

## LENDING STANDARDS AND POLICIES

### General Standards for Mortgage Loans

Saxe Mortgage Company engages in the business of making loans secured by deeds of trust that encumber real estate located in California, primarily in San Francisco, San Mateo or Marin counties. Saxe Mortgage loans will be secured by commercial and residential properties, including multi-unit residential property, office buildings, industrial and warehouse facilities, retail stores, shopping centers and single family homes. Saxe Mortgage loans will not be insured or guaranteed by any governmental agency or private entity. Saxe Mortgage will select loans for investment pursuant to a strict set of guidelines set forth below, that are designed to set standards for the quality of the real property security given for the loans.

1. **Priority of Mortgages.** Licensed in California, set are of concentration in the San Francisco bay area excluding the East bay.

2. **Geographic Area of Lending Activity.** All Saxe Mortgage loans will be secured by deeds of trust on properties located in California.

3. **Loan-to-Value Ratios.** Saxe Mortgage shall obtain a valuation for each security property on which it will make or invest in a mortgage loan based upon an appraisal and/or market value analysis performed by an independent certified appraiser (a “**Market Value Analysis**”). The amount of a Saxe Mortgage loan combined with the outstanding debt secured by any senior deed of trust on the security property generally will not exceed the following percentage, based on the value of the security property as determined by the Market Value Analysis at the time the loan is made:

<u>Type of Property/Loan</u>	<u>Loan to Value Ratio</u>
Residential	70%
Commercial Property (including multi-unit residential property, office buildings, industrial and warehouse facilities, retail properties)	60%

The foregoing loan-to-value ratios may be increased if, in the reasonable discretion of the , a higher loan amount is warranted by the circumstances of a given loan.

4. **Terms of Loans.** The term of Saxe Mortgage loans will vary at the discretion of the underwriter. Saxe Mortgage loans will generally have a term of between one to five years and will be interest only with a “balloon payment” at the end of the term.

5. **Escrow Conditions.** Saxe Mortgage funds loans through an escrow account handled by Saxe Mortgage or a qualified title insurance or escrow company. The escrow agent will be instructed not to disburse any funds until the following conditions are met:

(a) Satisfactory title insurance coverage will be obtained for all loans, with the title insurance policy naming Saxe Mortgage as the insured and providing title insurance in an amount equal to the principal amount of the loan. Title insurance insures only the validity and priority of the Saxe Mortgage'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 security property, over-appraisals, borrower's defaults, etc.

(b) Satisfactory fire and casualty insurance has been obtained for all loans, which insurance shall name Saxe Mortgage as loss payee in an amount equal to the principal amount of the Saxe Mortgage loan.

### **Credit Evaluations**

Saxe Mortgage may consider the income level and general creditworthiness of a borrower, and any guarantor, to determine a borrower's ability to repay the Saxe Mortgage loan according to its terms, but such considerations are subordinate to a determination that a borrower has sufficient equity in the security property to satisfy the loan-to-value ratios described above. Therefore, Saxe Mortgage may make loans to borrowers with impaired credit (e.g., to consolidate their debts) or who do not have verifiable sources of income that would be sufficient to qualify for loans from other lenders such as banks or savings and loan associations.

### **Loan Servicing**

It is anticipated that all Saxe Mortgage loans will be "serviced" (i.e., loan payments will be collected and other administrative services performed) by the Saxe Mortgage; however, Saxe Mortgage may obtain a third party loan servicer, including an affiliate of Saxe Mortgage. Saxe Mortgage and its affiliates will be compensated for such loan servicing activities.

Borrowers will make loan payments in arrears (i.e., with respect to the preceding month) and will be instructed to mail their checks either to Saxe Mortgage directly or to the duly licensed servicer for deposit in the servicer's trust account on behalf of Saxe Mortgage.

### **SAXE MORTGAGE TEAM**

**Gene Kristul** is the President of Saxe Mortgage, is a California licensed attorney and a California real estate broker. He graduated from the University of San Francisco with a BBA in Finance and Golden Gate University School of Law with a JD degree, being admitted to the California Bar in 1996. He has 18 years' experience in practicing real estate, has been a board member of a publicly-traded mortgage bank, has headed a large Internet and direct mail originating Mortgage Company and was in private law practice for several years with an emphasis on business.

## **RISKS AND OTHER IMPORTANT FACTORS**

Any investment in fractionalized lending 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 investments, 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.”

### **Sub-Prime Lending Market**

While the Saxe Mortgage does not arrange and does not service traditional “sub-prime” loans, recent media attention regarding the increased foreclosures of such loans and the resulting failure of many institutional lenders in the sub-prime lending industry has and will continue to increase some of the potential risks associated with an investment in Shares.

The term “sub-prime lending” generally refers to loans secured by owner-occupied residential properties made or arranged on behalf of lenders who are generally in the market of making such loans and selling such loans on the secondary market (“Sub-Prime Lenders”). Sub-prime loans differ from traditional institutional loans, which are often referred to as “prime loans” or “A-paper” loans (“Traditional Loans”), for two main reasons: (i) the credit score or “FICO score” required of the borrower to qualify for a loan is less than that required for Traditional Loans; and (ii) the amount of the loan compared to the value of the property securing the loan (i.e., the loan-to-value ratio) is, in most cases, significantly higher than Traditional Loans. While the creditworthiness of borrowers on sub-prime loans can be less than Traditional Loans, the underwriting of such loans nonetheless are credit based loans that rely very little on the equity held in the security property. With the steady rise of real estate values over the last 10 years it became very common to see Sub-Prime Lenders offering loans with loan-to-value ratios of 100% (i.e., a loan equal to the value of the property securing the loan). Therefore, unless there is considerable appreciation in the value of the security property, sub-prime loans have a higher risk of loss upon default and foreclosure.

Loans made and arranged by Saxe Mortgage are underwritten on an asset basis rather than a credit basis. Consequently, the diminution of the value of the security property upon foreclosure will result in a loss to the lenders on a loan only to the extent that such diminution exceeds the Borrower’s equity in such property.

Nonetheless, asset based loans involve the various risks set forth herein. Additionally, the failure of the “sub-prime” market can affect the overall housing market and can increase many of these risks. These increased risks include: (i) an increased risk of the non-availability of credit for the Borrower to develop the Property or refinance the Secured Note at maturity; (ii) an increased risk of foreclosures in the area surrounding the security property negatively affecting the value of the Property securing the Loan; (iii) increased constraints on consumer credit affecting the ability of borrower’s to sell completed residential projects; (iv) increased risk of foreclosures by the Borrower on other unrelated loans and/or the diminution of the value of the completed project causing an abandonment of the project by the Borrower.

## **Loan Defaults and Foreclosures**

Saxe Mortgage is in the business of lending money and, as such, takes the risk of defaults by borrowers and other risks faced by lenders. Some Saxe Mortgage loans will provide for monthly payments of interest only, but be entirely due and payable in five years or less. Thus, the borrower may have to make a large “balloon” payment of principal due at the end of the term. Many borrowers are unable to repay such loans out of their own funds and are compelled to refinance. Fluctuations in interest rates and the unavailability of mortgage funds could adversely affect the ability of borrowers to refinance their loans at maturity.

Saxe Mortgage will frequently be an “asset” rather than a “credit” lender although all borrowers will need to demonstrate adequate ability to meet its financial obligations under the terms of any loan which Saxe Mortgage may offer. This means that Saxe Mortgage may rely primarily on the value of the real property securing loans to protect its investment however with repayment ability always being taken into consideration. There are a number of factors which could adversely affect the value of any such real property securing loans, including, among other things, the following:

1. Saxe Mortgage will rely on a Market Value Analysis to determine the fair market value of real property used to secure loans made by Saxe Mortgage. No assurance can be given that the Market Value Analysis will in any or all cases, be accurate. Moreover, since a Market Value Analysis 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 nationwide, statewide or local economic, demographic, property or other trends, or may include specific local events such as freeway construction or adverse weather conditions. Neither an appraiser, a broker nor Saxe Mortgage will be able to predict with any certainty whether these events will occur after a loan is made.

2. If the borrower defaults, the investors may be forced to purchase the property at a foreclosure sale. If Saxe Mortgage cannot quickly sell such property, and the property does not produce any significant income, the investors profitability will be adversely affected.

3. To the extent that 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.”)

4. Due to certain provisions of California law applicable to all real estate loans, if the real property security proves insufficient to repay amounts owing to the Investor, the Saxe Mortgage may not have a right to recover any deficiency from the borrower. (See “Certain Legal Aspects Of Fund Loans.”)

5. The property securing Saxe Mortgage loans could be adversely affected by earthquakes, floods, mud slides, similar events and acts of God that may not be insured against. (See “Uninsured Losses,” below.)

## **Uninsured Losses**

The Manager will arrange for title, fire and casualty insurance on the properties securing the Saxe Mortgage loans. Saxe Mortgage may also, but is not required to, arrange for earthquake insurance. However, there are certain types of losses (generally of a catastrophic nature) which are either uninsurable or not economically insurable, such as losses due to war, floods, mudslides or other acts of God. Should any such disaster occur, or if casualty insurance is allowed to lapse through oversight, Saxe Mortgage could suffer a loss of principal and interest on the loan secured by the uninsured property. Furthermore, other losses could occur which may result in the denial of insurance coverage or inadequate inaccurate coverage or other unforeseen circumstances and may also lead to loss of principal and interest or damages on a loan investment.

## **Lack of Regulation**

The management and investment practices of Saxe Mortgage are not supervised or regulated by any federal or state authority, except to the extent that the lending and brokerage activities of the Saxe Mortgage are subject to supervision or regulation by the California Department of Real Estate.

## **Environmental Liabilities**

Under current federal and state law, the owner of real property contaminated with toxic or hazardous substances (including a mortgage lender that has acquired title through foreclosure) may be 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.

Even if the Saxe Mortgage does not foreclose on a contaminated site, the mere existence of hazardous substances on the property may depress the market value of the property such that the loan is no longer adequately secured.

A lender's best protection against environmental risks is to thoroughly inspect and investigate the property before making or investing in a loan; however, environmental inspections and investigations are very expensive, and often are not financially feasible in connection with loans of the size and type to be made by Saxe Mortgage, particularly in the case of residential mortgage loans. As a result, toxic contamination reports or other environmental site assessments will generally not be obtained by the Saxe Mortgage in connection with its loans. Saxe Mortgage will, however, take certain precautions to avoid environmental problems, such as not making or investing in loans secured by properties known or suspected to have (or to be likely to have) environmental problems.

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

When the investor acquires any equity or leasehold interest in real property by direct investment, foreclosure or otherwise, the investor is exposed to the risks of liability incident to real property ownership or tenancy. 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.

## **Risks of Litigation**

Saxe Mortgage will act in good faith and use reasonable judgment in selecting borrowers and making and managing the loans. However, as a lender, the Saxe Mortgage is exposed to the risk of litigation by a borrower for any allegations by the borrower (warranted or otherwise) regarding the terms of the loans or the actions or representations of the Saxe Mortgage in making, managing or foreclosing on the loans. It is impossible for the Saxe Mortgage to foresee what allegations may be brought by a specific borrower, and Saxe Mortgage will use its best efforts to avoid litigation if, in Saxe Mortgage's judgment, the circumstances warrant an alternative resolution.

## **ERISA CONSIDERATIONS**

The Employee Retirement Income Security Act of 1974 ("**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 man 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 Saxe Mortgage insofar as the diversification requirements of ERISA are concerned. An investment in the Saxe Mortgage is relatively illiquid, and fiduciaries must not rely on an ability to convert an investment in the Saxe Mortgage 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 HIS OWN TAX ADVISOR OR PENSION CONSULTANT TO DETERMINE THE APPLICATION OF ERISA TO HIS OR HER PROSPECTIVE INVESTMENT.**

## **CERTAIN LEGAL ASPECTS OF FUND LOANS**

Each of Saxe Mortgage's loans will be secured directly by a deed of trust, the most commonly used real property security device in California. The deed of trust (also commonly referred to as a mortgage) formally has three parties: a debtor-trustor, a third-party grantee called the "trustee," and the 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 investor will be the beneficiary under all deeds of trust securing Saxe Mortgage loans.

## **Foreclosure**

Foreclosure of a deed of trust is accomplished in most cases by a nonjudicial trustee's sale under the power-of-sale provision in the deed of trust. Prior to such sale, the trustee must record a notice of default and send a copy to the trustor, to any person who has recorded a request for a copy of a notice of default and notice of sale, to any successor in interest to the trustor and to the beneficiary of any junior deed of trust. If the default is not cured within 90 days after the filing of the notice of default, then at least 20 days before the trustee's sale, notice of sale must be posted in a public place and published once a week over such period. A copy of the notice of sale must be posted on the property, and sent to the trustor, to each person who has requested a copy, to any successor in interest to the trustor and to the beneficiary of any junior deed of trust, at least 20 days before the sale. The trustor or any person having a junior lien or encumbrance of record may; until five business days prior to the date of a scheduled foreclosure date, cure the default by paying the entire amount of the debt then due, exclusive of principal due only because of acceleration upon default, plus costs and expenses actually incurred in enforcing the obligation and statutorily limited attorney's and trustee's fees. Following the sale, neither the debtor-trustor nor a junior lienor has any right of redemption, and the beneficiary may not obtain a deficiency judgment against the trustor.

A judicial foreclosure (in which the beneficiary's purpose is usually to obtain a deficiency judgment where otherwise unavailable) is subject to most of the delays and expenses of other lawsuits, sometimes requiring up to several years to complete. Following a judicial foreclosure sale, the trustor or his successors in interest will have certain rights to redeem the property, unless the creditor waives any right to a deficiency. Saxe Mortgage generally will not pursue a judicial foreclosure to obtain a deficiency judgment, except where, in the sole discretion of the Saxe Mortgage, such a remedy is warranted in light of the time and expense involved.

## **Anti-Deficiency Legislation**

California has four principal statutory prohibitions which limit the remedies of a beneficiary under a deed of trust. Two statutes limit the beneficiary's right to obtain a deficiency judgment against the trustor following foreclosure of a deed of trust, one based on the method of foreclosure and the other on the type of debt secured. Under one statute, a deficiency judgment is barred where the foreclosure was accomplished by means of a nonjudicial trustee's sale. It is anticipated that all of Saxe Mortgage's loans will be enforced by means of a nonjudicial trustee's sale, if foreclosure becomes necessary. Under the other statute, a deficiency judgment is barred in any event where the foreclosed deed of trust secured a "purchase money" obligation, i.e., a promissory note evidencing a loan used to pay all or a part of the purchase price of a residential property occupied, at least in part, by the purchaser.

Another statute, commonly known as the "one form of action" rule, requires the beneficiary to exhaust the security under the deed of trust by foreclosure before bringing a personal action against the trustor on the promissory note. The fourth statutory provision limits any deficiency judgment obtained by the beneficiary following a judicial sale to the excess of the outstanding debt over the fair market value of the property at the time of sale, thereby preventing a beneficiary from obtaining a large deficiency judgment against the debtor as a result of low bids at the judicial sale. 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 a foreclosed property.

### **Special Considerations in Connection with Junior Encumbrances**

In addition to the general considerations concerning trust deeds discussed above, there are certain additional considerations applicable to second, third or fourth deeds of trust (“junior encumbrances”). By its very nature, a junior encumbrance is less secure than more senior ones. Only the holder of a first trust deed is permitted to bid in the amount of his credit at his foreclosure sale; junior lienholders must bid cash. If a senior lienholder forecloses on its loan, unless the amount of the bid exceeds the senior encumbrances, the junior lienholders will receive nothing. Because of the limited notice and attention given to foreclosure sales, it is possible for junior lienholders to be sold out, receiving nothing from the foreclosure sale. However, in such event the junior lienholder may have a personal action against the borrower to enforce the debt.

Accordingly, a junior lienholder (such as Saxe Mortgage) may find that the only method of protecting its security interest in the property is to take over all obligations of the trustor with respect to senior encumbrances while the junior lienholder commences his foreclosure, making adequate arrangements either to (i) find a purchaser of the property at a price which will recoup the junior lienholder’s interest or (ii) to pay off the senior encumbrances so that his encumbrance achieves first priority. Either alternative will require the Fund to make substantial cash expenditures to protect its interest. (See “Risk Factors -- Defaults in Loan Payments; Foreclosures.”)

Saxe Mortgage will record a Request For Notice of Default at the time its trust deed is recorded. This procedure entitles the Saxe Mortgage to notice when any senior lienholder files a Notice of Default and will provide more time to make alternate arrangements to protect its security interest.

In the event the borrower defaults solely upon his debt to Saxe Mortgage while continuing to perform with regard to the senior lienor, the Saxe Mortgage (as junior lienor) will foreclose upon its security interest in the manner discussed above in connection with deeds of trust generally. Upon foreclosure by a junior lienor, the property remains subject to all liens senior to the foreclosed lien. Thus, were Saxe Mortgage to purchase the security property at its own foreclosure sale, it would acquire the property subject to all senior encumbrances.

The standard form of deed of trust used by most institutional lenders, like the one that will be used by Saxe Mortgage, confers on the beneficiary the right both to receive all proceeds collected under any hazard insurance policy and all awards made in connection with any condemnation proceedings, and to apply such proceeds and awards to any indebtedness secured by the deed of trust, in such order as the beneficiary may determine. Thus, in the event improvements on the property are damaged or destroyed by fire or other casualty, or in the event the property is taken by condemnation, the beneficiary under the underlying first deed of trust will have the prior right to collect any insurance proceeds payable under a hazard insurance policy and any award of damages in connection with the condemnation, and to apply the same to the indebtedness secured by the first deed of trust before any such proceeds are applied to repay



the investors loan. Applicable case law, however, imposes upon the lender the good faith obligation to apply the proceeds toward reconstruction where the lender's security would not be impaired.

### **“Due-on-Sale” Clauses**

Saxe Mortgage's forms of promissory notes and deeds of trust, like those of most lenders, contain “due-on-sale” clauses permitting Saxe Mortgage to accelerate the maturity of a loan if the borrower sells the property, but do not usually contain “due-on-encumbrance” clauses which would permit the same action if the borrower further encumbers the property (i.e., executes further deeds of trust). The enforceability of these types of clauses is discussed below:

1. Due-on-Sale. Due-on-sale clauses contained in mortgage loan documents executed by Saxe Mortgage after October 15, 1982 are enforceable in accordance with their terms. However, acquisition of a property by Saxe Mortgage by foreclosure on one of its loans would also constitute a “sale” of the property, and would entitle a senior lienholder to accelerate its loan against Saxe Mortgage. This would be likely to occur if then-prevailing interest rates were substantially higher than the rate provided for under the accelerated loan. In that event, Saxe Mortgage may be compelled to sell or refinance the property within a short period of time, notwithstanding that it may not be an opportune time to do so.

2. Due-on-Encumbrance. With respect to mortgage loans on residential property containing four or less units, federal and California law prohibits acceleration of the loan merely by reason of the further encumbering of the property (e.g., execution of a junior deed of trust). This prohibition does not apply to mortgage loans on other types of property. Although most of the Saxe Mortgage's second mortgages will not be on properties that qualify for the protection afforded by federal law as they will be secured by apartment buildings or other commercial properties. Second mortgage loans made by Saxe Mortgage may trigger acceleration of senior liens on such properties if the senior loans contain due-on-encumbrance clauses, although both the number of such instances and the actual likelihood of acceleration is anticipated to be minor. Failure of a borrower to pay off the accelerated senior loan would be an event of default and subject Saxe Mortgage (as junior lienholder) to the attendant risks.