ***Taxation of Tax-Exempt Members***

Tax-exempt entities, including qualified employee pension and profit sharing trusts and individual retirement accounts, generally are exempt from U.S. federal income taxation. However, they may be subject to taxation on their unrelated business taxable income, or UBTI. While some investments in real estate may generate UBTI, the IRS has ruled that dividend distributions from a REIT to a tax-exempt entity do not constitute UBTI. Based on that ruling, and provided that (i) a tax-exempt Member has not held Shares as “debt financed property” within the meaning of the Code (i.e., where the acquisition or holding of the property is financed through a borrowing by the tax-exempt Member), and (ii) Shares are not otherwise used in an unrelated trade or business, distributions and income from the sale of Shares generally should not give rise to UBTI to a tax-exempt Member except as described in the following paragraph.

Tax-exempt Members that are social clubs, voluntary employee benefit associations, and supplemental unemployment benefit trusts exempt from U.S. federal income taxation under Sections 501(c)(7), (c)(9), and (c)(17) of the Code, respectively, are subject to different UBTI rules, which generally will require them to characterize distributions from the Fund as UBTI.

In certain circumstances, a pension trust that owns more than 10% of Shares could be required to treat a percentage of the dividends as UBTI if the Fund is a “pension held REIT.” The Fund will not be a pension held REIT unless it is required to “look through” one or more pension trust Members in order to satisfy the REIT closely held rules and either (A) one pension trust owns more than 25% of the value of Shares, or (B) a group of pension trusts, each individually holding more than 10% of the value of Shares, collectively owns more than 50% of such Shares. Certain restrictions on ownership and transfer of Shares should generally prevent a tax-exempt entity from owning more than 10% of the value of Shares, or the Fund from becoming a pension held REIT.

Tax-exempt shareholders are urged to consult their tax advisor regarding the U.S. federal, state, local and foreign income and other tax consequences of owning Shares.

## **Taxation of the Fund**

The Fund elected to be taxable as a REIT under the Code commencing with its taxable year beginning July 1, 2018, and ending December 31, 2018, and generally will not be subject to U.S. federal taxes on income to the extent it currently distributes all of its income to its Members and maintains its qualification as a REIT.

Qualification and taxation as a REIT depend on the Fund's ability to meet on a continuing basis, through actual operating results, distribution levels and diversity of share ownership, various qualification requirements imposed upon REITs by the Code. The Fund's ability to qualify as a REIT also requires that it satisfy certain asset tests, some of which depend upon the fair market values of assets owned by the Fund. Such values may not be susceptible to a precise determination. Accordingly, no assurance can be given that actual results of operations for any taxable year satisfy such requirements for qualification and taxation as a REIT.

### ***Taxation of REITs in General***

As indicated above, qualification and taxation as a REIT depends upon the Fund's ability to meet, on a continuing basis, various qualification requirements imposed upon REITs by the Code. The material qualification requirements are summarized below under “—Requirements for Qualification—General.” While the Fund intends to operate so that it qualifies as a REIT, no assurance can be given that the IRS will not challenge its qualification, or that it will be able to operate in accordance with the REIT requirements in the future. See “—Failure to Qualify.”

If the Fund qualifies as a REIT, it will generally be entitled to a deduction for dividends that it pays and therefore will not be subject to U.S. federal corporate income tax on taxable income that is currently distributed to Members. This treatment substantially eliminates the “double taxation” at the corporate and shareholder levels that generally results from investment in a corporation. Rather, income generated by a REIT generally is taxed only at the shareholder level upon a distribution of dividends by the REIT.

If the Fund qualifies as a REIT, it will nonetheless be subject to U.S. federal tax in the following circumstances:

- It will be taxed at regular corporate rates on any undistributed REIT taxable income, including undistributed net capital gains.
- If the Fund has net income from prohibited transactions, which are, in general, sales or other dispositions of inventory or property held primarily for sale to customers in the ordinary course of business, other than foreclosure property, such income will be subject to a 100% tax. See “—Prohibited Transactions” and “—Foreclosure Property” below.
- If the Fund elects to treat property that it acquires in connection with a foreclosure of a mortgage loan or certain leasehold terminations as “foreclosure property,” it may thereby

avoid a 100% tax on gain from a resale of that property (if the sale would otherwise constitute a prohibited transaction), but the income from the sale or operation of the property may be subject to corporate income tax at the highest applicable rate (currently 21%).

- If the Fund should fail to satisfy the 75% gross income test or the 95% gross income test, as discussed below, but nonetheless maintain its qualification as a REIT because there is a reasonable cause for the failure and other applicable requirements are met, the Fund may be subject to a 100% tax on an amount based on the magnitude of the failure adjusted to reflect the profit margin associated with its gross income.
- If the Fund should fail to satisfy the asset or other requirements applicable to REITs, as described below, yet nonetheless maintain its qualification as a REIT because there is reasonable cause for the failure and other applicable requirements are met, it may be subject to an excise tax. In that case, the amount of the tax will be at least \$50,000 per failure, and, in the case of certain asset test failures, will be determined as the amount of net income generated by the assets in question multiplied by the highest corporate tax rate (currently 21%) if that amount exceeds \$50,000 per failure.
- If the Fund should fail to distribute during each calendar year at least the sum of (a) 85% of its REIT ordinary income for such year, (b) 95% of its REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, it would be subject to a non-deductible 4% excise tax on the excess of the required distribution over the sum of (i) the amounts actually distributed, plus (ii) certain retained amounts.
- A 100% tax may be imposed on transactions between a REIT and a “taxable REIT subsidiary” (as defined in the Code), or TRS, that do not reflect arm’s length terms.
- If the Fund acquires appreciated assets from a C corporation that is not a REIT (i.e., a corporation taxable under subchapter C of the Code) in a transaction in which the adjusted tax basis of the assets in its hands is determined by reference to the adjusted tax basis of the assets in the hands of the subchapter C corporation, it may be subject to tax on such appreciation at the highest corporate income tax rate then applicable if it subsequently recognizes gain on a disposition of any such assets during the five-year period following their acquisition from the subchapter C corporation.

In addition, the Fund may be subject to a variety of taxes, including payroll taxes and state, local and foreign income, property and other taxes on assets and operations. The Fund could also be subject to tax in situations and on transactions not presently contemplated.

### ***Requirements for Qualification—General***

The Code defines a REIT as a corporation, trust or association:

- (i) that is managed by one or more trustees or directors;
- (ii) the beneficial ownership of which is evidenced by transferable shares of beneficial interest, or by transferable certificates of beneficial interest;
- (iii) that would be taxable as a domestic corporation but for the special Code provisions applicable to REITs;
- (iv) that is neither a financial institution nor an insurance company subject to specific provisions of the Code;
- (v) the beneficial ownership of which is held by 100 or more persons;
- (vi) in which, during the last half of each taxable year, not more than 50% in value of the outstanding shares of beneficial interest is owned, directly or indirectly, by five or fewer "individuals" (as defined in the Code to include specified tax-exempt entities);
- (vii) that makes an election to be treated as a REIT for the current taxable year or has made an election for a previous taxable year which has not been terminated or revoked; and
- (viii) which meets other tests described below, including with respect to the nature of its income and assets.

The Code provides that conditions (i) through (iv) must be met during the entire taxable year, and that condition (v) must be met during at least 335 days of a taxable year of 12 months, or during a proportionate part of a shorter taxable year. Conditions (v) and (vi) need not be met during an entity's initial tax year as a REIT. The Operating Agreement contains restrictions regarding the ownership and transfer of Shares, which are intended to assist the Fund in satisfying the share ownership requirements described in conditions (v) and (vi) above.

To monitor compliance with the share ownership requirements, the Fund is generally required to maintain records regarding the actual ownership of Shares. To do so, the Fund must demand written statements each year from the record holders of significant percentages of Shares in which the record holders are to disclose the actual owners of the Shares (i.e., the persons required to include the dividends paid by the Fund in their gross income). A list of those persons failing or refusing to comply with this demand must be maintained as part of the Funds records. Failure to comply with these record keeping requirements could subject the Fund to monetary penalties. A Member that fails or refuses to comply with the demand is required by Treasury Regulations to submit a statement with its tax return disclosing the actual ownership of the Shares and other information.

In addition, an entity generally may not elect to become a REIT unless its taxable year is the calendar year. The Fund has adopted December 31 as its year end, and thereby satisfy this requirement.

### *Income Tests*

To qualify as a REIT, the Fund annually must satisfy two gross income requirements. First, at least 75% of gross income for each taxable year, excluding gross income from sales of inventory or dealer property in “prohibited transactions,” and certain hedging transactions generally must be derived from investments relating to real property or mortgages on real property, including interest income derived from mortgage loans collateralized by real property, “rents from real property,” dividends received from other REITs, and gains from the sale of real estate assets, as well as “qualified temporary investment income.” Second, at least 95% of gross income in each taxable year, excluding gross income from prohibited transactions and certain hedging transactions, must be derived from some combination of such income from investments in real property (i.e., income that qualifies under the 75% income test described above), as well as other dividends, interest and gain from the sale or disposition of stock or securities, none of which need have any relation to real property.

The Fund believes that its investments in mortgage loans will generate income that complies with both the 75% test and the 95% test, and it intends to monitor compliance on an ongoing basis. If the Fund fails to satisfy one or both of the 75% or 95% gross income tests for any taxable year, it may still qualify as a REIT for the year if it is entitled to relief under applicable provisions of the Code. These relief provisions will be generally available if the failure to meet the gross income tests was due to reasonable cause and not due to willful neglect and the Fund files a schedule of the source of its gross income in accordance with Treasury Regulations. It is not possible to state whether the Fund would be entitled to the benefit of these relief provisions in all circumstances. If these relief provisions are inapplicable to a particular set of circumstances involving the Fund, it would not qualify as a REIT. Even where these relief provisions apply, a tax would be imposed based upon the amount by which the Fund failed to satisfy the particular gross income test.

### *Asset Tests*

At the close of each quarter of the taxable year, the Fund must satisfy seven tests relating to the nature of its assets.

1. At least 75% of the value of its total assets must be represented by “real estate assets,” cash, cash items and government securities, as such terms are defined in the Code.
2. Not more than 25% of the value of its total assets may be represented by securities, other than those in the 75% asset class.
3. Except for certain investments in REITs, TRSs and other securities in the 75% asset class, the value of any one issuer’s securities owned by the Fund may not exceed 5% of the value of its total assets.
4. Except for certain investments in REITs, TRSs and other securities in the 75% asset class, the Fund may not own more than 10% of the total voting power of any one issuer’s outstanding securities.

5. Except for certain investments in REITs, TRSs and other securities in the 75% asset class, the Fund may not own more than 10% of the total value of the outstanding securities of any one issuer, other than securities that qualify for certain debt safe harbors.
6. The aggregate value of all securities of TRSs held by the Fund may not exceed 20% of the value of its gross assets.
7. No more than 25% of the value of the Fund's total assets may consist of debt instruments issued by "publicly offered REITs" (as defined in the Code) to the extent such debt instruments are not secured by real property or interests in real property.

Certain relief provisions are available to REITs to satisfy the asset requirements or to maintain REIT qualification notwithstanding certain violations of the asset and other requirements. One such provision allows a REIT which fails one or more of the asset requirements to nevertheless maintain its REIT qualification if (a) it provides the IRS with a description of each asset causing the failure, (b) the failure is due to reasonable cause and not willful neglect, (c) the REIT pays a tax equal to the greater of (i) \$50,000 per failure and (ii) the product of the net income generated by the assets that caused the failure multiplied by the highest applicable corporate tax rate (currently 21%), and (d) the REIT either disposes of the assets causing the failure within six months after the last day of the quarter in which it identifies the failure, or otherwise satisfies the relevant asset tests within that time period.

In the case of *de minimis* violations of the 10% and 5% asset tests, a REIT may maintain its qualification despite a violation of such requirements if (a) the value of the assets causing the violation does not exceed the lesser of 1.0% of the REIT's total assets and \$10,000,000, and (b) the REIT either disposes of the assets causing the failure within six months after the last day of the quarter in which it identifies the failure, or the relevant tests are otherwise satisfied within that time period.

The Fund believes that its holdings of securities and other assets will comply with the foregoing REIT asset requirements, and it intends to monitor compliance on an ongoing basis. No independent appraisals will be obtained, however, to support the Fund's conclusions as to the value of total assets, or the value of any particular security or securities. Moreover, values of some assets may not be susceptible to a precise determination, and values are subject to change in the future. Accordingly, there can be no assurance that the IRS will not contend that the Fund's asset holdings do not meet one or more of the REIT asset tests.

### ***Annual Distribution Requirements***

To qualify as a REIT, the Fund is required to distribute dividends, other than capital gain dividends, to Members in an amount at least equal to:

- (a) the sum of
  - (1) 90% of the Fund's "REIT taxable income," computed without regard to net capital gains and the deduction for dividends paid, and

- (2) 90% of the Fund's net income, if any (after tax), from foreclosure property (as described below), minus
- (b) the sum of specified items of non-cash income.

These distributions generally must be paid in the taxable year to which they relate, or in the following taxable year if declared before the Fund timely file its tax return for the year and if paid with or before the first regular dividend payment after such declaration. For distributions to be counted for this purpose, and to give rise to a tax deduction by the Fund, they must not be "preferential dividends." A dividend is not a preferential dividend if it is pro rata among all outstanding Shares within a particular class and is in accordance with the preferences among different classes of Shares as set forth in the Fund's organizational documents.

To the extent that the Fund distributes at least 90%, but less than 100%, of its "REIT taxable income," as adjusted, the Fund will be subject to tax at ordinary corporate tax rates on the retained portion. The Fund may elect to retain, rather than distribute, its net long-term capital gains and pay tax on such gains. In this case, the Fund could elect to have its Members include their proportionate share of such undistributed long-term capital gains in income, and to receive a corresponding credit for their share of the tax paid by the Fund. Members would then increase the adjusted basis of their Shares by the difference between the designated amounts of capital gains from the Fund that they include in their taxable income, and the tax paid on their behalf by the Fund with respect to that income.

If the Fund should fail to distribute during each calendar year at least the sum of (a) 85% of its REIT ordinary income for such year, (b) 95% of its REIT capital gain net income for such year, and (c) any undistributed taxable income from prior periods, it would be subject to a non-deductible 4% excise tax on the excess of such required distribution over the sum of (x) the amounts actually distributed and (y) certain retained amounts.

It is possible that the Fund, from time to time, may not have sufficient cash to meet the distribution requirements due to timing differences between (a) the actual receipt of cash and (b) the inclusion of items in income by the Fund for U.S. federal income tax purposes. In the event that such timing differences occur, in order to meet the distribution requirements, it might be necessary to make distributions in the form of Shares or taxable in-kind distributions of property.

The Fund may be able to rectify a failure to meet the distribution requirements for a year by paying "deficiency dividends" to Members in a later year, which may be included in the Fund's deduction for dividends paid for the earlier year. In this case, the Fund may be able to avoid losing its REIT qualification or being taxed on amounts distributed as deficiency dividends. However, the Fund will be required to pay interest and a penalty based on the amount of any deduction taken for deficiency dividends.

### ***Failure to Qualify***

If the Fund failed to satisfy one or more requirements for REIT qualification, other than the gross income tests and the asset tests, it could avoid disqualification if the failure is due to reasonable cause

and not to willful neglect and the Fund pays a penalty of \$50,000 for each such failure. In addition, there are relief provisions for a failure of the gross income tests and asset tests, as described above under “—Income Tests” and “—Asset Tests.”

If the Fund failed to qualify for taxation as a REIT in any taxable year, and the relief provisions described above did not apply, it would be subject to tax on its taxable income at regular corporate rates (currently 21%). Distributions to Members in any year in which the Fund were not a REIT would not be deductible by it, nor would they be required to be made. In this situation, to the extent of current and accumulated earnings and profits, distributions to domestic Members that are individuals, trusts and estates would generally be taxable at capital gains rates and, subject to limitations of the Code, corporate distributees may be eligible for the dividends received deduction. Unless the Fund was entitled to relief under specific statutory provisions, it would also be disqualified from re-electing to be taxed as a REIT for the four taxable years following the taxable year during which qualification was lost. It is not possible to state whether, in all circumstances, the Fund would be entitled to this statutory relief.

### ***Prohibited Transactions***

Net income derived by a REIT from a prohibited transaction is subject to a 100% tax. The term “prohibited transaction” generally includes a sale or other disposition of property (other than foreclosure property, as discussed below) that is held primarily for sale to customers in the ordinary course of a trade or business. The Fund intends to conduct its operations so that no asset owned by it will be held for sale to customers, and that a sale of any such asset will not be in the ordinary course of business. Whether property is held “primarily for sale to customers in the ordinary course of a trade or business” depends, however, on the particular facts and circumstances. No assurance can be given that any property sold by the Fund will not be treated as property held for sale to customers, or that it can comply with certain safe harbor provisions of the Code that would prevent such treatment.

### ***Foreclosure Property***

Foreclosure property is real property and any personal property incident to such real property (i) that is acquired by a REIT as the result of the REIT having bid on the property at foreclosure, or having otherwise reduced the property to ownership or possession by agreement or process of law, after there was a default (or default was imminent) on a lease of the property or a mortgage loan held by the REIT and collateralized by the property, (ii) for which the related loan or lease was acquired by the REIT at a time when default was not imminent or anticipated, and (iii) for which such REIT makes a proper election to treat the property as foreclosure property. REITs generally are subject to tax at the maximum corporate rate (currently 21%) on any net income from foreclosure property, including any gain from the disposition of the foreclosure property, other than income that would otherwise be qualifying income for purposes of the 75% gross income test. Any gain from the sale of property for which a foreclosure property election has been made will not be subject to the 100% tax on gains from prohibited transactions described above, even if the property would otherwise constitute inventory or dealer property in the hands of the selling REIT. To the extent that the Fund receives any income from foreclosure property that is not

qualifying income for purposes of the 75% gross income test, it intends to make an election to treat the related property as foreclosure property.

## **Other Tax Considerations**

### ***Legislative or Other Actions Affecting REITs***

The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Treasury. Changes to the U.S. federal tax laws and interpretations thereof could adversely affect an investment in Shares.

### ***State, Local and Foreign Taxes***

State, local and non-U.S. income tax laws may differ substantially from the corresponding federal income tax laws, and this discussion does not purport to describe any aspect of the tax laws of any state, local or non-U.S. jurisdiction. You should consult your tax advisor regarding the effect of state, local and non-U.S. tax laws with respect to the Fund's tax treatment as a REIT and on an investment in Shares.

## **SUMMARY OF OPERATING AGREEMENT**

The following is a summary of the Seventh Amended and Restated Operating Agreement of the Fund dated July 1, 2018, as amended and in effect as of the date of this Offering Circular. This summary is qualified in its entirety by the terms of the Operating Agreement itself. Potential investors are urged to read the entire Operating Agreement, which is set forth as Exhibit A to this Offering Circular. By executing a Subscription Agreement to purchase Shares, investors will agree to become Members of the Company subject to the terms of the Operating Agreement.

### **Rights and Liabilities of Members**

The rights, duties and powers of Members are governed by the Operating Agreement and by the California Limited Liability Company Act ("Act"), and the discussion herein of such rights, duties and powers is qualified in its entirety by reference to the Operating Agreement and the Act.

Members are generally not responsible for the obligations of the Fund and will be liable only to the extent of the purchase price of their Shares.

Members will have no control over the management of the Fund except that, in some cases with the consent of the Manager, Members representing a majority of the outstanding Shares may approve or disapprove any of the following matters: (a) dissolution of the Fund; (b) amendment of the Operating Agreement (other than certain amendments for which no approval is required); (c) removal of the Manager and election of a successor manager; (d) sale of the Fund or substantially all of its assets; (e) merger of the Fund with any other entity; or (f) certain transactions in which the Manager or its Affiliates are parties. In addition, upon the cessation of the Manager for any reason (such as the withdrawal or resignation of the

Manager), Members representing a majority of the outstanding Shares may elect a replacement manager to the Board of Managers.

### **Capital Contributions**

Shares will be sold for \$1,000 each, and no investor may subscribe for less than 250 Shares except at the sole discretion of the Manager. To purchase Shares an investor must deliver to the Fund a Subscription Agreement in the form attached to this Offering Circular as Exhibit B, together with a check for payment in full of the amount of Shares that the investor has subscribed for in the Subscription Agreement. At no time shall any Member be required to contribute additional capital in excess of its original payment for the Shares.

The capital contributions of each Member will initially be deposited and held by the Fund in escrow in an interest-bearing account (referred to as the “**Subscription Account**”), until such time as the Fund first makes use of the investor’s subscription amount. While the investor’s subscription funds are on deposit in the Subscription Account, the investor shall not be a Member nor be entitled to distributions from the Fund, with respect to amounts held in the Subscription Account. Rather, the investor shall receive any interest the funds may earn in said account pursuant to the terms of the Subscription Agreement. The investor’s subscription amount will be transferred from the Subscription Account into the Fund’s general operating account on a first in, first out basis, as capital is needed by the Fund. Commencing on the date of the transfer of the investor’s subscription amount from the Subscription Account to the operating account, the investor will be issued Shares and become a Member. Such transfers occur only on the first day of any calendar month, or, if the first calendar day of a calendar month is not a business day, on the first business day of such calendar month, provided that Subscriber shall become a member of the Fund, and the purchased Shares shall be credited to Subscriber, as of the first calendar day of such calendar month. Funds on deposit in the Subscription Account will not be transferred to the Fund’s operating account until all other available cash in the Fund’s operating account, except net income available for distribution to Members, has been expended, except at the discretion of the Manager where, in its opinion, the interests of Members will not be significantly diluted.

### **Rights, Powers and Duties of Manager**

Subject to the right of the Members to vote on specified matters as described below under the heading “**Voting and Other Rights of Members,**” the Board of Managers will have complete charge of the business of the Fund. The Manager is not required to devote full time to Fund affairs but only such time as is required for the conduct of Fund business. The Manager, acting alone, has the power and authority to act for and bind the Fund.

### **Voting and Other Rights of Members**

The Board of Managers may amend the Operating Agreement without the Members’ consent to remedy any ambiguity or formal defect or omission, conform it to applicable laws and

regulations, and make any change, which in the judgment of the Manager, is not to the prejudice of the Members. The vote or consent of a majority in interest of Members is required to do any of the following:

- amend the Operating Agreement, except in the instances mentioned above,
- dissolve the Fund and wind up the business,
- sell substantially all of the assets of the Fund,
- merge the Fund with another entity,
- add or remove a Manager,
- engage in certain transactions in which the Manager or one of its Affiliates is a party, other than as permitted under the Agreement, or
- engage in any action in contravention of the Agreement or that would make it impossible to carry on the business of the Fund.

Members may inspect the Fund's books and records at the principal office during regular business hours.

### **Meetings**

The Fund is not required to conduct regular meetings of Members, but either the Manager or Members representing at least 40.00% of the membership interests may call special meetings of the Members. Voting may be in person or by proxy at any meeting of Members, or by written consent in lieu of a meeting of Members.

### **Shares**

Each Share represents an undivided equity interest in the Fund. A Member may require the Fund to redeem his/her Shares by submitting a written request for redemption to the Manager, subject to certain requirements, including the Fund having adequate Net Capital Proceeds to make the requested redemption.

### **Distributions to Members**

The Mortgage Loans invested in by the Fund generate monthly income in the form of payments by the borrowers of interest. The Fund distributes current net income to the Members, monthly, in cash. Distributions are generally made by the 15<sup>th</sup> day of each month, or the next business day in the event the 15<sup>th</sup> day falls on a weekend or holiday. "**Net Income Available for Distribution**" is defined in

the Operating Agreement to mean cash funds from operations (but not interest earned on the Subscription Account or repayment of loan principal), less expenses charged to the Fund and reserves, if any. Members whose investments are held in the Subscription Account will not receive a share of Net Income for Distribution with respect to such amounts but will receive their pro rata share of the net interest earnings from the Subscription Account, without deduction of expenses of the Fund based on the number of Shares held by each Member.

The first distribution to each Member will be made for the month in which the Member's Shares were issued and the Member was admitted to the Fund. Investors whose subscription funds are held in the Subscription Account will share proportionately in the net interest earnings from the Subscription Account, and the Members whose subscription funds have been transferred to the Fund's general account will share proportionately in the Net Income Available for Distribution.

The Fund will not accumulate assets other than Mortgage Loans. Cash will not be accumulated except to the extent required for reserves established by the Manager and for payments of redemptions requested by the Members.

Proceeds from the repayment of principal on Mortgage Loans, net proceeds of a sale of REO, insurance proceeds on secured real property, payments by guarantors, and proceeds from sale of Fund assets are defined as "**Net Capital Proceeds**" in the Operating Agreement. The Board of Managers, in its sole discretion, will determine whether, when and how much of Net Capital Proceeds received by the Fund will be distributed in cash to the Members.<sup>1</sup> The Manager shall apply Net Capital Proceeds in the following order of priority: (i) paying permitted operating expenses and liabilities, (ii) maintaining and improving any property acquired through foreclosure, (iii), redeeming Members' Shares, (iv) reinvesting in new Mortgage Loans, and (v) making distributions to Members. The Board of Managers may use any Net Capital Proceeds not distributed to Members to repurchase Shares pursuant to the Fund's share repurchase program (See "**SHARE REPURCHASE PROGRAM**").

### **Assignment and Transfer of Shares**

A Member's rights to sell or transfer Shares are subject to certain conditions. There is no public market in which to sell Shares. It is not expected that a public market will emerge anytime in the future. See "**TERMS OF THE OFFERING – Restrictions of Ownership and Transfer of Shares**" – "**Transferability of Shares.**"

### **Redemption of Shares**

A Member may request that the Fund redeem any, or any part of, his or her Shares, by a written notice of withdrawal to the Manager, subject to the following additional conditions:

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<sup>1</sup> NTD: New sentence here is verbatim from Section 8.3 of the operating agreement. I have suggested adding it to establish the basis under the operating agreement for use of Net Capital Proceeds for repurchases.

- Unless redemption is due to the death, disability, mental incompetence or other personal hardship of the redeeming Member, as determined in the discretion of the Board of Managers, no redemptions may be made by any Member for at least one year from the date the Member acquired the Shares.
- Total redemptions that may be made by any one Member will be limited to no more than the greater of \$100,000 or 25.00% of the Member's total number of Shares per quarter, unless the withdrawal is due to the death, disability, mental incompetence or other personal hardship of the withdrawing Member, as determined in the discretion of the Board of Managers.
- In order to ensure that the proposed redemption will not impair the capital or operation of the Fund, funds for redemptions can be made only from Net Capital Proceeds and Capital Contributions, and the Fund must have sufficient funds from those sources.
- The Fund will not sell any portion of assets to fund a redemption or use any other sources of funds.
- The redemption price is \$1,000 per Share.
- All payments to meet requests for redemption are on a “**first-come, first-served**” basis. If the sums needed to fund redemptions in any particular month exceed the amount of cash available for redemptions, funds will be distributed first to the Member whose request is received first, until that Member's redemption request is paid in full, before any additional redemption payments are made to any other Member.
- The minimum aggregate redemption amount is \$25,000, and additional partial redemptions may be made only in increments of \$25,000.
- No redemption will be permitted if the redemption would cause any person to violate the restrictions on ownership and transfer discussed above in “**TERMS OF THE OFFERING-Restrictions of Ownership and Transfer of Shares.**”
- There is no penalty for redemptions.

Investors who wish to have the Fund purchase Shares in excess of the limitations on redemptions described above may request that the Fund repurchase some or all of their Shares. Shares will be repurchased in the sole discretion of the Board of Managers, and subject to certain limitations, including the availability of funds. See “**SHARE REPURCHASE PROGRAM.**”

### **Term of the Fund**

The term of existence of the Fund commenced on January 21, 2003, and shall continue indefinitely, unless terminated by the provisions of the Operating Agreement or as provided by law. Additionally, the Fund may dissolve if the two principal officers of the Manager cease to serve as officers of the Manager, by reason of death, resignation, incapacity or otherwise, or if Lone Oak Industries, Inc. is removed as the Manager and the Members cannot agree on a new Manager within six months.

## **Special Power of Attorney**

Under the terms of the Operating Agreement and the subscription agreement, the Manager is appointed the Member's attorney-in-fact for certain documents, including the signing of the Operating Agreement. This special power of attorney cannot be revoked, and it survives a Member's death and the assignment of the Shares.

## **Winding Up**

Upon dissolution of the Fund, the Manager will wind up the Fund's affairs as follows: (1) no new Mortgage Loans will be made or purchased; and (2) the Manager or its successor will liquidate the Fund's remaining assets as promptly as is consistent with obtaining the fair current value thereof, either by sale to third parties or by collecting loan payments under the terms of the Mortgage Loans. All funds received by the Fund shall be applied and promptly distributed first to pay permitted operating expenses and liabilities, including maintaining and improving any REO, second to the establishment and maintenance of a reserve for payment of contingent or unknown liabilities and third to the Members in accordance with their respective capital accounts.

## **SHARE REPURCHASE PROGRAM**

### **Repurchase Price, Timing and Amounts**

A Member may request that the Fund repurchase all or any portion of the Member's Shares, upon one year of ownership, at a repurchase price of \$1,000 per Share, on the terms and conditions outlined below. If a Member submits a request for redemption of Shares as described above under "SUMMARY OF THE OPERATING AGREEMENT – Redemption of Shares", a Member may also request that the Fund repurchase all, or any part, of their Shares in excess of the limits on redemption of Shares. All repurchases will be made in the sole discretion of the Board of Managers on the terms and conditions and subject to the limitations described below. The Board of Managers may elect to cause the Fund to repurchase fewer Shares than are the subject of repurchase requests in any particular month, or none at all, in the Board's sole discretion.

The Board of Managers currently intends to authorize the Fund to repurchase Shares on the terms and conditions below:

*Repurchase Price:* The repurchase price will be \$1,000 per Share, which may be more or less than the current fair market value or Net Asset Value of the Shares repurchased.

*Sources of Funds:* The repurchase price will be funded only from Net Capital Proceeds and Capital Contributions. The amount of funds used to repurchase Shares in any period will be determined in the sole discretion of the Board of Managers, after evaluation of cash needs for (i) paying permitted operating expenses and liabilities, (ii) maintaining and improving any property acquired through

foreclosure, (iii), redeeming Members' Shares, (iv) reinvesting in new Mortgage Loans, and (v) making distributions to Members. The Fund will not be required to establish a reserve fund for funding future repurchase requests or to sell or otherwise liquidate any portion of the Fund's Mortgage Loans or any other assets in order to fund any requested repurchase. Any election by the Fund to repurchase Shares is in the sole discretion of the Board of Managers, the Fund is not required to repurchase any Shares pursuant to the share repurchase program, and the Fund may decline to repurchase Shares in any month, or at all, notwithstanding the availability of funds.

*Minimum Holding Period:* A Member must have held the Shares for at least one year prior to offering them for sale to the Fund through the share repurchase program, except in cases of death or disability of a Member. Upon the death or disability of a Member, upon request, the Board of Managers may waive the one-year holding requirement. A Member (or his or her estate, heir or beneficiary in the event of the death of the Member) must provide such evidence as the Manager may reasonably require in connection with such a waiver and will make determinations of a Member's disability in its sole discretion. In such instances, such repurchases will be subject to the other conditions and limitations described in this Offering Circular.

*Minimum Repurchase Amount:* The minimum aggregate repurchase amount is \$25,000, and additional partial repurchases may be made only in increments of \$25,000 or, if less, a Member's entire remaining interest in the Fund.

*Maximum Annual Repurchase Amount:* The Fund does not intend to repurchase more than ten percent (10%) of the Fund's issued and outstanding Shares in any year.

*Monthly Closing Dates:* The Fund intends to repurchase Shares only on the last day of any calendar month. Each Member whose repurchase request is granted will receive the repurchase amount within [15] days after the end of the calendar month in which his or her repurchase request is accepted.

*Priority of Repurchases:* If the Board of Managers authorizes the Fund to repurchase some, but not all, of the Shares submitted for repurchase during any month, Shares will generally be repurchased as follows: (i) first, pro rata as to repurchases upon the death or disability of a Member; (ii) next, pro rata as to repurchases from Members who demonstrate, in the discretion of the Board of Managers, another involuntary exigent circumstance, such as bankruptcy; (iii) next, pro rata as to repurchases from Members subject to a mandatory distribution requirement under such Member's IRA or qualified plan; (iv) next, pro rata as to Members who requested repurchase of their Shares in a prior month, with repurchase requests from the earliest month accepted, pro rata, before repurchase requests submitted in later months will be accepted; and (v) finally, pro rata as to all other repurchase requests. Any repurchase request not accepted by the Fund in any month will be carried forward to the next monthly repurchase period unless and until the repurchase request is accepted by the Fund, or the Member withdraws his or her request for repurchase.

*Compliance with Laws:* Repurchases of Shares under the share repurchase program will be subject to compliance with applicable federal and state securities laws and restrictions applicable to

preserve the status of the Fund as a REIT under the Code. No Shares will be repurchased if the repurchase would cause any person to violate the restrictions on ownership and transfer discussed above in “**TERMS OF THE OFFERING--Restrictions of Ownership and Transfer of Shares.**”

*ERISA Limitations:* The Fund will not repurchase any Shares of any Member if, in the sole discretion of the Board of Managers, the repurchase could result in the assets of the Fund being deemed to be plan assets of one or more benefit plan investors.

Shares repurchased under the share repurchase program will have the status of authorized but unissued Shares.

### **Modification or Waiver of the Share Repurchase Program**

The Fund may modify, suspend or terminate the share repurchase plan at any time or from time to time in the sole discretion of the Board of Managers. Material modifications, including any amendment to the annual limitations on repurchases, to and suspensions of the share repurchase plan will be promptly disclosed to Members. In addition, the Fund may suspend the share repurchase plan due to regulatory changes, changes in law or if the Manager becomes aware of undisclosed material information that it reasonably believes should be disclosed before Shares are repurchased. Once the share repurchase plan is suspended, the Board of Managers must affirmatively authorize the recommencement of the share repurchase plan before Member repurchase requests will be considered again. Any material modifications, suspension, termination or reinstatement of the share repurchase program will be disclosed to Members promptly.

The Fund reserves the right, in the sole discretion of the Board of Managers, at any time and from time to time, to:

- waive the 1-year holding period requirement in the event of involuntary exigent circumstances such as bankruptcy or a mandatory distribution requirement under a Member's IRA or qualified plan;
- reject any request for repurchase;
- change the purchase price for repurchases;
- increase, decrease or waive for one or more Members the annual limit on total repurchases to be made pursuant to the share repurchase program; or
- otherwise amend, suspend or terminate the terms of the share repurchase program.

## **Procedures for Requesting Repurchase**

Under the share repurchase program, to the extent the Board of Managers authorizes the Fund to repurchase Shares in any particular month, the Fund will only repurchase Shares as of the last business day of the month. Repurchase requests must be received in good order by noon (Pacific time) on the business day prior to the last business day of each month. A Member may withdraw (cancel) their repurchase request by notifying the Fund in writing. Such requests must be received by noon (Pacific time) on the second business day prior to the last business day of each month.

A Member who wishes to have Shares repurchased must mail or deliver to the Fund a written request on a form attached to this Offering Circular as **Exhibit C**, or such other form as the Manager may require, executed by the Member or the Member's authorized agent. An estate, heir or beneficiary that wishes to have Shares repurchased following the death of a Member must mail or deliver to the Fund a written request on a form provided by the Manager, including evidence acceptable to the Manager of the death of the Member, and executed by the executor or executrix of the estate, the heir or beneficiary, or their trustee or authorized agent. To request a waiver of the limitations set forth above due to disability of a Member, the Fund must receive a written determination of the Member's disability.

## **INVESTOR SUITABILITY STANDARDS**

An investment in the Fund is designed for the sophisticated investor who has such business and financial experience or who, together with his representative, has such business and financial experience that he is capable of evaluating the merits and risks of an investment in the Fund, and who has sufficient assets to permit continued investment in the Fund.

The Fund will sell Shares only to "**Accredited Investors**" as that term is defined in Rule 501(a) of Regulation D.

The Fund has established these standards for the purchase of Shares based upon the risks inherent in the business to be conducted by the Fund, the lack of liquidity of the Shares, and because the Fund Shares represent a long-term investment. See "**RISK FACTORS AND OTHER IMPORTANT CONSIDERATIONS.**"

Prospective investors will be required to complete a Subscriber Suitability Questionnaire in the form included in the Subscription Agreement (Exhibit "**B**" hereto) which provides the information necessary to verify the foregoing suitability standards. In addition, investors will be required to provide the Fund with any additional information or documentation that may be required to verify the representations contained in the Subscriber Suitability Questionnaire. The admission of any prospective investor to the Fund, and the acceptance of the subscription of any potential investor will be in the sole discretion of the Fund.

## **ADDITIONAL INFORMATION**

The Fund undertakes to make available to each offeree every opportunity to obtain any additional information from the Fund or the Manager necessary to verify the accuracy of the information contained in this Offering Circular, to the extent that it possesses such information or can acquire it without unreasonable effort or expense. This additional information includes, without limitation, all the organizational documents of the Fund, and all other documents or instruments relating to the operation and business of the Fund and material to this offering and the transactions contemplated and described in this Offering Circular.

## EXHIBITS