

**Blackburne & Brown Mortgage Company, Inc.  
4811 Chippendale Drive, Suite 101  
Sacramento, California 95841  
(916) 338-3136**

**July 3, 2006**

Blackburne & Brown Mortgage Company, Inc. (“B&B”) is a California corporation that is licensed to do business as a real estate broker in the State of California. B&B is offering to qualified California residents undivided fractional interests (“Fractional Interests”) in a promissory note (a “Secured Note”) that is secured by either (i) a first mortgage or deed of trust (the “Deed of Trust”) encumbering developed or undeveloped real property located within or outside the State of California (the “Property”), or by (ii) other promissory note(s) that are themselves each secured by a Deed of Trust that encumbers Property (“Hypothecated Notes”). As used herein, the term “Property” can mean real property that directly secures the Loan or real property that secures a Hypothecated Note, depending on the context. The persons or entities that invest in Fractional Interests are referred to herein as “Investors.”

The Fractional Interests may represent an investment in either a new loan that is originated by the Investors to the underlying borrower and is secured by a Deed of Trust, or a purchase of an existing note that is secured by a Deed of Trust or by Hypothecated Notes. The Loan may be secured by existing improved real property that is fully funded at closing or a construction loan that may provide for the funding of the Loan in installments (a “Construction Loan”). See “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN.” attached as Exhibit B to this Offering Circular for a description of the terms of the specific Loan, the borrower and the nature of the security for the Loan.

B&B will service the Loan and other Loan documents on behalf of the Investors. See “LOAN SERVICING.” B&B does not insure or guarantee repayment of the Loan.

The Fractional Interests are not immediately liquid because they are not redeemable and are not traded over any exchange or other established market and there is only a limited secondary market for the resale of the Fractional Interests. Investors should not purchase a Fractional Interest unless they intend to hold the interest for the full term of the Loan. See “RISK FACTORS” for a detailed description of these and other risks.

---

THIS OFFERING INVOLVES SIGNIFICANT RISKS WHICH ARE DESCRIBED IN DETAIL HEREIN. INVESTORS SHOULD NOT INVEST ANY FUNDS IN THIS OFFERING UNLESS THEY CAN AFFORD TO LOSE THEIR ENTIRE INVESTMENT. SUBSTANTIAL FEES WILL BE PAID TO B&B, WHICH IS SUBJECT TO CERTAIN CONFLICTS OF INTEREST. (SEE “RISKS AND OTHER IMPORTANT FACTORS,”

“COMPENSATION TO LOAN SERVICER” AND “CONFLICTS OF INTEREST.”) PROSPECTIVE PURCHASERS OF FRACTIONAL INTERESTS SHOULD READ THIS OFFERING CIRCULAR IN ITS ENTIRETY.

---

THESE SECURITIES ARE BEING OFFERED AND SOLD ONLY TO RESIDENTS OF THE STATE OF CALIFORNIA PURSUANT TO A PERMIT GRANTED BY THE CALIFORNIA COMMISSIONER OF CORPORATIONS. THE COMMISSIONER OF CORPORATIONS DOES NOT RECOMMEND OR ENDORSE THE PURCHASE OF THESE SECURITIES, NOR HAS THE COMMISSIONER PASSED UPON THE ACCURACY OF THE INFORMATION SET FORTH HEREIN. THESE FRACTIONAL INTERESTS ARE BEING OFFERED SOLELY TO CERTAIN SELECTED RESIDENTS OF THE STATE OF CALIFORNIA, AND THE OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF ANY OFFER TO BUY WITH RESPECT TO ANY OTHER PERSON.

---

THE SALE OF FRACTIONAL INTERESTS COVERED BY THIS OFFERING CIRCULAR HAS NOT BEEN REGISTERED WITH THE U.S. SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “ACT”), IN RELIANCE UPON THE EXEMPTIONS FROM SUCH REGISTRATION REQUIREMENTS PROVIDED FOR UNDER SECTION 3(A)(11) AND SECTION 4(2) OF THE ACT AND/OR UNDER SECTION 3(b) OF THE ACT AND REGULATION D, RULE 147, RULE 504 AND/OR RULE 505 PROMULGATED THEREUNDER; HOWEVER, THE COMMISSION HAS NOT MADE AN INDEPENDENT DETERMINATION THAT THESE SECURITIES ARE EXEMPT FROM REGISTRATION. THESE FRACTIONAL INTERESTS MAY NOT BE SOLD OR OTHERWISE TRANSFERRED WITHOUT REGISTRATION UNDER THE ACT OR PURSUANT TO AN EXEMPTION THEREFROM.

---

THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY IN ANY STATE OTHER THAN THE STATE OF CALIFORNIA OR WITH RESPECT TO ANY PERSON WHO IS NOT A BONA FIDE RESIDENT OF CALIFORNIA, NOR DOES IT CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY WITH RESPECT TO ANY PERSON EXCEPT THOSE PARTICULAR PERSONS WHO SATISFY THE SUITABILITY STANDARDS DESCRIBED HEREIN. (SEE “INVESTOR SUITABILITY STANDARDS.”)

---

THERE IS NO MARKET FOR FRACTIONAL INTERESTS AND NONE IS EXPECTED TO DEVELOP IN THE FUTURE. FRACTIONAL INTERESTS ARE NOT REDEEMABLE AND ARE ALSO SUBJECT TO SUBSTANTIAL RESTRICTIONS ON WITHDRAWAL AND TRANSFER, AND THEREFORE SHOULD BE PURCHASED ONLY BY INVESTORS WHO HAVE NO NEED FOR LIQUIDITY IN THEIR INVESTMENT.

---

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. ANY PROSPECTIVE PURCHASER OF FRACTIONAL INTERESTS WHO RECEIVES ANY SUCH INFORMATION OR REPRESENTATIONS SHOULD CONTACT B&B IMMEDIATELY TO CHECK ITS ACCURACY. 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 B&B SINCE THE DATE HEREOF.

---

PROSPECTIVE PURCHASERS SHOULD NOT REGARD THE CONTENTS OF THIS OFFERING CIRCULAR OR ANY OTHER COMMUNICATION FROM B&B AS A SUBSTITUTE FOR CAREFUL AND INDEPENDENT TAX ADVICE AND FINANCIAL PLANNING. LEGAL COUNSEL FOR B&B DOES NOT REPRESENT THE INTERESTS OF PURCHASERS OF FRACTIONAL INTERESTS WITH RESPECT TO THAT INVESTMENT DECISION. EACH POTENTIAL INVESTOR IS ENCOURAGED TO CONSULT WITH HIS OR HER OWN INDEPENDENT LEGAL COUNSEL, ACCOUNTANT AND/OR OTHER PROFESSIONAL ADVISORS WITH RESPECT TO THE LEGAL AND TAX ASPECTS OF THIS INVESTMENT AND WITH SPECIFIC REFERENCE TO HIS OR HER OWN TAX SITUATION, PRIOR TO SUBSCRIBING FOR FRACTIONAL INTERESTS.

**TABLE OF CONTENTS**

	<u>Page</u>
SUMMARY OF THE OFFERING .....	1
TERMS OF THE OFFERING.....	4
INVESTOR SUITABILITY STANDARDS .....	6
DESCRIPTION OF FRACTIONAL INTERESTS .....	7
LOAN FUNDING .....	9
LENDING STANDARDS AND POLICIES.....	11
OPERATIONS TO DATE.....	15
LOAN SERVICING .....	16
COMPENSATION TO LOAN SERVICER AND AFFILIATE.....	20
CONFLICTS OF INTEREST.....	22
RISKS AND OTHER IMPORTANT FACTORS .....	23
CERTAIN LEGAL ASPECTS OF LOANS SECURED BY REAL ESTATE OR PERSONAL PROPERTY .....	32
ERISA CONSIDERATIONS .....	35
LOAN SERVICER .....	37
LEGAL MATTERS.....	38
PLAN OF DISTRIBUTION .....	38
ADDITIONAL INFORMATION AND UNDERTAKINGS.....	38
COMMISSIONER’S RULE 260.141.11 .....	39
Exhibit A      Loan Servicing and Tenancy in Common Agreement	
Exhibit B      Loan Package – Description of Specific Loan	
Exhibit C      Subscription Agreement	

## **SUMMARY OF THE OFFERING**

The following information is a brief summary of, and is qualified in its entirety by, the information contained elsewhere in this Offering Circular. This Offering Circular, together with the exhibits attached, should be read in their entirety before any investment decision is made.

### **Terms of the Offering**

Fractional Interests are offered only to residents of the State of California. The minimum investment is \$5,000, and additional amounts may be invested in increments of \$500 only. Each Investor must meet certain minimum standards of income and/or net worth as described in the “INVESTOR SUITABILITY STANDARDS” section.

### **Fractional Interests**

Fractional Interests represent an undivided fractional interest in a secured promissory note evidencing the Loan (the “Secured Note”) and a concurrent undivided fractional interest in a Deed of Trust or Hypothecated Note that secures the repayment of the Secured Note. The Fractional Interests may represent an investment in a new loan that is originated by the Investors to the underlying borrower and secured by a Deed of Trust, or a purchase of an existing note that is secured by a Deed of Trust or by Hypothecated Notes. See “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN” attached to this Offering Circular for a description of the terms of the Loan, the borrower and the nature of the security for the Loan. If the Loan is a Construction Loan that is funded in phases, a single Secured Note will be issued for the maximum amount to be loaned in favor of B&B and all Investors whose subscriptions have been accepted by B&B prior to the closing of the Loan (the “Initial Investors”). (See “TERMS OF THE OFFERING - Subscription Procedures.”) B&B will hold all Fractional Interests in the Construction Loan not yet sold to Investors; however, B&B will have the rights and obligations of an Investor only if B&B purchases or funds Fractional Interests to meet the funding requirements of the Loan Documents. (See “LOAN FUNDING.”) All Investors that purchase Fractional Interests together with B&B will hold the Secured Note and the Deed of Trust or Hypothecated Notes pursuant to the terms of this Offering Circular and the Loan Servicing and Tenancy in Common Agreement attached to this Offering Circular as Exhibit A and as otherwise provided at law. (See “DESCRIPTION OF FRACTIONAL INTERESTS.”) The Investors, together with B&B to the extent it purchases Fractional Interests, are collectively referred to herein as the “Lenders.”

### **Lending Standards and Policies**

The amount of the Loan in which Fractional Interests are offered is set forth in Exhibit B entitled “LOAN PACKAGE – DESCRIPTION OF SPECIFIC LOAN.” The Loan will be evidenced by the Secured Note. If the Loan is for construction or rehabilitation of a property, the Loan will be directly secured by a Deed of Trust encumbering the Property being improved or rehabilitated and will be subject to a Construction Loan Agreement and may be funded in installments (see “LOAN FUNDING”). The amount of the Loan will not exceed a certain percentage of the appraised value of the property securing the Loan (see “DESCRIPTION OF LOANS AND LOAN CRITERIA – Loan-To-Value Ratio; Appraisal Requirement”). The Loan

will provide that Lenders will receive monthly payments as described in the Loan documents and may provide for a balloon payment of the outstanding principal and interest when the Secured Note matures. The Secured Note may be payable earlier if the Property securing the Secured Note is sold or if the Borrower refinances the loan. Information regarding the Borrower and the specific terms of the Loan are set forth in Exhibit B attached hereto (“LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN”).

### **Loan Servicing**

B&B will service the Loan pursuant to the terms of the Loan Servicing and Tenancy in Common Agreement, a copy of which is attached hereto as Exhibit A (“Loan Servicing and Tenancy in Common Agreement”). B&B will collect and disburse to the Investors on a monthly basis interest and principal payments made by the Borrower under the Loan, less a loan servicing fee and any holdbacks, as provided for in the Loan Servicing and Tenancy in Common Agreement. If necessary, B&B will enforce the terms of the Secured Note, the Deed of Trust or, with respect to a Loan secured by Hypothecated Notes, the security agreement whereby the Borrower grants the Investors a security interest in the Hypothecated Notes (the “Security Agreement”). If the Borrower should default under the Loan and the Investors should foreclose on or otherwise take title to the Property or Hypothecated Notes, B&B will provide property management services or loan servicing services and collect a property management or loan servicing fee as provided in the Loan Servicing and Tenancy in Common Agreement. If use of the Loan proceeds are subject to a Construction Loan Agreement, B&B will monitor disbursements, expenditures and construction on behalf of Lenders to enforce compliance with the restrictions set forth in the Construction Loan Agreement.

B&B reserves the right to bill the Investors for the loan servicing fee or the property management fee if the monthly payments from the Borrower, the rents from the Property or, with respect to a Loan secured by a Hypothecated Note, the payments from the Hypothecated Notes are not sufficient to pay such fees. If the Property consists of undeveloped land and the Investors should foreclose on or otherwise take title to the Property, then B&B will charge a property management fee equal to \$400 a month. Since undeveloped land will probably not generate any income, B&B will bill the Investors on a monthly basis for this property management fee. Additionally, B&B may assess the Investors from time to time for additional funds in order to protect the value of the Property or Hypothecated Notes as security, to enforce the documents that evidence, secure or relate to the Loan (“Loan Documents”) and/or to manage, refinance or sell the Property or the Hypothecated Notes. For Construction Loans, these items, costs and expenses may include, without limitation, the advancement of funds necessary to complete construction or renovation of all or a phase of the construction. If Investors fail to pay these assessments when demanded by B&B, such Investors will have their right to receive principal, interest, late charges and other amounts owing under the Secured Note or any rent, sales or other proceeds if the Investors should take title to the Property or the Hypothecated Notes (collectively, “P&I”) automatically subordinated to the right of Investors who pay such assessments to receive P&I. If the delinquent Investors fail to pay their delinquent share of an assessment within 60 days, then their right to receive P&I will be permanently and irrevocably subordinated to the rights of Investors who pay their share of an assessment to receive P&I. Also, if Investors pay more than their share of an assessment (to make up for Investors who fail to pay their share of the assessments), such Investors shall be entitled to a priority return of P&I

before those Investors who pay their share of an assessment receive their P&I. Investors who have paid their share of an assessment can restore their priority as to P&I by reimbursing those Investors who have paid more than their share of an assessment (to make up for delinquent Investors), together with interest.

### **Loan Servicer**

Blackburne & Brown Mortgage Company, Inc. (“B&B”) is a California corporation and is licensed to do business as a real estate broker in the State of California.

### **Compensation to Loan Servicer and Affiliate**

B&B and its affiliates will receive compensation in connection with the funding and servicing of each Loan (see “COMPENSATION TO LOAN SERVICER AND AFFILIATE”).

### **No Liquidity**

The Fractional Interests are subject to substantial restrictions on transferability and no established market exists for the trading of Fractional Interests. Investors should not purchase Fractional Interests unless they intend to hold them for the full term of the Secured Note.

## **TERMS OF THE OFFERING**

The minimum investment is \$5,000. Additional amounts must be invested in increments of \$500. Each Investor must meet certain investor suitability standards (see “INVESTOR SUITABILITY STANDARDS”). The Fractional Interests sold in this Offering Circular are subject to certain restrictions on resale and transfer (see “RISKS AND OTHER IMPORTANT FACTORS”).

### **Subscription Procedures**

Prospective Investors can subscribe to purchase Fractional Interests by (i) completing and returning to B&B the Lender/Purchaser Disclosure Statement, the Subscription Agreement and the Loan Servicing and Tenancy in Common Agreement and the Subscription Agreement that accompany this Offering Circular, and (ii) executing and delivering to an independent escrow company identified in the Lender’s Instructions to Escrow attached hereto as Exhibit C (the “Escrow Agent”) (x) a form of Lender’s Instructions to Escrow (“Lender’s Instructions”) delivered to prospective Investors by B&B, a copy of which is attached to this Offering Circular, and (y) a check in the amount of the desired investment for deposit in the Trust Account. The check should be made payable to the Escrow Agent. B&B reserves the right to reject subscriptions if a prospective Investor has not fully completed and signed these documents, if B&B determines that the prospective Investor does not meet the investor qualifications described in the “INVESTOR SUITABILITY STANDARDS” section or for any other reason. B&B will accept or reject a subscription within three (3) business days after the Escrow Agent’s receipt of such subscription.

The Escrow Agent will promptly deposit all subscription checks into an interest-bearing trust account established with a federally insured bank or savings and loan (the “Trust Account”) upon its receipt of such checks. There may be some period of time between when B&B accepts subscriptions and when the Loan “closes,” i.e., when it is actually funded to the Borrower (see “Pre-Loan Closing”). If a subscription is not accepted, B&B will cause the Escrow Agent to promptly return to the prospective Investor his or her investment.

This offering is only for, and B&B will only accept subscriptions up to, an amount equal to the original principal amount of the Loan. Subscriptions will be accepted in the order that they are received by B&B. When B&B has received subscriptions that collectively equal the original principal amount of the Loan, B&B will reject all subsequently received subscriptions and will cause the Escrow Agent to promptly return the accompanying subscription checks.

### **Pre-Loan Closing**

B&B has entered into a commitment letter with the Borrower that contains certain conditions that must be satisfied before B&B is obligated to fund the Loan to the Borrower. Accordingly, there may be some period of time between when B&B receives and accepts subscriptions and when the Loan is actually funded to the Borrower.

All subscription checks will be deposited by the Escrow Agent into the Trust Account. Interest that accrues on funds held in the Trust Account will be disbursed by B&B on a monthly basis to the Investors. When all of the conditions that must be satisfied for Loan closing have

been met, the Escrow Agent will oversee the Loan closing pursuant to the Lender's Instructions and to separate escrow instructions submitted to the Escrow Agent by B&B. See "LOAN FUNDING." If the conditions precedent to Loan funding are not satisfied by the Borrower, then the Escrow Agent shall promptly return the Investor funds to the Investors, together with any passbook rate interest thereon.

By executing and delivering the documents described above and delivering a subscription check to the Escrow Agent, a prospective Investor unconditionally and irrevocably agrees to purchase the Fractional Interests if and when the Loan closes (see "LOAN FUNDING"). Subscriptions are non-cancelable and irrevocable and subscription funds are non-refundable unless the Loan fails to close or except as provided for by B&B.

### **Restrictions on Transfer**

As a condition to this offering, restrictions have been placed upon the ability of Investors to resell or otherwise dispose of any Fractional Interests purchased hereunder, including without limitation the following:

(1) No Investor may resell or otherwise transfer any Fractional Interests except to a person or entity that meets the eligibility standards described in the "INVESTOR SUITABILITY STANDARDS" section.

(2) Fractional Interests may not be sold or transferred without the prior written consent of the California Commissioner of Corporations, except as permitted in Section 260.141.11 of the Rules of the California Corporations Commissioner. (See "COMMISSIONER'S RULE 260.141.11.")

(3) Fractional Interests have not been registered with the Securities and Exchange Commission under the Securities Act of 1933, as amended (the "Act"), in reliance upon the exemptions provided for under Section 3(a)(11) and Rule 147 thereunder. Fractional Interests may not be sold or otherwise transferred without registration under the Act or pursuant to an exemption therefrom. In addition, no sales or transfers may be made to non-California residents for at least nine-months after the last sale by B&B of a Fractional Interest in that Loan. In the case of Construction Loans, that nine-month period will not begin to run until the last loan disbursement under the Construction Loan Agreement has been funded.

(4) No sale or transfer shall be effective unless the buyer or transferee has executed and delivered to B&B a Lender/Purchaser Disclosure Statement, a Loan Servicing and Tenancy in Common Agreement and a Subscription Agreement in the forms attached hereto.

A legend will be placed upon all instruments or certificates evidencing ownership of Fractional Interests stating that the Fractional Interests have not been registered under the Act and setting forth the foregoing applicable limitations on resale.

## **INVESTOR SUITABILITY STANDARDS**

To purchase a Fractional Interest, a prospective Investor must meet certain eligibility and suitability standards, some of which are set forth below, and must execute and deliver the documents described in the “TERMS OF THE OFFERING - Subscription Procedures” section above. By executing the Subscription Agreement and Loan Servicing and Tenancy In Common Agreement, an investor makes certain representations and warranties, upon which B&B will rely in accepting subscriptions. Read the Loan Servicing and Tenancy in Common Agreement, the Subscription Agreement and the LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN carefully before investing. Each prospective Investor must represent in writing that such investor is a bona fide resident of the State of California (or if the investor is a trust, corporation or other entity, that the principal office of such trust, corporation or other entity is located in California). In addition:

(1) Each Investor must have either (a) a net worth (exclusive of home, furnishings and automobiles) of at least \$250,000 and an annual gross income of at least \$65,000; or (b) a net worth (exclusive of home, furnishings and automobiles) of at least \$500,000; and

(2) The amount of each Investor’s investment in a Fractional Interest offered hereby must not exceed ten percent (10%) of such Investor’s net worth (exclusive of home, furnishings and automobiles).

If the investor is an ERISA Plan (such as a pension or profit sharing plan, Individual Retirement Account, or 401(k) plan), the foregoing requirements must be met by either the ERISA Plan or, if the investment is being made on behalf of a plan participant who has the power to direct the investment on his/her behalf, by the plan participant for whose account the investment is being made.

If the investor is a fiduciary account other than an ERISA Plan (such as a family trust or a custodial account for the benefit of a minor), the foregoing suitability standards may be met by any of the following: (i) by all beneficiaries of the account; (ii) by the trustee or custodian if that person is the donor of the funds for investment; or (iii) by the donor of the funds for investment if the only beneficiaries of the fiduciary account are the donor’s ancestors, descendants or spouse.

## DESCRIPTION OF FRACTIONAL INTERESTS

Fractional Interests represent an undivided fractional interest in a promissory note (the “Secured Note”) and an undivided fractional interest in the following security: (i) a first deed of trust or mortgage (in either case, a “Deed of Trust”) that encumbers developed or undeveloped real property located within or outside of California (the “Property”), or (ii) other promissory notes that are themselves secured by Deeds of Trust that encumber Property (“Hypothecated Notes”).

The Fractional Interests may represent an investment in a new loan that is originated by the Investors to the underlying borrower and secured by a Deed of Trust, or a purchase of an existing note that is secured by a Deed of Trust or by Hypothecated Notes. See “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN” for a description of the terms of Loan, the borrower and the nature of the security for the Loan (i.e., a Deed of Trust or Hypothecated Notes, including the Property that secures the Deed of Trust and the borrowers and Property that secure Hypothecated Notes). For the purchase of an existing loan, Fractional Interests will be created when the Secured Note is assigned to the Investors, an assignment of Deed of Trust is recorded, naming each of the Investors as the assignees of the mortgagee’s or beneficiary’s interest under the Deed of Trust, and an endorsement has been secured for the title insurance policy recognizing the assignment of the Deed of Trust.

For loans that are secured by Hypothecated Notes, Fractional Interests will be created when the Secured Note is signed and delivered (with respect to a new loan) or assigned to the Investors (with respect to the purchase of an existing loan), the Hypothecated Notes are assigned by the Borrower to the Investors pursuant to a security agreement given by the Borrower to the Investors (the “Security Agreement”), a UCC-1 financing statement or equivalent is filed, where required, the Borrower has signed and delivered notices of assignment that, on Loan default will be delivered to the borrowers under the Hypothecated Notes directing them to make loan payments directly to B&B, as agent for the Investors, and the Borrower has signed and delivered recordable assignments of the Deeds of Trust that secure the Hypothecated Notes, which B&B shall be entitled to record if the Investors take title to the Hypothecated Notes following a Loan default.

If a loan is a Construction Loan to be funded in installments, a single Secured Note will be issued in the full amount to be loaned, and B&B will hold all unsold Fractional Interests and will sell the unsold Fractional Interests to Investors (see “RISK FACTORS – Partially Funded Loans”). As additional loan disbursements are made and additional Fractional Interests are sold to new Investors, the purchase price for the sale of the Fractional Interests will be deposited into a construction disbursement account (the “Disbursement Account”). The subsequent purchasers of Fractional Interests in the Secured Note will have the same rights and priorities under the Deed of Trust as the initial purchasers and will all be tenants in common under the Loan Servicing and Tenancy in Common Agreement for that loan.

Monies will be disbursed from the Disbursement Account to the Borrower, or on the Borrower’s behalf, for the purposes and on the terms described in the Construction Loan Agreement. B&B’s obligation to fund the initial advance to the Borrower will be subject to the execution of the Construction Loan Agreement by the Borrower, the Borrower’s Contractor (if

any) and delivery of the Borrower's plans, specifications, permits, budgets and related information as required under the Construction Loan Agreement. Subsequent disbursements from the Disbursement Account will be made by B&B pursuant to the draw schedule outlined in the Construction Loan Agreement (see "LOAN SERVICING").

B&B and the Initial Investors will appear as the initial payees on the Secured Note, and as the initial beneficiaries under the Deed of Trust or as the secured party and assignee under the Hypothecation Security Agreement. If the Loan is a Construction Loan, B&B will appear as the Lender under any Construction Loan Agreement and as the secured party, for the benefit of the Investors, under the Security Agreement for the Disbursement Account. In the case of sales of Fractional Interests in an existing Loan after the Loan has closed, B&B will assign in writing a proportionate part of the unfunded interests in the Secured Note, Deed of Trust, any Hypothecated Notes and any Construction Loan Agreement to Investors upon the purchase of Fractional Interests in a Loan, and such Investors will thereupon become Lenders on that Loan. Those assignments will be delivered to Lenders, except that assignments of the Deed of Trust will be sent directly to the County Recorder for recordation in the county in which the underlying Property is located within 10 business days after the Lender's funds are delivered to B&B. The written assignments will evidence the Fractional Interest of each Lender and the Lenders will become direct, legal owners as tenants in common in the Secured Note and related Loan documents. B&B will continue to act as loan servicing agent for all Lenders. (See "LOAN SERVICING.")

All Lenders, including B&B to the extent that it acquires an interest in a Secured Note, will be tenants in common and their rights as tenants in common will be governed by the Loan Servicing and Tenancy in Common Agreement. Under that agreement, each Lender that has acquired a Fractional Interest will be entitled to receive his or her pro rata share of interest and principal payments, after deduction of loan servicing fees and any costs incurred as a result of any default, such as the costs to enforce the Loan, to foreclose on the security Property in a non-judicial foreclosure, to complete construction, or to sue under any guarantee.

## LOAN FUNDING

B&B has entered into a commitment letter (the “Commitment Letter”) with the Borrower that contains certain conditions that must be satisfied before B&B is obligated to fund the Loan. B&B may waive one or more of these conditions and proceed to fund the Loan if it determines, in its reasonable business judgment, that the waiver of such condition(s) will not materially affect the likelihood that the Borrower will repay the Loan or the value of the property serving as security for the Loan.

When all of the conditions contained in the Commitment Letter have been satisfied or waived or will be satisfied at the closing, the Escrow Agent will close the Loan pursuant to the Lender’s Instructions and escrow instructions submitted by B&B. The escrow instructions submitted by B&B will contain numerous conditions to Loan closing, including without limitation, execution and delivery of the following: a signed Secured Note or the assignment thereof, a signed Deed of Trust or an assignment thereof, a signed Security Agreement and UCC-1, signed assignments of the Hypothecated Notes, signed notices of assignment and assignments of Deeds of Trust (with respect to Hypothecated Loans), a title insurance company being prepared to issue, with respect to a new loan secured by a Deed of Trust, a lender’s policy of title insurance that names B&B and any other Initial Investors as the insured thereunder and that insures the first lien priority of the Deed of Trust, subject only to exceptions approved by B&B, a title insurance company being prepared to issue, with respect to the purchase of an existing loan, an endorsement to the original title insurance policy recognizing the assignment of the mortgagee’s or beneficiary’s interest under the Deed of Trust, and the Escrow Agent being prepared to record the Deed of Trust or assignment of Deed of Trust in the county recorder’s office of the county where the Property is located and deliver the other executed Loan Documents to B&B on behalf of itself and any other Initial Investors. If the conditions precedent to Loan funding are not satisfied by the Borrower, then the Escrow Agent shall promptly return the Investor funds to the Investors, together with any passbook rate interest thereon.

If the Loan is a Construction Loan, following the initial closing, the Lender’s funds will be placed, as received, into the Disbursement Account and disbursements from the Disbursement Account to the Borrower will be made by B&B or a third party Disbursement Company as called for in the Construction Loan Agreement (see “LOAN PACKAGE – DESCRIPTION OF SPECIFIC LOAN”).

At the time Lender's funds are placed in the Disbursement Account, the Lender will receive a Fractional Interest in the Secured Note and Deed of Trust and as assignees under the Loan Servicing and Tenancy in Common Agreement, the Construction Loan Agreement and the Security Agreement and such funds shall be deemed loaned to the Borrower and shall bear interest as provided in the Secured Note. Actual cash disbursements from the Disbursement Account and from any other accounts as may be required will be controlled by B&B or a third party disbursement company acting for the Lenders. If Loan proceeds must be disbursed to the borrower pursuant to the Construction Loan Agreement at a time when insufficient Fractional Interests have been sold to adequately fund the Disbursement Account, B&B shall purchase the amount of Fractional Interests necessary to adequately fund the Construction Disbursement Account for the Loan disbursement due and will hold such Fractional Interests unless and until it resells them to Investors at par (i.e., without any mark-up or premium) pursuant to this offering.

If the Loan is a Construction Loan, a minimum initial funding amount may be specified. If so, after the conditions for the initial funding have been met, that amount must be deposited in Escrow before the Loan will be made and the funds will be disbursed in accordance with the Lenders escrow instructions for the benefit of the Borrower. If a minimum offering amount is specified, B&B and/or its affiliates may purchase Fractional Interests in order to fulfill the minimum. If a minimum funding amount is specified and the minimum is not fulfilled, all subscription funds will be returned to subscribers.

## **LENDING STANDARDS AND POLICIES**

B&B has applied the following standards and policies in underwriting the Loan, except as otherwise indicated in the “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN” section (which contains detailed information concerning the terms of the Loan, the Property and the Borrower).

### **Priority of Security**

The mortgage or deed of trust that secures the Loan will have a first lien priority, subject to no monetary liens other than liens for taxes and assessments not yet due and payable. If the security for the Loan is Hypothecated Notes, the Investors will have a first priority lien in the Hypothecated Notes.

### **Types of Security**

The Loan (or the Hypothecated Notes, with respect to a Loan that is secured by Hypothecated Notes) will be secured by an income producing property including, without limitation, an office building, warehouse or other industrial property, a strip shopping center or other retail property or an apartment building, by a mixed-use property that combines one or more of these types of properties, or by undeveloped land. See “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN” for details on the Property that secures the Loan or the Hypothecated Notes. The Property will be located within or outside of California. If the Loan is a Construction Loan, Loan proceeds will be required to be deposited in a Disbursement Account in which the Lenders will also have a security interest. The loan may also be secured by one or more additional deeds of trust encumbering other California property owned by Borrower or its affiliates where, in the reasonable judgment of B&B, such cross-collateralization is necessary to meet the loan-to-value ratio requirements below.

### **Loan to Value Ratios**

If the Loan is secured by a Deed of Trust, the amount of the Loan (plus, if the Loan is secured by a second deed of trust, the amount of any senior liens) will generally not exceed a certain percentage (the “loan-to-value ratio”) of the appraised value of the property securing the Loan, as set forth below:

<u>Type of Property</u>	<u>Loan-to-Value Ratio</u>
Improved Commercial or Residential	75%
New Construction	75%
Unimproved Land	50%

Notwithstanding the foregoing, the loan-to-value ratio for a Loan may exceed the foregoing percentages if, in B&B’s reasonable judgment, a higher loan amount is warranted by the circumstances of the particular Loan, such as personal guaranties, prior loan history with the

particular borrower, market conditions, etc. In such cases, B&B will provide a written record of the reason(s) that a higher loan-to-value ratio was justified.

Appraisals will be performed by an independent appraiser certified or otherwise qualified by the state where the Property is located. The appraisal shall be dated no earlier than one (1) year before the date the Loan closes.

Appraisals for Construction Loans will be prepared on an “as completed” basis, i.e., assuming that the improvements for which the Loan is obtained will be completed. The appraiser may also assume that all public improvements to be funded by special assessment district bonds will be completed as proposed and that the property will be marketed and sold in the manner planned by the Borrower. In the case of a Construction Loan, the loan-to-value ratio as estimated in the appraisal and the budget for the project may exceed 75% at times during the term of the Loan. This may occur because the appraisal is based upon the value of the property when construction is completed; however, before the construction is completed, the value of the property will generally be less than the “as completed” appraised value and the outstanding balance of the Loan may therefore be more than 75% of this lesser, uncompleted value.

Although B&B may conduct a cursory physical inspection of the Property, due to the costs involved it will not obtain inspection reports from licensed civil engineers. Additionally, B&B will conduct a cursory investigation to determine the existence of any toxic or hazardous substances in, on or about the Property. However, due to the costs involved B&B will not engage the services of an engineer or environmental consultant to conduct a third party environmental site assessment of the Property. (See “RISKS AND OTHER IMPORTANT FACTORS - Environmental Liabilities.”)

If the Loan is secured by Hypothecated Notes, the amount of the Loan will not exceed 80% of the then-present value of the Hypothecated Notes, assuming that such Hypothecated Notes are discounted using the prevailing rate of interest at the time the Loan is to be made. B&B will only originate a Loan that is secured by Hypothecated Notes if the then-present value of each Hypothecated Note does not exceed 70% of the value of the Property that secures such Hypothecated Note, which value is determined as follows: if the Hypothecated Note constitutes seller financing and the sale occurred within two years of when B&B is to issue the commitment letter, then the sales price will be presumed to be the value of the Property. If the Borrower can provide B&B with an appraisal of the Property that is dated within two years of the date B&B is to issue the commitment letter, then the appraised value contained in such appraisal shall be presumed to be the value of the Property. If the sale that created a Hypothecated Note occurred more than two years before B&B is to issue the commitment letter, or if B&B cannot review an appraisal of the Property that is dated within two years of the date it is to issue the commitment letter, then the Property will be appraised pursuant to a written appraisal prepared by an independent appraiser who meets the qualifications described above.

### **Insurance Requirements**

The Loan will be funded through an escrow account handled by an independent escrow company (see “LOAN FUNDING”). The escrow company will not be authorized to disburse

any of the Investor funds out of the escrow for purposes of funding the Loan until, among other things,

(1) satisfactory title insurance coverage has been obtained for the Loan, with the title insurance policy naming the Lenders as loss payees 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 lien of the Deed of Trust, and does not insure against loss by reason of other causes, such as diminution in the value of the Property, over-appraisals, borrower's defaults, etc.

(2) Satisfactory fire insurance naming the Lenders as loss payees in an amount at least equal to the replacement cost of the improvements on the Property, subject to commercially reasonable deductibles. (See "RISKS AND OTHER IMPORTANT FACTORS.") B&B will not require the Borrower to maintain liability insurance or mortgage insurance. If the Property consists of undeveloped land, B&B may not require the Borrower to carry fire insurance as there would be no improvements to insure.

(3) If the Loan is a purchase of an existing note, then the title company that insures the existing Deed of Trust will provide an endorsement recognizing the assignment of the existing note and Deed of Trust to the Investors.

(4) If the Loan is secured by Hypothecated Notes, then the Borrower must require the borrowers under the Hypothecated Notes to procure and maintain the fire insurance described in clause (2) above. The title insurance policies that insure the Deeds of Trust securing the Hypothecated Notes will not, however, be endorsed over to the Investors since the Deeds of Trust that secure the Hypothecated Notes will continue to recognize the Borrower as the mortgagee or beneficiary.

### **Credit Evaluations**

B&B will evaluate the income level and general creditworthiness of the Borrower and of any guarantor to determine the Borrower's ability to repay the Loan according to its terms and the financial strength and resources of the guarantors. The Borrower may not have sources of income that would be sufficient to qualify him or her for loans from other lenders such as banks or savings and loan associations. If the Property consists of undeveloped land, it will probably not generate any income. In such event, the Borrower must have sources of income other than the Property with which to repay the Loan. B&B will obtain certified financial statements from, and conduct an independent credit check of, the Borrower. If the Loan is secured by Hypothecated Notes, B&B will review credit information concerning the underlying borrowers under the Hypothecated Notes to the extent such information is reasonably available. If the Loan is a Construction Loan, the Borrower will likely be a corporation, partnership or other business entity that may have been formed for the purpose of developing the property. Information regarding the Borrower is set forth in Exhibit B attached hereto.

The Secured Note will be recourse to the Borrower and may also be guaranteed by persons related to the Borrower. The guarantor, if any, or the Borrower must be considered creditworthy by B&B. B&B will make inquiries of sources which it believes are reliable but B&B will not be liable in the event its inquiries are incomplete or the information it obtains and

relies upon is later determined to be inaccurate. Notwithstanding the foregoing, the Borrower is unlikely to be able to repay the principal amount of the Loan from sources other than the Property securing the Loan and such Property is considered to be the primary (and perhaps sole) source of repayment of the Loan.

### **Term of Loan**

The Loan has the term specified in the “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN.”

### **Loan Documents**

If the Fractional Interests represent an investment in a new loan, each of the Initial Investors, as tenants in common in proportion to their respective investments, will appear as the payee on the Secured Note and the beneficiary or mortgagee under the Deed of Trust. The Deed of Trust will be recorded with the county recorder’s office of the county in which the Property is located (see “LOAN FUNDING”). B&B will retain the original Secured Note as the agent of the Investors, although B&B will deliver the original Secured Note to another party if directed in writing by a majority in interest of the Investors. B&B will appear as the lender on any Construction Loan Agreement as agent for the Lenders. In addition to the Secured Note and the Deed of Trust (and Construction Loan Agreement, if applicable), the Borrower will execute and deliver an Environmental Warranty and Indemnification Agreement and such other documents as B&B shall require as a condition to the closing of the Loan.

If the Fractional Interests represent a purchase of an existing loan, each of the Investors, as tenants in common in proportion to their respective investments, will appear as the assignee of the note, the assignee of the mortgagee’s or beneficiary’s interest under the Deed of Trust and shall be named in the endorsement to the title policy that recognizes the assignment of the mortgagee’s or beneficiary’s interest under the Deed of Trust.

If the Fractional Interests are secured by Hypothecated Notes, each of the Investors, in proportion to their respective investments, will be named as the assignees of the Hypothecated Notes, the secured parties under the Security Agreement and, if needed, the UCC-1 financing statement or equivalent, and the assignees under the recordable assignments of the Deeds of Trust that secure the Hypothecated Notes.

## **OPERATIONS TO DATE**

Since 1998, B&B has raised a total of \$138,659,382 through this offering. These funds have been used to fund 322 loans, which range in amount from \$3,750 to \$2,750,000. The average amount of these 322 loans is \$382,485. One hundred forty-three (143) loans, which total \$61,107,784, are secured by real property located in California, while the remaining one hundred seventy-nine (179) loans, which total \$77,551,598, are secured by real property located outside of California. These 322 loans were secured by a variety of commercial property types, including industrial buildings, apartment complexes, retail buildings and residential care homes.

As of June 1, 2006, of the 322 loans arranged or sold through this offering, B&B has foreclosed on 20 such loans.

B&B is the sole general partner of Blackburne & Brown Mortgage Fund I, a mortgage fund that began operations in 1991. As of June 1, 2006, Blackburne & Brown Mortgage Fund I has invested in 250 mortgage loans made through the offering in the aggregate amount of \$76,377,795. B&B is also the sole manager of Blackburne & Brown Mortgage Fund II, another mortgage fund that began operations in 2001. As of June 1, 2006, Blackburne & Brown Mortgage Fund II has invested in no mortgage loans pursuant to this offering. (See "LOAN SERVICER.")

## LOAN SERVICING

### Note Servicing

B&B will service the Loan on behalf of the Investors pursuant to the terms of a Loan Servicing and Tenancy in Common Agreement, a copy of which is attached to this Offering Circular. B&B will receive a monthly servicing fee for these services not to exceed one-twelfth (1/12) of two and nine-tenths percent (2.9%) of the principal balance of the Loan outstanding at the beginning of such month (the "Servicing Fee"). See "COMPENSATION TO LOAN SERVICER AND AFFILIATE."

Servicing the Loan encompasses collecting monthly payments of principal, interest and any other amounts owing by the Borrower under the Secured Note, the Deed of Trust or Security Agreement and the other Loan Documents, and depositing such funds in an interest bearing trust account established with a federally insured bank or savings and loan. Servicing a construction loan will also include acting for Lenders in authorizing expenditures from the Disbursement Account and monitoring Borrower's use of the Loan proceeds and, if the Borrower is permitted to use sales proceeds to finance continued construction of the Property, Borrower's reborrowing of sales proceeds deposited in the Disbursement account.

After deducting the Servicing Fee and any holdbacks made by B&B pursuant to the Loan Servicing and Tenancy in Common Agreement, B&B will, on a monthly basis and within twenty-five (25) days of B&B's receipt of such funds, disburse such funds to the Investors in proportion to their Fractional Interests. If B&B fails to receive from the Borrower interest sufficient to pay the Servicing Fee, B&B has the option to bill the Investors for their pro rata share (based on each Investor's Fractional Interest) of the Servicing Fee. If billed by B&B, the servicing fee must be paid promptly by the Investors. Delinquent payments will be subject to a late charge and interest. Alternatively, B&B may accrue the Servicing Fee and recoup it, together with interest thereon, from the proceeds, if any, from a Loan payoff or refinance or sale of the Property.

### Holdbacks

If B&B should determine, in its reasonable judgment, that the Borrower may default in its payment or other obligations under the Secured Note or the other Loan Documents and that costs may need to be incurred to protect the value of the Property as security and/or to enforce the rights of the Investors under the Loan Documents, then B&B shall have the right to retain in the Trust Account up to two months' interest under the Note in order to pay for such costs.

### Assessments

If B&B should determine from time to time, in its reasonable business judgment, that additional funds (beyond any holdbacks of interest made by B&B) are needed to protect the Property or Hypothecated Notes, to enforce the rights of the Investors under the Loan Documents or, if necessary, to manage, refinance or sell the Property or Hypothecated Notes, it shall be entitled to assess the Investors for such additional funds (an "Assessment"). Each Investor shall pay its pro rata share of an Assessment within ten days after delivery of such written request. The value of the Property or Hypothecated Notes as security, the ability of B&B

to enforce the rights of the Investors under the Loan Documents and/or the ability of B&B to manage, refinance or sell the Property or Hypothecated Notes may be materially impaired if any Investor fails to pay its pro rata share of an Assessment when requested to do so by B&B. B&B will not, and has no obligation to, advance funds on behalf of any Investor in connection with any Assessment.

If an Investor fails to timely pay its pro rata share of an Assessment, such Investor's pro rata share of the Assessment shall bear interest as provided in the Loan Servicing and Tenancy in Common Agreement. B&B reserves the right to seek payment of an Assessment from the non-paying Investor through available legal avenues. B&B will notify all Investors in writing if any Investor should fail to pay its pro rata share of an Assessment when requested and provide the other Investors with the opportunity to pay the non-paying Investor's share of such Assessment. Any such additional funds paid by an Investor (over such Investor's pro rata share of the Assessment) shall bear interest at the lesser of (i) the rate of interest owing under the Secured Note, plus three percent, or (ii) the maximum rate allowed by law, and shall be repaid when B&B collects from the non-paying Investor, if other Investors reimburse the Investor who has paid more than his or her share of the Assessment, when the loan is repaid or when the Property or Hypothecated Notes is/are eventually refinanced or sold.

It may be prudent under certain circumstances for other Investors to pay the pro rata share of an Assessment that is owing by a delinquent Investor in order to protect the value of the Property or Hypothecated Notes as security or so that B&B can timely enforce the rights of the Investors under the Loan Documents. For example, if the Borrower has neglected to maintain fire insurance on the Property, other Investors may want to pay the non-paying Investor's pro rata share of the insurance premium so that the Property will not go uninsured. Although B&B will diligently pursue the non-paying Investor for its share of such premium, it may take several weeks or months before B&B is able to obtain and execute a judgment for such amounts. If damage should occur to the Property during this period when no fire insurance is in effect, the value of the Property as security for the loan could be severely diminished or the Property could even become worthless.

Those Investors who fail to advance their pro rata share of an Assessment shall have their right to receive P&I automatically subordinated to the right of Investors who do advance their pro rata share of an Assessment to receive P&I. If the delinquent Investors fail to pay their delinquent share of an assessment within 60 days, then their right to receive P&I will be permanently and irrevocably subordinated to the rights of Investors who pay their share of an assessment to receive P&I. Additionally, those Investors who advance more than their pro rata share of an Assessment (in order to make up the amounts owing by an Investor who fails to advance its pro rata share of an Assessment) shall be entitled to a priority return of their P&I before those Lenders who advance only their pro rata share of an Assessment are entitled to receive their P&I. Investors who have paid their share of an assessment can restore their priority as to P&I by reimbursing those Investors who have paid more than their share of an assessment (to make up for delinquent Investors), together with interest. See the Loan Servicing and Tenancy in Common Agreement attached to this Offering Circular.

## **Enforcement**

B&B shall promptly notify the Investors when it discovers the occurrence of any event of default under the Loan Documents. Unless otherwise directed by a majority in interest of the Investors, B&B shall either (i) proceed to foreclose non-judicially under the Deed of Trust or, with respect to a Loan secured by Hypothecated Notes, commence to exercise on behalf of the Investors their rights under the Security Agreement and as otherwise provided to a secured party under the Uniform Commercial Code and other laws of the governing state, or in either instance take such other loan enforcement actions as are typically undertaken by commercial lenders in the state that governs the enforcement action, or (ii) forbear from foreclosing or exercising the rights of a secured party for up to 90 days, if the purpose of such forbearance is to allow the Borrower additional time to refinance or sell the Property or Hypothecated Notes or otherwise arrange to repay the Loan. Additionally, B&B may accept a deed in lieu of foreclosure and commence legal action against the Borrowers or against any guarantors of the Loan if B&B determines that such actions are prudent under the circumstances. If there is a Construction Loan Agreement, B&B may, without first obtaining Lenders' consent, cease to make any further Loan disbursements, declare that all payments due under the Secured Note are immediately due and payable, order construction stopped if it appears work is being done in breach of the Construction Loan Agreement, use undisbursed funds in the Disbursement Account to complete all or any phase of the construction, or disburse funds in the Disbursement Account to Lenders. Except as provided above, B&B will have no authority to agree to waive a default or to forbear to enforce the loan agreements on behalf of Lenders without the consent of a majority-in-interest of the Lenders. The agreement of a majority-in-interest of Lenders is also required for a judicial foreclosure.

Each Investor also waives any right it may have to individually commence foreclosure proceedings if there should occur an event of default and to seek to partition the Property if the Investors should obtain title to the Property by foreclosure, deed in lieu of foreclosure or otherwise.

## **Property Ownership**

If title to the Property or the Hypothecated Notes should be transferred from the Borrower as a result of an event of default (a "Transfer"), whether such Transfer is by foreclosure, a deed in lieu of foreclosure, a sale of the Hypothecated Notes, retention of the Hypothecated Notes in satisfaction of the Loan or otherwise, then the title shall be held in the name of one of the following, as determined by B&B in its sole discretion: (i) B&B, in trust for the Investors, (ii) B&B, as agent for the Investors, (iii) the Investors, as tenants in common, or (iv) a corporation or partnership or limited liability company, of which the Investors are the shareholders or partners or members in proportion to their respective Fractional Interests.

## **Property Management or Loan Servicing**

Unless a majority in interest of the Investors should elect otherwise, B&B shall serve as the exclusive property manager for the Property following a Transfer or, with respect to Hypothecated Notes, B&B shall serve as the loan servicer. If B&B serves as the property manager, it shall receive a monthly property management fee equal to the greater of \$300 or

eight percent (8%) of the scheduled gross monthly rents and income from the Property, which gross monthly rents and income shall be calculated assuming that the Property is fully leased. If B&B serves as the loan servicer for the Hypothecated Notes or as the property manager for Properties that formerly secured Hypothecated Notes, it shall receive a commercially reasonable monthly loan servicing fee and property management fee.

If B&B fails to receive rents and income from the Property or payments from the Hypothecated Notes sufficient to pay the property management or loan servicing fee, B&B has the option to bill the Investors for their pro rata share of such property management or loan servicing fee. If billed by B&B, the property management or loan servicing fee must be paid promptly by the Investors. Delinquent payments will be subject to a late charge and interest. Alternatively, B&B may accrue the property management or loan servicing fee, with interest thereon, and recoup it from the proceeds, if any, from a sale or refinance of the Property or the Hypothecated Notes. If the Property consists of undeveloped land and the Investors should foreclose on or otherwise take title to the Property, then B&B will charge a property management fee equal to \$400 a month. Since undeveloped land will probably not generate any income, B&B will bill the Investors on a monthly basis for this property management fee.

### **Sale/Refinance of Property/Hypothecated Notes**

If there should occur a Transfer, B&B may sell the Property or Hypothecated Notes without first obtaining the written consent of the Investors if (i) the proceeds of the sale are sufficient to repay all Additional Funds advanced, accrued but unpaid Servicing Fees, interest on the foregoing, accrued and unpaid interest under the Note and unpaid principal under the Note, and (ii) the sale is not made to an affiliate of B&B. In any other proposed sale and in any proposed refinance of the Property or the Hypothecated Notes, B&B must first obtain the consent of a majority in interest of the Investors.

### **Distribution of Proceeds**

If B&B should sell or refinance the Property or the Hypothecated Notes following a Transfer, the proceeds will be distributed in the order set forth in the Loan Servicing and Tenancy in Common Agreement.

### **Replacement of Loan Servicer**

A majority in interest of the Investors may remove B&B as the loan servicer or the property manager on thirty (30) days' prior written notice. The removal will not be effective until B&B has received a termination fee equal to three and one-half percent (3 1/2%) of the then-outstanding principal amount of the Secured Note. If the Investors obtain a final judicial determination that the removal was for cause, then the termination fee will be refunded to the Investors.

## COMPENSATION TO LOAN SERVICER AND AFFILIATE

The following is a summary of the forms of compensation that B&B and B&B Law Firm will receive in connection with the Loan and this offering. None of the following compensation was determined by arm's length negotiation.

### Loan Origination Fees

As compensation for funding the Loan, B&B will receive a loan origination fee, or "points," in the amount described in the "LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN" section. The loan origination fee will be payable by the Borrower out of the Loan proceeds, and not out of the funds provided by the Investors. B&B anticipates charging loan origination fees ranging from one percent (1%) to six percent (6%) of the original loan amount.

### Loan Servicing Fee

As compensation for servicing the Loan (i.e., collecting and disbursing to the Investors monthly payments by the Borrower of principal and interest, monitoring the Borrower's compliance with the terms of the Loan Documents and, if necessary, enforcing the rights of the Investors under the Loan Documents), B&B will receive a monthly loan servicing fee not to exceed one-twelfth (1/12) of two and nine-tenths percent (2.9%) of the principal balance of the Loan outstanding at the beginning of such month. The loan servicing fee is deductible from the monthly payments made by the Borrower under the Loan. If the monthly payments from the Borrower are not sufficient to pay the loan servicing fee, B&B may either bill the Investors for their pro rata share of such loan servicing fee or accrue the loan servicing fee, with interest accruing on the unpaid portion thereof at the rate provided in the Loan Servicing and Tenancy in Common Agreement. If billed by B&B, the loan servicing fee must be paid promptly by the Investors. Delinquent payments will be subject to a late charge and interest.

If the Investors take title to the Hypothecated Notes and B&B services the Hypothecated Notes on behalf of the Investors, then B&B shall be entitled to a commercially reasonable monthly loan servicing fee.

### Property Management Fee

If the Borrower has defaulted on the Loan and the Investors foreclose and take title to the Property, B&B will serve as property manager for the Property pursuant to the terms of the Loan Servicing and Tenancy in Common Agreement. In connection with these property management services, B&B will be entitled to a monthly property management fee equal to the greater of \$300 or eight percent (8%) of the scheduled gross monthly rents and income from the Property. If the Property is fully or partially vacant, the scheduled gross monthly rents and income for the unoccupied portion of the Property will be determined based on a reasonable estimate of fair market rent or income. If the actual gross monthly rents and income from the Property are not sufficient to pay the property management fee, B&B may either bill the Investors for their pro rata share of such property management fee or accrue the property management fee, with interest accruing on the unpaid portion thereof at the rate provided in the Loan Servicing and Tenancy in Common Agreement. If billed by B&B, the property management fee must be paid promptly by the Investors. Delinquent payments will be subject to a late charge and interest. If the Property

consists of undeveloped land and the Investors should foreclose on or otherwise take title to the Property, then B&B will charge a property management fee equal to \$400 a month. Since undeveloped land will probably not generate any income, B&B will bill the Investors on a monthly basis for this property management fee.

If the Investors take title to Property that formerly secured a Hypothecated Note and B&B manages the Property on behalf of the Investors, then B&B shall be entitled to a commercially reasonable monthly property management fee.

### **Termination Fee**

Although B&B will receive a loan origination fee, or “points,” from the Borrower for originating the Loan, B&B’s principal compensation for originating the Loan and obtaining the required securities permit from the California Department of Corporations comes from the monthly loan servicing fees it is to earn under the Loan Servicing and Tenancy in Common Agreement. The loan origination fee that B&B charged for originating the Loan is less than B&B would otherwise have charged if not for the anticipated loan servicing fees it expects to earn for servicing the Loan. Accordingly, if a majority in interest of the Investors should remove B&B as the loan servicing agent or property manager, such removal will not be effective until B&B has received a termination fee equal to three and one-half percent (3 1/2%) of the then-outstanding principal balance of the Secured Note. If the Investors obtain a final judicial determination that the removal was for cause, then the termination fee will be refunded to the Investors.

### **Possible Additional Compensation**

If, after a default by Borrower, Lenders take title to property that is still under construction, B&B may recommend that the Lenders complete all or part of the construction before selling property, and B&B may propose itself, or another affiliate to supervise the construction or to provide other services required in order to complete construction. B&B will not propose a rate of compensation in excess of the rate customary in the industry. If a majority-in-interest of the Lenders elect to complete construction and to employ B&B or its affiliate, B&B would receive additional compensation in an amount which cannot be determined at this time.

## **CONFLICTS OF INTEREST**

The following is a summary of the principal areas in which the interests of B&B may conflict with the interests of the Investors.

### **Compensation to Loan Servicer and Affiliate**

None of the compensation described in the “COMPENSATION TO LOAN SERVICER AND AFFILIATE” section, including the loan origination fee, the loan servicing fee, the property management fee or the termination fee was determined by arm’s length negotiation. The loan origination fees charged to the Borrower by B&B will range from one to six percent (1% to 6%) of the principal amount of the Loan. See “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN” for the amount of loan origination fees charged with respect to the Loan. Any increase in loan origination fees may reduce the amount of interest that a borrower would be willing to pay for a loan, thus reducing the overall rate of return to investors. Conversely, if B&B reduces its loan origination fees, a borrower may be willing to pay a higher interest rate for a loan. Additionally, the payment by a borrower of loan origination fees may diminish the borrower’s ability to repay the loan.

### **Competing Loans and Business Ventures**

B&B originates, arranges and negotiates loans on behalf of investors other than the investors to this offering. These other investors include Blackburne & Brown Mortgage Fund I (the “Fund”), a California limited partnership of which George Blackburne, III, who is the sole shareholder of B&B, is the general partner. If these other investors have funds to invest at the same time that this offering is made, there will exist a conflict of interest on the part of B&B as to whether it offers a particular loan opportunity to these other investors or to the investors who invest in this offering. B&B will determine whether a loan opportunity is appropriate for funding by the investors to this offering or by other investors after considering the nature of the loan opportunity (e.g., the size of the loan, the terms of the loan, such as interest rate, maturity and payment terms, the creditworthiness of the Borrower, and the nature and location of the underlying real property security), and any stated investment goals of such investors, as determined by B&B based on its contacts with such investors.

In addition to originating, arranging and negotiating loans on behalf of investors other than the investors to this offering, B&B may engage in other business activities that involve real property that are in the same geographic location as, or that compete for tenants, business or occupants with, the Property. Additionally, these other business activities will require B&B’s time and attention. B&B will devote as much time to the fulfillment of its duties under the Loan Servicing and Tenancy in Common Agreement as it determines is reasonably required. B&B believes that it has sufficient personnel and resources to be fully capable of fulfilling its obligations under the Loan Servicing and Tenancy in Common Agreement and its other obligations arising out of its other business activities.

## **RISKS AND OTHER IMPORTANT FACTORS**

Any investment in a Fractional Interest 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, as well as the other matters described in this Offering Circular. These risks represent only some of the risks involved in connection with an investment in the Fractional Interests. Additionally, changes in circumstances with respect to the Borrower, the Property or the general economic climate may exacerbate existing risks or create new risks.

### **Lack of Liquidity**

There is no public market for the Fractional Interests and none is expected to develop in the future. Even if a potential buyer could be found, the transferability of Fractional Interests will be restricted by the provisions of the Securities Act of 1933, as amended, and the intrastate exemption, Regulation D, Rule 147, Rule 504 and Rule 505 thereunder, and by the provisions of the Loan Servicing and Tenancy in Common Agreement. Unless an exemption is available, Fractional Interests may not be sold or transferred without registration under the Securities Act of 1933, as amended, or pursuant to an exemption thereunder, and the prior written consent of the California Commissioner of Corporations. Investors must be capable of bearing the economic risks of this investment with the understanding that Fractional Interests may not be liquidated by resale or redemption. Investors should expect to hold Fractional Interests through the scheduled maturity date of the Secured Note.

### **Tax Risks**

Investment in the Fractional Interests involves certain tax risks of general application to all Investors, and certain other tax risks specifically applicable to ERISA plans, Individual Retirement Accounts, qualified-pension and profit-sharing plans and other tax-exempt investors. (See “FEDERAL TAX CONSIDERATIONS” and “ERISA CONSIDERATIONS.”)

### **Loan Defaults and Foreclosures**

An investment in a Fractional Interest represents a loan from the Investor to the Borrower, which loan is secured by real property and the improvements thereto, by undeveloped land (the “real property security”) or by Hypothecated Notes. Accordingly, the Investor assumes the risk of default by the Borrower. In the event of a default by the Borrower, the real property security or the Hypothecated Notes will be the primary protection for the Investor’s investment. The loan may be an interest-only or partially amortizing loan that provides for relatively small monthly payments of interest only or interest and some portion of principal, with a large “balloon” payment of principal due at the end of the term. Most borrowers are unable to repay the principal amount of such loans out of their own funds and therefore must sell the real property security or refinance the loan at maturity. A downturn in the real estate market, fluctuations in interest rates, and the unavailability of mortgage funds could adversely affect the ability of borrowers to pay off or refinance their loans at maturity. These same factors can impair the value of the Hypothecated Notes as security, since the Hypothecated Notes are themselves secured by real property security. If the real property security consists of

undeveloped land, it may be more difficult for the Borrower to sell or refinance the Loan than if the real property security were improved real estate because undeveloped land is generally viewed as being a riskier and more speculative form of investment or real property security than is improved real estate. See “Risks Associated with Undeveloped Land” elsewhere in this Offering Circular.

There are a number of factors that could adversely affect the value of the real property security, whether the real property security secures the Loan directly or secures Hypothecated Notes that serve as security for the Loan, including, among other things, the following:

(1) B&B will rely on appraisals to determine the fair market value of the property used to secure the Loan, and may rely on appraisals in connection with valuing the real property that secures Hypothecated Notes. No assurance can be given that such appraisals will, in any or all cases, be accurate. Moreover, 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, but are not limited to, changes in general or local economic conditions, neighborhood values, interest rates, or applicable zoning laws.

(2) If a borrower defaults, the investors may be forced to purchase the real property security at a foreclosure sale by credit bidding some or all of the outstanding debt. The ability of the investors to recoup their investment will then depend primarily on their ability to operate the real property security on a profitable basis and/or to refinance or sell the real property security in an amount sufficient to fully repay the Investors’ initial investment, together with interest that is owing on this investment.

(3) The laws of the state in which the Property is located and the manner in which the Investors’ security interest in the security is enforced may preclude the Investors from recovering any deficiency from the Borrower if the real property security proves insufficient to repay amounts owing to the Investors. (See “CERTAIN LEGAL ASPECTS OF LOANS SECURED BY REAL ESTATE and “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOANS.”)

(4) The recovery of sums advanced by the Investors in making loans and protecting their security 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 or in which the rights of the Investors under the Loan Documents are enforced. A foreclosure sale or attempts to enforce rights against the Hypothecated Notes may be delayed by the filing of 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 Investors’ ability to recoup some or all of their investment. If the Loan is secured by Hypothecated Notes, then a bankruptcy filing by one of the borrowers under the Hypothecated Notes can weaken the value of the Investors’ security for the Loan and/or delay or impair the Borrower’s collections on or enforcement efforts with respect to such Hypothecated Notes, even if the Borrower under the Loan is not in bankruptcy.

## **Borrower's Financial Status**

B&B will evaluate the creditworthiness of the Borrower based on a review of financial information provided by the Borrower, and by making other inquiries (e.g., running a credit check). However this financial information and these inquiries will be given and made as of a particular point in time. The financial condition and/or credit status of the Borrower could change subsequent to when this Financial Information and these inquiries are given and made.

If the Loan is secured by Hypothecated Notes, the creditworthiness of the borrowers under the Hypothecated Notes, as well as the creditworthiness of the Borrower who pledges the Hypothecated Notes as security, needs to be considered. B&B will evaluate such credit information as is reasonably available to it concerning the borrowers under the Hypothecated Notes. This credit information is also made as of a particular point in time, and the financial conditions and/or credit status of the borrowers under the Hypothecated Notes can also change.

## **B&B Not Required to Devote Full Time to Loan Servicing Activities**

B&B is not required to devote its full time to the fulfillment of its duties under the Loan Servicing and Tenancy in Common Agreement, but only such time as it determines is reasonably required.

## **Investors Not Independently Represented**

Investors in the Partnership have not been represented by independent counsel in connection with the formation of this Offering or the preparation of the Loan Servicing and Tenancy in Common Agreement or the Loan Documents (see "CONFLICTS OF INTERESTS").

## **Investment Delays**

There will be a delay between the time B&B accepts an Investor's subscription and the time a loan is funded to the borrower. During this period, all Investors' funds will be invested in a passbook account with a federally insured bank or savings and loan association, which will not yield a return as high as the return to be earned by the Investor from the Loan. This delay is not anticipated to be more than sixty (60) days in most cases.

## **Risks of Litigation**

B&B will act in good faith and use reasonable judgment in selecting borrowers and making and servicing the loans. However, the Investors are 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 B&B in making, managing or foreclosing on the loans. It is impossible for B&B to foresee what allegations may be brought by a specific borrower, and B&B will use its best efforts to avoid litigation if, in B&B's judgment, the circumstances warrant an alternative resolution. If an allegation is brought and/or litigation is commenced against B&B, the Investors may be named as defendants in any such litigation and could incur legal fees and costs to respond to the allegations and to defend any resulting litigation.

## **Uninsured Losses**

As a condition to the funding of a loan, B&B will require a borrower to obtain and maintain fire insurance on the real property security. However, there are certain types of losses (generally those of a catastrophic nature, such as losses due to war, earthquakes, hurricanes, floods or mudslides) that are either uninsurable or not economically insurable. Should any such disaster occur, Investors could suffer a loss of principal and interest on the loan secured by the uninsured property. If the Property consists of undeveloped land, B&B may not require the Borrower to carry fire insurance as there would be no improvements to insure. B&B will not require the borrower to carry liability insurance with respect to the real property security. If an accident should occur on the real property security (e.g., a “slip and fall”) or some other event should occur that would be covered under a liability insurance policy, the borrower would be liable to pay any resulting claims. This could impair the borrower’s ability to repay the loan.

## **Environmental Liabilities**

B&B intends to make loans that are primarily secured by commercial and industrial properties. B&B may also make loans that are secured by undeveloped land. Even if a Loan is secured by Hypothecated Notes, the principal security for these Hypothecated Notes will be commercial, industrial or multi-family properties or undeveloped land. Under current federal and state law, the owner of real property contaminated with toxic or hazardous substances (including, in certain circumstances, a lender that has acquired title through foreclosure) is liable for all costs associated with any remedial action necessary to bring the property into compliance with applicable environmental laws and regulations. This liability generally arises regardless of who caused the contamination or when it was caused. If real property security is found to be contaminated, this could adversely impair the value of the real property security (e.g., decreased desirability of the property, which could lead to lower rent 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 tenants of the real property or owners or occupants of adjoining real property for property damage, bodily injury, lost profits or other consequential damages). If the borrower fails to remove or clean up contaminated real 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 real property security to pay for the costs of such removal or cleanup. These factors can significantly decrease the value of the Property or the Hypothecated Notes as security for the Loan. Furthermore, even if an Investor does not foreclose on contaminated real property security, the mere existence of hazardous substances on such real property security may depress the market value of such real property security such that the loan is no longer adequately secured.

An Investor’s best protection against environmental risks is to thoroughly inspect and investigate the real property security before making a loan and before foreclosing on such real property security following a default; 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 from the proceeds of an offering. As a result, toxic contamination reports or other environmental site assessments conducted by engineers or environmental consultants will generally not be obtained by B&B in connection with its loans, whether secured by Deeds of Trust or by Hypothecated Notes. B&B will, however, take certain precautions to avoid

environmental problems, such as not making loans or taking as security Hypothecated Notes that are secured by properties that are currently used as gas station sites or heavy manufacturing sites, or are generally known to have been used in the past for such purposes.

### **Risks of Ownership**

If a borrower defaults on a loan and the Investors foreclose and take title to the real property security, the Investors will bear the economic and other risks borne by an owner of real property. These risks include, but are not limited to, the financial risks involved in leasing, operating and selling the real property, the risks for environmental clean-up costs and related environmental liabilities described in the “Environmental Liabilities” section above and the risk of liability for uninsured casualties on the real property. If the Property consists of undeveloped land, the risks of owning such land may be greater than the risks of owning improved real estate. See “Risks Associated with Undeveloped Land” elsewhere in this Offering Circular. These same risks apply to a loan that is secured by Hypothecated Notes, since these notes are themselves secured by real property security and the Borrower who has pledged these notes as security for its loan will be exposed to the risks of ownership if it has to take title to such real property security.

The Investors can lessen their potential liability for environmental clean-up costs, uninsured casualties and other liabilities relating to the ownership of the real property by taking back title to the real property through a corporation, limited partnership or limited liability company of which the Investors would be the shareholders, limited partners or members.

### **Construction Loans**

In making a Construction Loan based upon the appraised value of a Property “as constructed,” Lenders are subject to the risks that actual construction costs may exceed budget, construction delays could occur, labor or supply shortages may exist, or, the market value of the project once completed could be less than anticipated. Also, if the Lenders must foreclose on the Property before the project is completed, it is unlikely that the Property will then have a value as high as its appraised value “as constructed,” and therefore there is a greater likelihood that the Lenders will not be able to sell the Property for the full amount owing to them. Furthermore, if Lenders must foreclose before construction is completed, and if there are insufficient funds in the Disbursement Account to complete construction, Lenders will need to choose between selling the property with construction incomplete or incurring debt to finance completion of the project before it is sold. If they elect to sell the Property before completing construction, the Property is more likely to sell at a price which will not return to the Lenders the amount owed. On the other hand, if monies are borrowed to complete construction, those monies will have to be repaid before Lenders will receive the amount they invested. B&B may, but is not obligated to, advance the funds required to complete construction of a property or to otherwise increase its marketability and Investors may be assessed for additional funds needed to complete construction where B&B feels such funds are necessary to protect the security for the loan (see LOAN SERVICING – ASSESSMENTS”).

## **Lack of Diversity**

There will be no diversification of risk for persons who become Investors in a loan secured by a single Deed of Trust. All of their funds will be loaned to one borrower and will be secured by a single parcel of real property security. If the loan is secured by Hypothecated Notes, the funds will still be loaned to one borrower; however, there may be some diversity if each Hypothecated Note represents a loan made to a different borrower and is secured by different real property security.

## **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, or the value of the Hypothecated Notes and the real property securing the Hypothecated Notes. While B&B will make an investigation regarding the real property security and the 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 B&B will base its decision to make a loan and offer Fractional Interests in the loan to prospective Investors. There is no guarantee that this information will be accurate. Individual prospective Investors may request and will be given an opportunity to review any information obtained by B&B with respect to the Loan, the Borrower, the Property, the Hypothecated Notes, the borrowers under the Hypothecated Notes and the real property securing the Hypothecated Notes in order to assess for themselves the reliability of that information.

## **Reliance on B&B to Service the Loan and Manage the Property**

Unless and until the Investors remove B&B by a vote of a majority-in-interest, they must rely on B&B to service the Loan and, if the Investors should take title to the Property or the Hypothecated Notes, to manage the Property or service the Hypothecated Notes. While B&B believes it has adequate financial resources and personnel to service the Loans, manage the Property or service the Hypothecated Notes, it is possible that over the term of the Loan B&B's resources could deteriorate. If that were to occur and Investors desired to replace B&B, obtaining the majority-in-interest vote required to do so would be difficult and expensive. The Investors could also find it difficult to find someone willing to replace B&B as the loan servicer or property manager, and such new loan servicer or property manager might require compensation in excess of that paid to B&B.

## **Additional Funds from Investors**

If the interest paid under the Loan or, should the Investors take title to the Property or Hypothecated Notes following a default, if the gross rents and income from the Property or payments from the Hypothecated Notes are not sufficient to pay the loan servicing fee or the property management fee, respectively, then B&B reserves the right to bill the Investors for such fees. If billed by B&B, such fees must be paid promptly by the Investors. Interest will accrue on delinquent payments. If the Property consists of undeveloped land and the Investors should foreclose on or otherwise take title to the Property, then B&B will charge a property

management fee equal to \$400 a month. Since undeveloped land will probably not generate any income, B&B will bill the Investors on a monthly basis for this property management fee.

If B&B should determine from time to time, in its reasonable business judgment, that Assessments are needed to protect the Property or Hypothecated Notes, to enforce the rights of the Investors under the Loan Documents or, if necessary, to manage, refinance or sell the Property or the Hypothecated Notes, B&B may impose such Assessments on the Investors. The ability of B&B to protect the Property or Hypothecated Notes and/or to perform the acts described in the preceding sentence may be materially impaired if any Investor fails to pay its pro rata share of an Assessment when requested to do so by B&B. If an Investor fails to timely pay its pro rata share of an Assessment, B&B reserves the right to seek payment of such Assessment from the non-paying Investor through legal action. B&B will not, and is under no obligation to, advance funds on behalf of any Investor in connection with an Assessment.

In order to protect the value of their Fractional Interests, Investors may need to pay the pro rata share of an Assessment owing by a non-paying Investor, in addition to their own pro rata share of the Assessment. See the discussion in the “LOAN SERVICING - Assessments” section of this Offering Circular.

Those Investors who fail to advance their pro rata share of an Assessment shall have their right to receive P&I automatically subordinated to the right of Investors who do advance their pro rata share of an Assessment to receive P&I. If the delinquent Investors fail to pay their delinquent share of an assessment within 60 days, then their right to receive P&I will be permanently and irrevocably subordinated to the rights of Investors who pay their share of an assessment to receive P&I. Additionally, those Investors who advance more than their pro rata share of an Assessment (in order to make up the amounts owing by an Investor who fails to advance its pro rata share of an Assessment) shall be entitled to a priority return of their P&I before those Lenders who advance only their pro rata share of an Assessment are entitled to receive their P&I. Investors who have paid their share of an assessment can restore their priority as to P&I by reimbursing those Investors who have paid more than their share of an assessment (to make up for delinquent Investors), together with interest. See the Loan Servicing and Tenancy in Common Agreement attached to this Offering Circular.

### **Risks Associated with Undeveloped Land**

The Property that secures the Loan, or the property that secures Hypothecated Notes, may consist of undeveloped land. For a number of reasons, undeveloped land is generally considered a riskier and more speculative form of security for a loan than is improved real estate. For example, before improvements can be constructed on undeveloped land the owner of the land may need to secure entitlements (e.g., zoning approvals, variances, and architectural approvals), undergo review of and obtain clearance on environmental impact issues (including issues concerning traffic, open space, school or transit impact, endangered species, wetlands, noise and air quality), obtain building permits, secure access and connections to necessary utilities, obtain construction financing, undertake and complete construction, and find buyers or tenants once the undeveloped land has been improved. Many of these risks are no longer at issue with respect to improved real estate.

Moreover, it is likely that undeveloped land will not generate any income that can be used to pay the interest and/or principal owing under the Loan or real property taxes assessed against the undeveloped land. Accordingly, the Borrower must have other sources of income in order to make these payments. If Hypothecated Notes are secured by undeveloped land, then the borrowers under such Hypothecated Notes must also have other sources of income in order to make their payments under the Hypothecated Notes.

Even if the owner of undeveloped land intends to hold the undeveloped land for investment, rather than developing the land itself, any prospective purchaser of the undeveloped land will take these risks into account when it sets the purchase price. Additionally, it can take up to several years or more to market and sell undeveloped land. Due to this potentially protracted time frame, it may be difficult for the owner of undeveloped land to sell the undeveloped land in time to pay off the Loan at maturity. Finally, most lenders are more reluctant to lend against undeveloped land than against improved real estate due to the risks and other matters described above. Due to these considerations, it may be more difficult for the Borrower to sell or refinance the real property security in order to repay the Loan, or for the borrowers under Hypothecated Notes to sell or refinance in order to repay the Hypothecated Notes.

In acknowledgment of these increased risks, B&B will not make a loan secured by undeveloped land that exceeds fifty percent (50%) of the fair market value of the undeveloped land (as compared to a 50% loan-to-value ratio for improved real estate). If the Loan is secured by Hypothecated Notes, B&B provides two threshold tests that must be met before it will originate the Loan: the Loan will not exceed 80% of the then-present value of the Hypothecated Notes, and the then-present value of each Hypothecated Note will not exceed 50% of the value of the undeveloped land. This more conservative underwriting does not, however, eliminate the risks described above. It merely provides the Investors with a greater equity cushion should the Borrower default under the Loan.

### **Local Market Conditions**

B&B is based in Sacramento, California, whereas the Borrower of the Loan, the Property that serves as security for the Loan, the borrowers under the Hypothecated Notes and the Property that secures the Hypothecated Notes may reside or be located within or outside of California (see “LOAN PACKAGE - DESCRIPTION OF SPECIFIC LOAN”). Although B&B will obtain and analyze financial information about the Borrower, obtain an appraisal of the Property that indicates that the Property meets the minimum loan to value ratio set forth in the “LENDING STANDARDS AND POLICIES” section and conduct other investigation as described in this Offering Circular with respect to Hypothecated Notes and the underlying real property security, B&B may not be as familiar with the Borrower, the Property, and/or the local market conditions that affect the Borrower, the Property and/or the value of the Property or the Hypothecated Notes as it might be with borrowers or properties that are located in California. Prior to this offering, all of the loans that B&B has underwritten have been to borrowers who reside in California and have been secured by properties located in California.

### **Early Loan Payoff**

Interest rates are subject to fluctuation, and the cost and availability of funds may increase and decrease from time to time. If a borrower is able to borrow funds at a lower interest rate than the interest rate that it is obligated to pay under a loan arranged through this offering, it may elect to refinance its loan. This would result in an Investor being repaid some or all of its investment prior to the stated loan maturity. B&B's loan documents typically allow a borrower to prepay its loan without prohibition or the payment of a prepayment premium. If a borrower repaid its loan because interest rates were lower, then, due to the lower interest rate environment, the Investor may have difficulty re-lending its funds at the same yield that it was receiving from the prepaid loan.

## **CERTAIN LEGAL ASPECTS OF LOANS SECURED BY REAL ESTATE OR PERSONAL PROPERTY**

Repayment of the Loan and the Secured Note will be secured by either a mortgage or a deed of trust or by Hypothecated Notes that are themselves secured by a mortgage or deed of trust. In some states, a mortgage is the form of security instrument used to secure a real property loan, while in other states a deed of trust is the form of security instrument used to secure a real property loan. A mortgage has two parties: a borrower called the “mortgagor” and the lender called the “mortgagee”. The mortgagor gives the mortgagee a lien on the property as security for the loan or, in some states, the mortgagor conveys legal title of the property to the mortgagee until the loan is repaid but retains equitable title and the right of possession to the property so long as the loan is not in default. For loans that are secured by a mortgage or deed of trust, each Investor would be named a mortgagee, as a tenant in common with the other Investors, of an undivided fractional interest under the mortgage that secures the loan. 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 Borrower will be the trustor, an independent title or escrow company will be the trustee, and each Investor will be a beneficiary, as a tenant in common with the other Investors, of an undivided fractional beneficial interest under the deed of trust that secures the Loan.

### **Foreclosure**

The manner in which B&B will enforce its rights under a mortgage or deed of trust, and in which a Borrower may enforce its rights with respect to Hypothecated Notes, will depend on the laws of the state in which the Property is situated. Depending on local laws, a lender may be able to enforce its mortgage or deed of trust by judicial foreclosure or by non-judicial foreclosure through the exercise of a power of sale. Local laws will also 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, either concurrently with or following a judicial or non-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 or non-judicial sale.

A judicial foreclosure is a public sale of the Property conducted under an order of the court of the state in which the Property is located, 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 mortgagee, in the case of a mortgage, or the trustee, in the case of a deed of trust, 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.

A lender would typically undertake a judicial foreclosure when the lender seeks to obtain a deficiency judgment. In some states, a lender is not entitled to recover a deficiency judgment if the lender forecloses non-judicially. Some states also limit the amount of deficiency that can be recovered from a borrower following a judicial foreclosure sale 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”). Moreover, some states provide that a borrower and/or junior lienholder has a 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 and/or the junior lienholder’s right of redemption.

If a lender elects to undertake a non-judicial foreclosure sale it would, in many states, forego the right to obtain a deficiency judgment. However, real property that is sold through a non-judicial foreclosure sale is, in many states, not subject to a right of redemption.

In summary, whether or not a lender would pursue a judicial or a non-judicial foreclosure, and the extent and nature of other remedies available to a lender against a borrower in connection with a real property secured loan, will depend on the laws of the state in which the real property is located. If the Borrower were to default under the Loan, B&B, as the loan servicer, would evaluate the applicable laws, consider the enforcement practices typically undertaken by commercial lenders in the state in which the Property is located and consider the constraints imposed on it under the Loan Servicing and Tenancy in Common Agreement before commencing enforcement actions.

## **Hypothecated Notes**

Hypothecated Notes are considered personal property security. As such, the manner in which the Investors would enforce their security interest in the Hypothecated Notes following a loan default would be governed by the terms of the Security Agreement and the Uniform Commercial Code and other laws applicable in the governing state. In many states, a secured creditor may sell the personal property security by providing notices to the debtor and perhaps to other secured creditors of the debtor and then to sell the personal property security at a public or private sale. Generally, the secured party must act in good faith and in a commercially reasonable manner in noticing and conducting this sale. Depending on the laws of the governing state, the debtor may be entitled to reinstate the debt by paying the delinquent amount prior to the sale, and the secured party may or may not be entitled to purchase at the sale.

If a secured creditor fails to comply with the laws that govern the sale of personal property security, the secured creditor’s ability to obtain a deficiency judgment (i.e., the deficiency that results if the proceeds from the sale of the personal property collateral are insufficient to cover the debt) may be limited, impaired or forfeited, a court may enjoin the sale,

and/or the secured party may be liable to the debtor for the damages that it suffered due to the secured party's failure to comply, which may include a claim for conversion.

Depending on the laws of the governing state, the secured party may be entitled to retain the personal property security in satisfaction of the debt by giving notice to the debtor and perhaps other parties of its intent to do so. If such parties fail to object within a prescribed period of time, the secured party can retain the personal property security in satisfaction of the debt. If such parties object to this course of action, the secured party will be obligated to conduct a public or private sale.

Generally, the proceeds from a sale of personal property collateral are applied first, against the costs of the sale, then to the senior secured claim, then to any junior secured claim, and the balance to the debtor.

### **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 a foreclosed property. Where a loan is secured by Hypothecated Notes, the bankruptcy of a borrower under a Hypothecated Note can impair the value of the Hypothecated Note as security.

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, depending on local laws, a guarantor may have defenses that would impair the ability of the lender to enforce its guaranty. For example, in some states 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. Other states may require that a lender first exhaust all of its remedies against the borrower and real property security and only then can seek any resulting deficiency from the guarantor. A guarantor may, under some local laws, be able to waive some of these defenses in advance provided that the waivers are sufficiently explicit.

## ERISA CONSIDERATIONS

### Tax Consequences to Qualified Employee Benefit Plans and IRAs

Interest income from Fractional Interests held by IRAs and qualified pension and profit sharing plans is anticipated to be exempt from federal income taxation under the Internal Revenue Code, but no tax opinion has been obtained with respect to this issue. Such interest is not expected to constitute income from a trade or business. Qualified plans and IRAs, consequently, should not have unrelated business taxable income (“UBTI”) as a result of receiving interest from a Secured Note. If the Lenders were to take title to the Property as a result of a default by the Borrower, however, Lenders could receive income from a sale of the Property assuming the Property sold for an amount in excess of the amount loaned plus interest and capitalized costs of foreclosure and of holding the Property for sale. If the Lenders were considered to have acquired the Property for resale and therefore to have the status of dealers in real estate, such gain could be considered UBTI. While unlikely, the Lenders might conceivably rent the Property pending its sale. Rent is generally not classified as UBTI. However, if the Lenders were also to incur debt to acquire the Property (for example, in order to pay off a senior lien) or to improve the Property, rent received would not be excluded from UBTI to the extent of average monthly acquisition indebtedness divided by average adjusted basis of the Property for the relevant tax period. Unrelated business taxable income in excess of \$1000 during any tax year is subject to tax. Qualified plans which receive UBTI, even if less than \$1000, must file reports with the IRS.

### ERISA

In considering an investment in a Fractional Interest, a fiduciary of a tax exempt employee benefit plan, such as a qualified pension or profit sharing plan, Keogh plan, 401(k) plan or IRA, should consider (a) whether the investment satisfies the diversification requirement of Section 404(a)(1)(c) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”); (b) whether the investment is prudent given the risks involved; (c) whether the investment is made solely in the interests of the plan participants; (d) whether the investment complies with the plan’s need for liquidity; (e) whether the compensation to persons providing services to the plan, such as B&B, is reasonable; and (f) whether the investment would otherwise constitute a transaction prohibited under Section 406 of ERISA and Section 4975 of the Internal Revenue Code of 1986, as amended. ERISA also requires that assets of a plan be valued at their fair market value as of the close of the plan’s fiscal year, and it may not be possible to satisfactorily value the Fractional Interests from year to year since there will be no market for the Fractional Interests.

Under ERISA and the regulations adopted by the Department of Labor, B&B may be considered a fiduciary if it exercises discretionary authority or control of the management or administration of a plan or its assets or renders investment advice to the plan. Since the investment decision to purchase a Fractional Interest will be made solely by each plan without any advice or recommendation from B&B, and since the actions that B&B may take under the Loan Servicing and Tenancy in Common Agreement without the consent of a majority-in-interest of the Lenders are limited, B&B does not believe B&B would be deemed a “fiduciary” of plan investors. However, if B&B were deemed to be a fiduciary, transactions with B&B

would be subject to scrutiny to determine whether they involved any prohibited transactions such as the charging of unreasonable fees or the use of plan assets for the benefit of the fiduciary. Other plan fiduciaries who were found to have participated in such transactions could be required to (a) restore to the plan any profit realized by the fiduciary on the transaction and (b) make good to the qualified plan any loss suffered by the plan as a result of its investment. The fiduciary and participating parties in interest could also be liable for an excise tax of 15% of the amount involved, and if the transaction were not corrected within a specified period, they could be liable for an additional excise tax of 100% of the amount involved. With respect to IRAs, the tax exempt status of the account could be lost but the other described penalties would not apply.

As a provider of services to Lenders who are employee benefit plans or IRAs, B&B will be considered a “party in interest” or “disqualified person” as those terms are defined in the Labor Code and the Internal Revenue Code. Under both Codes, a loan or an extension of credit to a plan by a party in interest or disqualified person is a prohibited transaction. The Loan Servicing and Tenancy in Common Agreement provides that B&B may advance costs to complete construction or of collection to Lenders if Lenders do not elect to pay their pro rata share of such costs. Even though these advances, plus interest, are only payable out of the sale of the Property or other proceeds from the collection efforts of B&B and are non-recourse to the plan, the advances may be deemed a loan of the type intended to constitute a prohibited transaction. Therefore, if B&B is advised by counsel that an advance of costs on behalf of plan Lenders would be treated by the Department of Labor or the Internal Revenue Service as a prohibited transaction, B&B will either notify the plans and require them to pay their pro rata share of the costs or avoid making the advance by deferring payment of the costs to be incurred.

Persons investing in Fractional Interests in a Loan on behalf of qualified ERISA Plans should consult their own tax advisors, accountants and attorneys to determine whether an investment in a Fractional Interest is permitted under the trust instrument and other documents establishing the plan as well as under ERISA and the regulations adopted thereunder.

## LOAN SERVICER

Loans will be arranged and serviced by Blackburne & Brown Mortgage Company, Inc., a California corporation (“B&B”). B&B was formed in 1980 for the purpose of originating loans that are secured by first and second deeds of trust on income-producing real property located in California. B&B is also the sole general partner of Blackburne & Brown Mortgage Fund I (“Fund I”), a mortgage fund that began operations in 1991. Fund I currently offers limited partnership interests to qualified investors pursuant to a permit originally issued by the Department of Corporations on August 16, 2002 (File No. 505-3976). B&B is also the sole general partner of Blackburne & Brown Mortgage Fund II, LP (“Fund II”), a second mortgage fund that currently offers limited partnership interests to qualified investors pursuant to a permit originally issued by the Department of Corporations on October 22, 2002 (File No. 506-2260). Loans originated by B&B are sold to individual investors, employee benefit plans, Fund I and Fund II and are fully serviced by B&B. B&B has experienced steady, controlled growth over the past twenty years and now services a loan portfolio of approximately \$47,810,000. B&B also brokers larger loan requests to selected financial institutions, specifically banks and savings and loans. George Blackburne, III is the sole officer of B&B.

**George Blackburne, III (Age 53):** George Blackburne, a licensed attorney and a licensed real estate broker, is the founder and president of B&B. He is a graduate of the University of Santa Clara where he majored in finance. In 1982 he received his M.B.A. from the University of Santa Clara, with an emphasis in finance. He graduated with honors from the University of Northern California School of Law in May of 1991 and was accepted to the California state bar in November of 1991. As President of B&B, he is responsible for all phases of operations.

## **LEGAL MATTERS**

B&B has retained Stein & Lubin LLP of San Francisco, California to advise it in connection with the preparation of this Offering Circular and the Loan Servicing and Tenancy in Common Agreement, as well as the offer and sale of the Fractional Interests offered hereby. Stein & Lubin LLP has not represented the interests of the Lenders in connection with this offering or the Loan. Lenders purchasing Fractional Interests in the Loan that wish to obtain the benefit of review by legal counsel on their behalf must retain their own attorneys to do so.

## **PLAN OF DISTRIBUTION**

Fractional Interests will be offered and sold by B&B or by its duly authorized agents and employees. Additionally, B&B, in its sole discretion, may arrange for Fractional Interests to be sold through registered securities broker-dealers who are members of the National Association of Securities Dealers, Inc. (“NASD”). Any such agents, employees or broker-dealers will be paid selling commissions to be negotiated on a case-by-case basis. These selling commissions will be paid by B&B and shall not be paid from the proceeds of this Offering. There is no firm commitment from any third party to purchase any Fractional Interest, and there is no assurance that the amount necessary to fund the Loan will be received (see “LOAN FUNDING”).

## **ADDITIONAL INFORMATION AND UNDERTAKINGS**

B&B undertakes to make available to each prospective Investor every opportunity to obtain any additional information from B&B necessary to verify the accuracy of the information contained in this Offering Circular or to assess the merits of the Loan, the Borrower, any guarantors, the Property, the Hypothecated Notes and any borrowers under and Property securing the Hypothecated Notes to the extent that it possesses such information or can acquire it without unreasonable effort or expense. This additional information includes, without limitation, financial and other information concerning the Borrower or any guarantors, appraisals and other information concerning the real property security, information regarding past mortgage lending experience of B&B, and all other documents or instruments that are material to this offering and the transactions contemplated and described in this Offering Circular.

## COMMISSIONER'S RULE 260.141.11

In addition to the various restrictions on the transfer of Fractional Interests imposed by state and federal securities laws generally, no Fractional Interest may be sold or transferred or any consideration received therefor without the prior written consent of the California Commissioner of Corporations, except as provided in the Commissioner's Rules. A copy of Commissioner's Rule 260.141.11 is as follows:

### **260.141.11 Restriction on Transfer.**

(a) The issuer of any security upon which a restriction on transfer has been imposed pursuant to Sections 260.141.10 or 260.534 shall cause a copy of this section to be delivered to each issuee or transferee of such security at the time that the certificate evidencing the security is delivered to the issuee or transferee.

(b) It is unlawful for the holder of any such security to consummate a sale or transfer of such security, or any interest therein, without the prior written consent of the Commissioner (until this condition is removed pursuant to Section 260.141.12 of these rules), except:

- (1) to the issuer;
- (2) pursuant to the order or process of any court;
- (3) to any person described in Subdivision (i) of Section 25102 of the Code or Section 260.105.14 of these rules;
- (4) to the transferor's ancestors, descendants or spouse, or any custodian or trustee for the account of the transferor or the transferor's ancestors, descendants, or spouse; or to a transferee by a trustee or custodian for the account of the transferee or the transferee's ancestors, descendants or spouse;
- (5) to holders of securities of the same class of the same issuer;
- (6) by way of gift or donation inter vivos or on death;
- (7) by or through a broker-dealer licensed under the Code (either acting as such or as a finder) to a resident of a foreign state, territory or country who is neither domiciled in this state to the knowledge of the broker-dealer, nor actually present in this state if the sale of such securities is not in violation of any securities law of the foreign state, territory or country concerned;
- (8) to a broker-dealer licensed under the Code in a principal transaction, or as an underwriter or member of an underwriting syndicate or group;
- (9) if the interest sold or transferred is a pledge or other lien given by the purchaser to the seller upon a sale of the security for which the Commissioner's written consent is obtained or under this rule not required;

(10) by way of a sale qualified under Sections 25111, 25112, 25113, or 25121 of the Code, of the securities to be transferred, provided that no order under Section 25140 or Subdivision (a) of Section 25143 is in effect with respect to such qualification;

(11) by a corporation to a wholly owned subsidiary of such corporation, or by a wholly owned subsidiary of a corporation to such corporation;

(12) by way of an exchange qualified under Section 25111, 25112, or 25113 of the Code, provided that no order under Section 25140 or Subdivision (a) of Section 25143 is in effect with respect to such qualification;

(13) between residents of foreign states, territories or countries who are neither domiciled nor actually present in this state;

(14) to the State Controller pursuant to the Unclaimed Property Law or to the administrator of the unclaimed property law of another state;

(15) by the State Controller pursuant to the Unclaimed Property Law or to the administrator of the unclaimed property law of another state if, in either such case, such person (i) discloses to potential purchasers at the sale that transfer of the securities is restricted under this rule, (ii) delivers to each purchaser a copy of this rule, and (iii) advises the Commissioner of the name of each purchaser;

(16) by a trustee to a successor trustee when such transfer does not involve a change in the beneficial ownership of the securities; or

(17) by way of an offer and sale of outstanding securities in an issuer transaction that is subject to the qualification requirement of Section 25110 of the Code but exempt from that qualification requirement by subdivision (f) of Section 25102; provided that any such transfer is on the condition that any certificate evidencing the security issued to such transferee shall contain the legend required by this section.

(c) The certificates representing all such securities subject to such a restriction on transfer, whether upon initial issuance or upon any transfer thereof, shall bear on their face a legend, prominently stamped or printed thereon in capital letters of not less than 10-point size, reading as follows:

“IT IS UNLAWFUL TO CONSUMMATE A SALE OR TRANSFER OF THIS SECURITY, OR ANY INTEREST THEREIN, OR TO RECEIVE ANY CONSIDERATION THEREFOR, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA, EXCEPT AS PERMITTED IN THE COMMISSIONER’S RULES.”

**EXHIBIT A**

**Loan Servicing and Tenancy in Common Agreement**

**(attached to Renewal Application filed July 6, 2004)**

**EXHIBIT B**

**Loan Package – Description of Specific Loan**

**(attached to Renewal Application filed July 6, 2004)**

**EXHIBIT C**

**Subscription Agreement**

**(attached to Renewal Application filed July 6, 2004)**