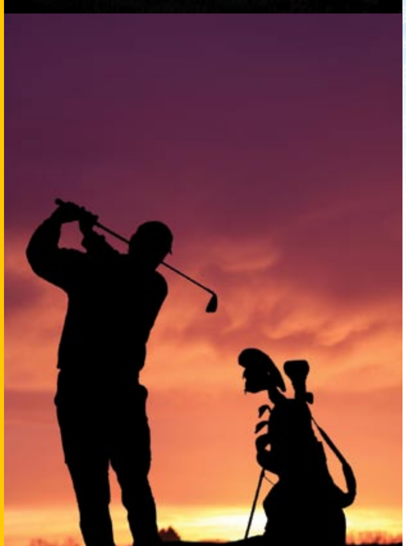
News Of Interest

Summer 2008

SFG Family of Funds

Seattle Funding Group, Ltd.

Yesterday's disciplines provide solid foundation for SFG portfolio



Underwriting lessons number three and four

At year-end 2006, we began the process of detailing SFG's top ten lessons over the last 15 to 20 years that form the foundation of our loan underwriting decisions. In that issue of *News Of Interest,* we discussed the first two lessons. Here we will discuss two more. Keep in mind some of these lessons are rudimentary; there is much more to the success of a loan than just these basics. We want to emphasize this point: It requires a thorough analysis of numerous complex issues, plus a commitment to sound fundamentals, to achieve a healthy loan portfolio in all types of markets.

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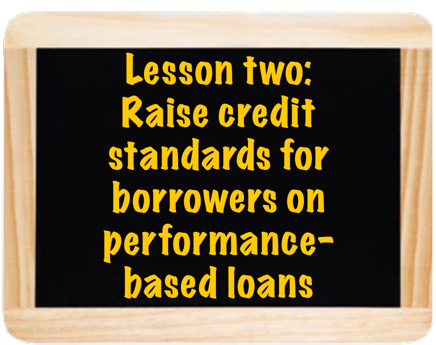
First, a quick recap of the first two lessons.

Other lenders have seen plenty of examples of this in the last 12 months. Without equity in the property, borrowers have insufficient motivation to maintain their obligations.



When lending to borrowers with poor credit, the risk of loss can be mitigated with sufficient, highly marketable collateral at a compensating loan-to-value ratio. However, with properties that require competent, organized management, such as income properties and new construction, it is best to raise the standards for acceptable borrower credit and competence. It is amazing how an excellent property or project can be run into the ditch by a borrower with poor credit, character and/or competence. The lesson? The borrower's track record is critical if you are expecting your borrowers to perform duties beyond simply making their payments.

Now let's move on to the new material.

We all know the basic premise that real estate's three most important rules are location, location and location. Good

school districts, well-kept streets, close-proximity shopping, parks and work centers all have an important role in a property's value.

These factors are primarily residential, but the same principles apply to commercial properties as well. Location in a great neighborhood is important. But the blind belief that great neighborhoods have nothing but great properties can lead to complacency and create lending and investment disasters.

We hear it all the time from mortgage brokers. They call us up and say, "It's a great location. It's in Beverly Hills..." or "Medina, Washington..." or "La Jolla, California..." Many lenders get so excited about neighborhood, they don't take a close enough look at the specific site. Especially in construction loans, the access, topography, view, immediate neighbors, soil quality for construction, allowable lot coverage ratio for improvements, privacy (or lack thereof) and school district all have a huge effect on the subject property's value and marketability.

A lender needs to take off the rose colored glasses of the great neighborhood and be very detailed in analyzing whether the subject property meets the standards of

competing properties in its price range. One side of the street may have very desirable school districts and the other side unsatisfactory school districts. An appraiser will generally ignore this and use the two as comparables simply because they are in close proximity. As a lender or investor, you have to beware and stay on top of these issues.

For commercial real estate there are even more location- and site-specific issues to analyze. Access, visibility, parking, zoning and utilities can vary dramatically from lot to lot, rendering one property worth several times that of a parcel close by. A shopping center on one side of the street may thrive due to excellent access while a competitor across the street is doomed to failure due to poor access—for example, if the direction of traffic makes it difficult to enter the parking lot.

Lesson four: Absorption Rate-Supply and demand of like product in the specific area

The absorption rate is a fairly basic concept that is many times overlooked by eager lenders. Excess supply of like products drives prices down. The tricky part is that you have to take a look at what is coming online over the next few months—or maybe even the next few years, depending on the product type.

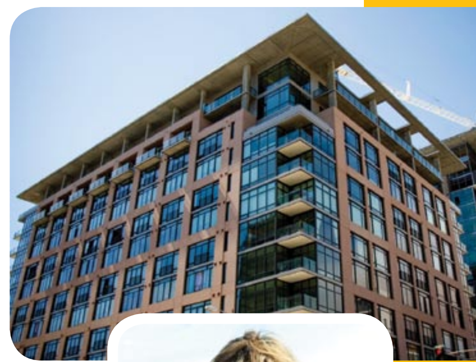
The damage from over supply can occur anywhere, but is most prevalent in desert communities

where there are low barriers to entry and large tracts of housing can be developed overnight. Think Riverside County, California; Maricopa County, Arizona; and Las Vegas County, Nevada.

Another way in which too much product can be brought to the market quickly is through high-density construction, like condominiums. Think Miami, San Diego and again Las Vegas.

> *The blind belief that great neighborhoods have nothing but great properties can lead to complacency and create lending and investment disasters.*

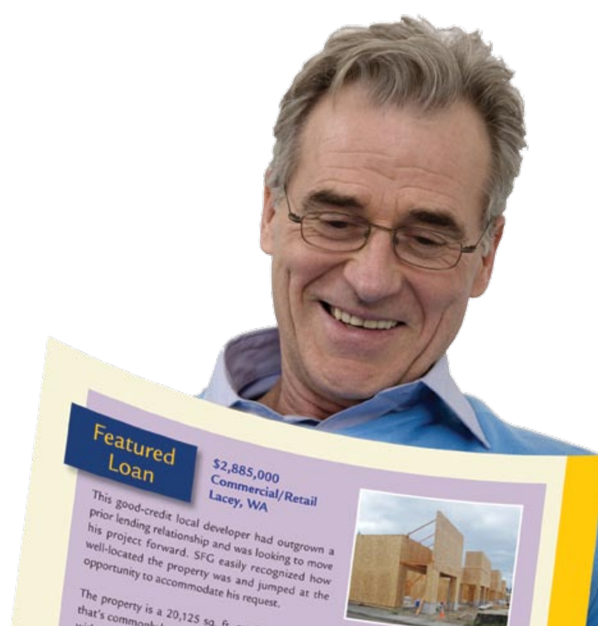
All major cities, at one time or another, have experienced the phenomenon of too much office space; that's another example of high density quickly providing too much product for the market to absorb. Of course excess supply can also result from attrition. This occurs when people and industries leave town, vacating commercial space and residences.



Once you have established the quantity of competing product, you look at how much is currently being absorbed (sold) monthly or annually to get a feel for "how long the line is." If the sales line is a long one, you may have to adjust your price, in some cases substantially, to gain a quick sale.

Thanks to the Internet, finding out how much product is on the market, or expected to be on the market, is much easier than in years past. There are several websites, including government websites, designed to provide this specific information.

There is no magic in absorption rate analysis unless you fail to factor in its effect on value. Then you might see a magical loss of equity or a magically long marketing time. ■



A majority of lenders are now adopting SFG's long standing lending policies!

Suddenly, lenders are no longer lending to almost everyone who applies! Suddenly lenders aren't just blindly using appraisals for value! Suddenly lenders are requiring borrowers to have their own money in the transaction and have lowered their loan-to-value ratios to protect their capital!

Sound familiar? They are just now adopting the SFG way—the way we have approached lending since our inception 20 years ago. Even with our conservative approach, we are dealing with a few frustrating foreclosures and expect a few more over the next year. Although our foreclosure frustrations will not affect investor capital or returns, we can only imagine where we'd be today if we had not remained so disciplined over the years. We are not an "I told you so" company. But to all the lenders out there who are suddenly exercising some rational discipline....
We told you so!

Excerpts from past issues of *News of Interest*

Since we are on the subject of "I told you so," here are some excerpts from *News Of Interest* over the years.

1. Know when to say "no"
"2006 was not the year to chase loan volume; it was a year to maintain vigilance. With a philosophy of safety first and yield second, we said "no" more in 2006 than any year previously. "
Year End 2006

2. "As an investor in the SFG Income Fund, you can rest assured that we are focused on the right long-lasting principles to ensure your capital is always well preserved, earning strong returns and available when you need it. That's just the SFG way."
Year end 2006

3. "SFG portfolio today...providing protection in turbulent markets."
1st quarter 2002

4. "We have always prided ourselves on delivering to investors a stable and predictable return regardless of economic conditions."
1st quarter 2002

Featured Loan

$2,885,000
Commercial/Retail
Lacey, WA

This good-credit local developer had outgrown a prior lending relationship and was looking to move his project forward. SFG easily recognized how well-located the property was and jumped at the opportunity to accommodate his request.

The property is a 20,125 sq. ft. retail condo building in Lacey, Washington, in an area that's commonly known as Hawks Prairie. The building sits on 1.98 acres on Martin Way with approx. 400 ft. of frontage. There has been tremendous growth in this area that has attracted national retail franchises such as Home Depot, Best Buy, Costco, Cabela's and many others. Borrowers brought the site to us free and clear of any debt plus ample additional capital giving them a huge equity position.... and SFG plenty of protection. That's just the way we like it!

Favorite Quotes

Weakness of attitude becomes weakness of character.
~Albert Einstein

Arriving at one goal is the starting point to another.
~John Dewey

He is richest who is content with the least.
~Socrates

There are two kinds of people: those who do the work and those who take the credit. Try to be in the first group; there is less competition there.
~Gandhi

It is easier to do a job right than to explain why you didn't.
~Martin Van Buren (Eighth President of the United States)

If you have any favorite quotes you'd like to see in the News of Interest, please pass them along to John Odegard. We'd even be happy to mention in our newsletter where they came from. E-mail your favorite quotes to: jodegard@sfgfunds.com.