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Frequently Asked Questions About Trust Deed Investing and Sterling Pacific Financial

This document is presented in four categories:

FAQs about Trust Deed Investments

Q: What exactly is a trust deed – and, what are trust deed investments?

A: A trust deed (or a deed of trust) is a document filed with a county recorder's office indicating that there is a loan against a property – creating a secured lien on the property, providing collateral for the lender or lenders. (Terminology may differ outside of California – some states may use a mortgage instrument, for example – but the filing of some sort of lien is typical when mortgage loans are provided.) Trust deed investments are opportunities for individuals to provide these mortgage loans privately, working through a licensed intermediary like Sterling Pacific Financial.

Q: What are the benefits of trust deed investing?

A: Trust deed investing offers an unusual combination of high returns and consistent cash flow with a secured investment. Investors receive monthly interest payments on their invested capital as they would with a fixed income investment or money market fund, but the yields are typically higher. But, because the loans are secured by the property, the risk is still relatively low.

Trust deeds also offer a vehicle for investing in real estate without the need to manage property. They're an excellent way to diversify a portfolio. Plus, unlike publicly traded real estate related securities – e.g., CMOs, MBSs, REITs – trust deed investments are straightforward and easy to understand.

Q: Why haven't I heard of trust deed investing before?

A: Most private money trust deeds are created by small mortgage companies, and are not typically sold or securitized on the secondary mortgage market – a prerequisite for trading in mainstream markets. This, combined with their smaller volume, makes them unattractive to large financial services firms to market to the masses – even though investors might benefit from awareness of these opportunities.

Q: What are the risks associated with trust deed investing?

A: There are four main sources of risk with trust deed investing: property devaluation, interruption of cash flow (i.e., borrower fails to make payments), legal action, and, in the case of second position deeds, subordination in the event of a foreclosure and sale.

Sterling Pacific Financial aims to manage all of these risks on behalf of investors. For example, requiring an appropriate loan-to-value (LTV) ratio keeps property devaluation risk to a minimum. Sterling Pacific carefully manages its relationships with borrowers throughout the loan term – helping to contain the risk of interrupted cash flow and the need for foreclosure. Detailed evaluation of potential borrowers before agreeing to lend money helps avoid backing properties that could be tied up in legal actions.

Q: Why would a borrower choose to use a private money lender – and pay a higher interest rate?

A: There are many reasons why a borrower would prefer a private loan to a bank loan. Most often, speed, service and flexibility are priorities.

Q: Are trust deed investments FDIC Insured?

A: FDIC insurance only applies to bank deposits. Trust deed investments are not FDIC insured.

For example, if a borrower needs a loan closed within 30 days, this is generally impossible for a commercial bank. Short term loans (e.g., one to five year term) are also typically outside the specifications of conventional loans. Or, sometimes a borrower may have minor credit issues – unlike a bank, a private lender can assess the potential risk and vary the terms to make a profitable loan in these situations.

Q: How do I choose a reputable mortgage company specializing in trust deed investments?

A: Find a company that has a successful track record of providing these types of investments. Research the company online at the website for the California Department of Real Estate (www.dre.ca.gov), where you can check to see if the company has an active license or any consumer complaints against them.

Q: Can I invest in trust deeds in my retirement account or my company's pension plan for employees?

You can invest in trust deeds in your IRA or pension provided that it is self-directed. Custodians who can help you set up a self-directed account include:

- Pensco www.pensco.com
- Polycomp www.polycomp.net
- Sterling Trust Company
- Equity Trust Company (www.trustetc.com)
- Trust Company of America

FAQs About Investing With Sterling Pacific Financial

Q: What type of investments does Sterling Pacific Financial offer?

A: We act as a mortgage broker to investors interested in making private real estate loans to California real estate borrowers we've identified and evaluated. A note and a first or second deed of trust secure these loans, which may be funded by a single investor or fractionally by multiple investors. Additionally, we offer mortgage pools that allow multiple investors to collectively fund multiple real estate loans.

Q: What roles does Sterling Pacific Financial play?

A: For both borrowers and investors, Sterling Pacific Financial provides a single management organization to handle evaluation of loan opportunities, loan origination and underwriting, documentation and compliance, payment operations, intake of investment funds and distribution of monies to investors. Sterling Pacific Financial acts as broker for investors lending directly by investing in a specific trust deed, and as fund manager for two mortgage pools, the Foundation Fund, LLC and the First Floor Fund, LLC.

Q: Why do investors choose Sterling Pacific Financial for private money lending?

A: First and foremost, investors tell us they appreciate Sterling Pacific's track record of successful real estate lending, and the underwriting and management techniques Sterling Pacific uses to achieve their results. To date, Sterling Pacific's investment record is free of incurred losses.

Sterling Pacific Financial's transparent information policies, along with the depth of information provided about loan opportunities, give investors confidence. Investors also appreciate the personal attention and "boutique" style service the firm provides.

Sterling Pacific Financial is comparatively well-capitalized. As a result, we're able to act on attractive opportunities quickly – unlike many other firms, we do not need to line up investors prior to approving a new loan. This often allows us first pick of the best lending opportunities.

Many investors also appreciate the fact that the managers of Sterling Pacific Financial are themselves investors in the fund.

Q: How do I know if I am eligible to invest?

A: Although trust deed investing is not widely marketed, it is available to many different kinds of investors through Sterling Pacific Financial.

Our net worth requirements (exclusive of home, furnishings and automobiles) are $500,000, or $250,000 when combined with annual gross income of at least $65,000. Also, investors must be prepared to commit their money for at least one year.

Q: What is the minimum amount I can invest?

A: The minimum initial investment is $25,000. There is no maximum investment amount. Additional investments can be made thereafter at any time.

Q: Why do borrowers choose Sterling Pacific Financial for funding? Why are they willing to pay higher interest rates than banks charge?

A: Borrowers choose a private money lender like Sterling Pacific Financial when bank financing is inappropriate or unavailable. For example, when a borrower needs to close a loan very quickly, needs a short-term bridge loan, has imperfect credit, or has a development plan that doesn't fit with (typically somewhat inflexible) standards required by banks. Often, a private money loan is the only option.

Many of Sterling Pacific Financial's borrowers are repeat clients. They prefer to work with Sterling Pacific over other private money lenders because they value the attention and personal service Sterling Pacific provides. Working with repeat clients in turn helps Sterling Pacific Financial keep its default risk low.

Q: What types of real estate projects are considered for loans by Sterling Pacific Financial?

Sterling Pacific Financial brokers trust deed loans on non-owner-occupied residential real estate, raw and improved land, and commercial real estate, including retail, mixed-use, offices, apartments and industrial properties. Our loans include purchase money loans, refinance loans, construction loans, and rehab loans. We do not broker unsecured business loans or personal loans.

Q: What measures do you take to prevent or minimize risk?

A: Sterling Pacific Financial takes several steps and precautions to minimize risk and to protect investor capital. Because we are primarily a collateral-based lender, our first and most important concern is that the property have sufficient protective equity. The loan-to-value ration (LTV) is determined on each and every property we consider by a licensed, third-party appraiser. Our standards for LTV are very strict, and are typically considerably more conservative than a commercial bank's.

Sterling Pacific Financial further mitigates risk by regularly monitoring other pertinent criteria including senior lender payments, taxes, and hazard insurance. By monitoring payments to senior lenders, we can protect our investors even when we are in second position. If a foreclosure action has been started by a senior mortgage holder, Sterling Pacific Financial will cure the defaulted payments and have the foreclosure rescinded. Sterling Pacific Financial would then initiate a foreclosure action to protect its investors' interests.

Q: What happens if, despite preventative measures, the borrower defaults?

A: Sterling Pacific Financial has advised investors on loan opportunities through all market cycles. Our in-house expertise in work-out situations allow us to work with the borrowers and successfully work-out the loan to protect invested capital. Foreclosure and sale of the real estate may be part of the process.

Q: How does Sterling Pacific Financial make its money?

A: Sterling Pacific Financial earns fees by originating, underwriting and servicing loans. The borrower pays both the origination fees and the underwriting fees. The servicing fee is netted out of the monthly distribution to investors and represents the spread between the note rate, which the borrower pays, and the investor yield. Sterling Pacific also earns a fee for managing its Foundation Fund and First Floor Fund mortgage pools.

Q: Is Sterling Pacific Financial a Real Estate Investment Trust (REIT)?

A: Sterling Pacific Financial is **not** a REIT - we are a California-licensed real estate mortgage broker that originates privately funded real estate loans.

In a REIT, investments are pooled primarily to *purchase* income properties, and the return to investors is typically dependent upon management of these properties and the generation of rental income. Sterling Pacific's investors, on the other hand, are simply providing mortgage loans, and earning interest income. The process is relatively simple, straightforward and transparent.

Q: Should I invest in individual trust deeds or in one of Sterling Pacific's mortgage pool funds? What other investment decisions do I need to consider?

A: The answer depends on your preferences. Some investors like the idea of funding a specific project – especially if the type of development or location are familiar to them, or if doing so provides a higher return. Other investors place more value on diversifying across multiple projects and delegating property selection entirely to a fund manager; mortgage pools are specifically designed for these goals.

If you are considering investing in a single trust deed (or fractional participation with a small number of co-investors), you should also consider whether a first or second deed is appropriate for you. Second trust deeds typically offer higher returns, but with somewhat higher risk.

Q: When do I get paid and how?

A: We distribute interest payments to investors in individual and fractional trust deeds on a monthly basis, on the 15^{th} of each month or the following business day. Until the borrower begins repayment of the loan, investors are paid from the impound account associated with the loan. Borrowers' payments are processed through our trust account, and then net interest due is paid to investors. You may have the interest check sent directly to you or electronically direct deposited.

For the mortgage pools, you can elect to receive a payout of your earnings, or reinvest them in the fund. Earnings are distributed on the first business day of the month.

FAQs fractional note and deed investments

Q: What are fractional note and deed investments?

A: When a large loan amount is required for a real estate project, the investment can be divided among multiple investors – each providing a fraction of the money. These fractional investments provide the investors a share in the deed proportionate to their portion of the loan amount. Their investments are collectively secured by the trust deed, and the entire loan is serviced and managed on behalf of all the investors involved by Sterling Pacific Financial.

Q: What should I look for a trust deed investment opportunity?

A: Sterling Pacific Financial suggests that investors choose mainstream real estate property where there is a resale market. This includes properties such as: homes, apartments, commercial and industrial buildings, churches, and land. Some properties we avoid include: water slide parks, fish farms, health clubs, and rural properties.

Because collateral is so important in reducing risk in trust deed investing, the ratio between the mortgage loan and the value of the real estate – the loan-to-value ratio, or LTV – is especially important. In the example below, a loan amount of $600,000 on a property worth $800,000 means an LTV of 75% -- a relatively conservative figure for a bank loan, but, depending upon the type of property, potentially a bit outside the desirable range for a private money loan.

$$\frac{\text{LOAN}}{\text{VALUE}} = \text{LTV} \qquad \frac{\$600{,}000}{\$800{,}000} = 75\%\ (\text{LTV})$$

Q: How do I decide which loan to invest in?

There are many criteria to consider, based on your own investment needs and preferences, including: loan term, location of the property, interest rate, and loan-to-value ratio.

Every opportunity we represent has undergone an evaluation by our staff before it is offered as an investment. We only offer investment opportunities that, in our opinion, have a very high probability of paying off successfully. Choosing among them is primarily a matter of deciding which specific deal features are most important to you.

Q: What information does Sterling Pacific Financial provide to help investors evaluate trust deed opportunities?

A: To help you make an informed decision, Sterling Pacific Financial provides the following:

- Loan summary for the trust deed investment
- Regional and local maps for the subject property
- Borrower's loan application
- Borrower's credit report
- Borrower's financial statements
- Appraisal from independent, certified appraiser with original photographs and area location map
- Current preliminary title report issued by the title insurer.

Q: What kind of security do trust deed investors have?

A: There are inherent risks with trust deed investments. We have developed many pre-funding and loan servicing practices to keep these risks to a minimum. Still, sometimes loans become non-performing for reasons that could not be predicted before writing the loan; when this happens, we handle the problem in a timely and professional manner, to protect the interests of our investors.

In the event of a default, and if it is determined that it is in our investor's best interest to foreclose, then we take steps to begin foreclosure. By adhering strictly to our loan-to-value limits, we protect the liquidation value of the investment, to help preserve investor capital even when foreclosure is necessary.

Q: What does this high level of service cost the investor?

A: Sterling Pacific Financial servicing fee is 0.50%. This fee is deducted directly from monthly earnings before distribution. For example, if the investor is earning a 10.0% interest rate, the borrower would pay 10.5% and Sterling Pacific Financial would take the 0.5% difference as our servicing fee. You will find that we express your return as a net yield, which is the note rate less servicing fee. There are no additional or “hidden” fees.

Q: What if I need my money before the loan I'm invested in comes due or pays off?

A: Your investment is applied to a loan for the development of a construction project. These loans are generally for a term of 12 to 36 months, so you should plan on your investment remaining in place for that period.

If you must request liquidation of your investment due to an unexpected hardship, we will do our best to accommodate the request in a timely manner. Our first step is to make your investment position available to other investors. If a new investor agrees to take over your position, we make the substitution and redeem your stake. Please note that, while we make best efforts to accommodate these requests, we cannot guarantee that pre-term liquidation can be accomplished.

Q: What happens when the loan matures? Is my invested capital automatically returned?

A: Part of our initial underwriting is to determine the borrower’s exit or payoff strategy. Generally, the borrower will pay off the loan by either selling the property or refinancing with another lender, or refinance into a new loan with Sterling Pacific Financial. Each of these outcomes provides an opportunity for the initial investors to be repaid.

FAQs About the Foundation Fund and the First Floor Fund Mortgage Pools

Q: What are the Foundation Fund and the First Floor Fund?

A: These funds are mortgage pools managed by Sterling Pacific Financial. Sterling Pacific Financial identifies and qualifies borrowers and originates and underwrites loans made by the fund. They offer investors the opportunity to invest in a variety of real estate lending opportunities with a single investment.

The funds are similar in investment philosophy. The main difference between the two is that the Foundation Fund is only available to US citizens residing in California, while First Floor is not geographically restricted.

Q: What types of investors participate in the funds?

A: Individuals, family trusts, investment funds and corporations invest in these mortgage pools. Besides direct investment, individuals invest through self-directed IRAs, Keoghs, and 401K Plans. Corporations may also invest their pension assets in the funds.

Q: Why invest in the Foundation Fund or the First Floor Fund?

- Diversification of investment risk: a portfolio of multiple loans, with a variety of property types, borrowers and locations.
- Performance: your investment is fully invested at all times in high yielding loans; high historical annual returns; monthly income distributed or reinvested at your choice; excellent for IRAs; low management fees.
- Effective risk management: experienced team; unblemished track record; all loans secured by real property.
- Expert fund management.
- Minimum personal commitment: fund management does the legwork for you.

Q: How are the funds able to pay such high returns to its investors?

A: The mortgage pools offered by Sterling Pacific Financial are portfolios of high yielding mortgage loans with interest rates currently ranging from 10-12% in most cases. After specific expenses and the management fee are deducted, the majority of the interest earnings collected are distributed to the investors in the form of dividend distributions.

Q: How am I assured that the funds invest in good loans?

A: Sterling Pacific Financial conducts a thorough loan analysis prior to creating or investing in a trust deed investment for its mortgage pools. This process includes (but is not limited to) securing a third-party appraisal to ensure a conservative loan-to-value (LTV) ratio, conducting a credit and re-payment analysis of the borrower, performing a thorough title search, and obtaining a full title insurance policy.

Throughout the loan term, each trust deed held by the funds is professionally serviced and tracked monthly by Sterling Pacific to minimize payment default. Hazard insurance is also monitored to make sure that all policies are in effect. Property taxes must be paid current at the time the loan is created or purchased.

In the unlikely event of a default, Sterling Pacific Financial's experienced team works with borrowers to resolve the situation. If necessary, foreclosure and sale of the property will occur to preserve fund capital.

Q: Is my investment in the fund secured?

A: Each loan in the portfolio is collateralized and secured by a trust deed – and your investment in the fund provides you an interest in the entire portfolio. So, even in the unfortunate event of a default, the fund's inherent diversification of your investment across many loans will mitigate the effect on your monthly income.

Q: What is my protection from liability as an investor?

A: Our funds are set up as limited liability companies (LLCs). Each investor in the funds becomes a member of the corresponding LLC, with all the rights and limited liability protection afforded to members of a limited liability company by law.

Q: Who regulates the funds?

A: The Foundation Fund and First Floor Fund are licensed by the California Department of Corporations under permit number 605-3666 and 605-3875, respectively. (These permits are permissive only and do not constitute a recommendation or endorsement of the securities permitted to be issued.)

Q: What are the fees charged? Are there load charges?

A: The fund pays its manager, Sterling Pacific Financial, a management fee of up to 1% per annum. In addition the fund pays Sterling Pacific Financial a loan servicing fee of 0.5% per annum on loans in the portfolio. These fees are deducted before annual yield is calculated – and are the only fees paid by the fund. No other fees are charged to investors.

Q: What yield can I expect? Are yields guaranteed?

A: Investors receive the actual interest paid by the borrowers to the fund less the costs of managing the fund, servicing the loans and administering the fund. The historical range has been 10-11% but this range can change at any time in response to market conditions.

Our regulating agency, the CA Department of corporations, prohibits us from guaranteeing any specific yield or that our funds will never suffer a loss of investors' capital. That said, the Foundation Fund and First Floor Fund invest only in high quality, low loan-to-value (LTV) mortgage loans. We follow an investment fund that we have tested in California through virtually every economic condition and cycle, across every type of property from farmland to skyscrapers, residential developments to commercial buildings.

Q: How are interest payments calculated?

A: The monthly payment each investor receives depends on the total performance of the loans held by fund – not the performance of any individual loan. The amount of payment is determined by the amount you have invested (i.e., your share of the total fund investment), and overall fund performance.

Q: How soon does my investment in the Foundation Fund or the First Floor Fund begin earning interest?

A: All new investment funds are deposited in a subscription account in a bank until they are needed to invest in a loan. This period will be less than 60 days, and during this time the funds will earn no interest. When the funds are accessed for a loan, the investor will receive the same aggregate yield as other investors in fund.

Q: Can dividends be reinvested?

A: Investors have the choice of receiving regular monthly cash distributions of fund income, or having their income credited to their capital accounts and reinvested by the fund. An investor may elect to switch from one of these options to the other only upon 90 days' notice to the fund manager.

Q: How do I know how much money I've made with fund(s) I've invested in? How can I monitor fund performance?

A: As an investor you will receive a monthly statement of your account, as well as annual with audited financial statements.

Q: Can I move my current investments into the mortgage fund?

A: Yes, we can do this for you immediately or when your current investments pay off.

Q: Can I invest funds from my IRA or pension plan into one or both of the funds?

A: Yes, provided that your IRA or pension plan is self-directed. Investing in Sterling Pacific Financial's mortgage pools through a tax-advantaged account allows you to benefit from the high earnings potential of the investment while delaying the tax implications until retirement – when your taxable rate may be lower.

Q: Should I invest all of my money in one or both of these funds?

A: While we're confident of our performance projections of the mortgage pools, we believe strongly that diversification is essential to building a healthy and balanced investment portfolio. Diversification spreads investment capital over different types of investments to distribute risk. For this reason, we qualify all investors and limit investment across Sterling Pacific Financial's offerings to a maximum of 10% of the investor's net worth.

Q: Is there a minimum term? What if I change my mind about investing? How soon after making an investment in one of the mortgage pool funds can I withdraw my money? Can I add funds at will?

A: There is an initial 12-month term beginning when you purchase your membership interest. After that, you may redeem some or all of your shares at will by giving us written notice. We commit to redeeming your shares within 60 days, based upon the availability of cash resources within the fund.

Keep in mind that our goal is to keep invested capital working, generating interest – which means that most of the capital in the fund at any time will be lent out to borrowers. Of course, as maturing loans are paid off and other investors provide new funds, the funds' cash reserves are replenished. We use these reserves to pay off investors who wish to redeem their shares.

Regarding adding funds, investors can invest in either fund as frequently as they like, as long as the fund is still offering membership interests.