

# **USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC**

Robert G. Worthen, Chairman of the Board

February 26, 2008

Dear USA Capital Diversified Trust Deed Fund, LLC Investor:

I again write on behalf of the Board of Directors of USA Capital Diversified Trust Deed Fund, LLC ("DTDF") to update you about DTDF's efforts to collect assets and to make distributions to investors. As described in more detail below, we continue to focus on recovering assets, with the goal of making a second distribution to investors later this year. As explained below, though, the recent national credit crunch and the collapse of the California new housing market will negatively impact both the speed with which future distributions may be made, and the amounts of such distributions.

## **DTDF Management.**

As you know from our prior letters to investors, DTDF emerged from chapter 11 on March 12, 2007. As of that date, Tom Allison's role for DTDF ceased, and Michael Tucker of FTI Consulting became DTDF's new manager. He answers to the Board of Directors, which is comprised of five DTDF investors: myself, as Chairman of the Board, Robert Hardy, Charles Nichols, Bob Fitzner and Richard Kreps. DTDF's counsel is Orrick, Herrington & Sutcliffe LLP, its Nevada counsel is Snell & Wilmer LLP, and its financial advisor is FTI Consulting.

## **First Distribution To DTDF Members.**

An initial distribution of \$3 million was mailed to investors in late December, representing just over 2% of your investment. If you did not receive a distribution check, please contact us at the FTI address provided in the next section of this letter. As noted in our November 20th letter, the Board set the initial distribution at \$3 million because much litigation and other recovery efforts remains in store for us, and we must maintain significant reserves in order to fund our recovery efforts. The first distribution had been delayed due to the late filing of a DTDF proof of claim asserting a creditor claim in excess of \$4.9 million. As explained in our November 20th letter, under the terms of the confirmed plan, DTDF was unable to make a distribution to equity investors unless creditor claims had been paid or funds had been reserved to pay contested creditor claims. But in November, we filed an objection to the late filed claim, and, at the conclusion of a hearing on December 5th, Judge Riegler sustained the objection disallowing the claim, thus clearing the way for the distribution.

## **Mailing of the K-1's to DTDF Members**

KPMG prepared DTDF's 2006 tax return, and has been retained by DTDF to prepare the 2007 tax return that includes the K-1's for individual members. We have been told that the 2007 K-1's should be mailed to DTDF investors within the next few weeks, so you should receive your K-1 in the mail in mid-March.

### **Communications With DTDF Members.**

We will send you another letter within the next three months. As it is very expensive to communicate with our professionals, who bill hourly fees, I am pleased to receive your phone calls and to answer questions about our status to the best of my ability. My personal cell phone number is (702) 239-4222.

Also, you may send us inquiries at [diversifiedfund@orrick.com](mailto:diversifiedfund@orrick.com). For address changes, please send a written request with your legal vesting name and account number to DTDF at the following address:

USA Capital Diversified Trust Deed Fund  
C/O FTI Consulting, Inc.  
Two North Central Avenue  
Suite 1200  
Phoenix, Arizona 85004

### **Accessing The DTDF Website**

The website provides a convenient way to track the progress in this case. There, you can view an updated court docket, with links to recent pleadings and informative updates. Every letter to DTDF investors, including this one, is posted on the website. I urge you to visit our website on a regular basis. Here are two ways to access the DTDF Website:

- TYPING: Type <http://usacapdtfd.bmcgroup.com/default.aspx> into the browser screen at the top of your monitor.
- GOOGLE: If you type “USA Capital Diversified Information” in Google, the first resulting link should be the DTDF Website. Simply click on the link, and you will be at the DTDF Website.

### **Actions To Collect Assets And The Non-Performing DTDF Loans.**

In our three previous letters to investors – each of which is posted on the DTDF website – we reported to you on our efforts to recover assets. In the following pages, we have updated the descriptions provided in the November 20th letter. As has been the case since the Effective Date, the status of many of these changes daily.

- Loans serviced by Compass
- 10-90, Inc. loan – owed by Investment Partners, a chapter 11 debtor
- Claims against Joe Milanowski and Tom Hantges, each a chapter 11 debtor
- Ashby real estate projects
- Colt Gateway LLC loans – The former Colt Armory located in Hartford, Connecticut

- BySynergy obligation – The subject property located in Sedona, Arizona
- Tree Moss Partners/EPIC Loan – The Marquis Villas in Palm Springs
- USA Investors VI – The Hotel Zoso in Palm Springs
- HMA litigation – Related to the sale of the Royal Hotel in Las Vegas
- Claims against USA Commercial Mortgage (“USACM”)
- Claims against other third parties

**Information We Are Unable To Provide To DTDF Members.**

DTDF will provide you with information regarding your investment. Please contact us through the website using the email address given earlier in this letter. However, we are unable to provide you with individualized legal or financial advice because the DTDF professionals represent the company, not members individually. In other words, the Board and the DTDF professionals are looking out for the interests of DTDF and its members as a whole, and if you need personal legal or financial advice, you ought to retain your own attorney or financial advisor. Also, remember that while we want to provide meaningful information to DTDF members, details about litigation and settlement strategies are both confidential and privileged.

**Conclusion.**

We continue to ask for your patience, and want to assure you that the Board and the DTDF professionals are giving our best efforts to obtain the best recovery for you.

Best Regards,  
Robert G. Worthen  
Chairman of the Board

Introduction.

Because our May 10, 2007, letter was the Board's first communication to DTDF investors, we went into great detail about each of DTDF's significant loans and claims. Thus, the attachment was five and a half pages of single-spaced text, all of it substantive. We updated that information in the August 20th and November 20th letters, and do so again in this attachment. The information provided below assumes that you have read the previous letters, but that you recall only the key details. After reviewing the following, you may want to re-read portions of the earlier letters.

- Loans Serviced By Compass.

Compass is the servicer of nine DTDF loans. As of December 31, 2007, the total outstanding amount due to DTDF for the nine loans approximated \$6.8 million. The two largest DTDF loans serviced by Compass are the Amesbury/Hatters Point loan with \$3.6 million owed to DTDF and the Ten-Ninety, LTD loan with \$1.5 million owed to DTDF.

Compass is now providing monthly loan status updates for each loan on it's website at <http://www.compassloans.net/currentloans> . Provided below is a brief summary of the collection status for each of DTDF's loans serviced by Compass:

1. Amesbury/Hatters Point – Compass is moving forward to take possession of the collateral.
2. Bay Pompano Beach – A discounted payoff offer has been accepted that would pay the direct lenders approximately 77% of the principal and non-default interest owed. DTDF holds a .47% interest in this loan and is owed approximately \$82,000. The discounted payoff is expected to close in February or March 2008, if that occurs DTDF would receive approximately \$63,000.
3. HFA – Clear Lake – Compass is negotiating a payoff with the borrower.
4. Huntsville – Compass has foreclosed on the collateral and is in negotiations with potential buyers of the property.
5. Lake Helen Partners – Compass has filed a notice of default and is currently foreclosing on the collateral, however the borrower is contesting the foreclosure.
6. Mountain House Business Park – Compass is moving forward with the foreclosure of the collateral.
7. Oak Shores II – Compass is negotiating a payoff with the borrower.
8. Ten-Ninety, LTD – Compass foreclosed on the collateral and is pursuing the personal guarantors.
9. The Gardens, LLC Timeshare - Compass negotiated an extension and modification to The Gardens Timeshare loan and is awaiting consent/non-consent from the direct lenders.

Compass and the Lender Protection Group have various disputes between each other, primarily with respect to the servicing rights of the direct lender loans. Diversified is not directly involved in those disputes and has not been impacted by them.

- Investment Partners, Its Chapter 11 Case And Trustee. Investment Partners was a vehicle controlled by Hantges and Milanowski. Under the guise of a loan to 10-90, Inc., DTDF transferred in excess of \$55 million of investor funds to 10-90, Inc./Investment Partners to enable Hantges and Milanowski to engage in speculative real estate activities (“10-90 Loan”). With interest, the amount owing on the 10-90 Loan exceeds \$100 million. DTDF joined with other creditors of Investment Partners in the filing of an involuntary chapter 11 petition against that entity in early April 2007. Lisa Poulin of Corporate Revitalization Partners was selected by the office of the U.S. Trustee to serve as the interim Trustee of Investment Partners. Thereafter, Judge Riegler entered an order for relief, concluding that the bankruptcy was proper. Ms. Poulin has taken control of the assets of Investment Partners, and, along with her counsel, Gordon & Silver, continues to identify, understand and liquidate Investment Partners’ assets for the benefit of creditors (of which DTDF is one of the largest). Both the amount of DTDF’s recovery from the Investment Partners case and the timing of any payment to Diversified are unknown at this time, as Ms. Poulin and her team continue to work to unravel the web of deceit spun by Hantges and Milanowski.

- Hantges And Milanowski Personal Bankruptcy Cases. DTDF and the USACM Trust orchestrated the filing of involuntary bankruptcy cases against Hantges and Milanowski in late May and the immediate appointment of interim trustees in early June. Michael Carmel is trustee in the Hantges case, and Ford Elsaesser is the permanent trustee in the Milanowski case. Largely because both Milanowski and Hantges personally guaranteed the 10-90 Loan, DTDF is by far the largest creditor of the two estates. The two trustees and their counsel continue to investigate the activities and assets of Messrs. Milanowski and Hantges, with a focus on family trusts established by both of them. The cost to the two bankruptcy cases continues to be high, and the efforts of the trustees continue to be hampered by the fact that both Milanowski and Hantges regularly invoke their Constitutional rights against self-incrimination and refuse to answer even requests for basic information. Earlier this month, DTDF filed a complaint in the Hantges case, alleging that his obligations to DTDF should not be discharged (forgiven) in bankruptcy on account of fraud and other unlawful conduct. A number of other creditors, including USACM and the Pension Benefit Guaranty Corporation, filed similar complaints. The deadline by which such complaints must be filed against Milanowski has been extended, with his consent, to March 17, 2008.

- Ashby Real Estate Projects, Including Roripaugh Ranch. The 10-90 Loan is secured by the assignment of membership interests in Ashby USA, LLC, Capital Land Investors, LLC and Random Developments, LLC. Investment Partners is the 50% owner of such entities, and as the trustee of Investment Partners, Ms. Poulin has worked with DTDF’s professionals in attempting to maximize value for the equity interests and for creditors such as DTDF. Ms. Poulin, her counsel and DTDF professionals have met with Ashby representatives in Las Vegas, Los Angeles and at the individual projects, and have had numerous telephone conversations with them in an attempt to achieve maximum value from the Ashby properties. DTDF’s opportunity to obtain substantial recoveries on account of Ashby-related real estate assets has become more challenging in light of the

current decline in the housing and land market and lending crisis that has threatened developers nationwide. Sadly, the Ashby entities are not immune, and lenders to the Ashby projects, (including Compass, as servicer of direct lender loans on the Oak Valley and Stoneridge projects), commenced foreclosure actions against the two projects in which DTDF, via its secured claim against Investment Partners, had an interest, namely Stoneridge and Oak Valley. The partnerships that own the Stoneridge and Oak Valley projects have commenced their own chapter 11 cases in Las Vegas. Furthermore, the partnership that owns the Roripaugh Ranch project – Ashby USA, Ltd. – faces lawsuits by its bonding company and its secured lenders. Bankruptcy or foreclosure are seemingly inevitable. DTDF and Investment Partners professionals are actively monitoring the situation, and, where appropriate, taking action. While the Ashby failures are disappointing, they are not surprising in light of the near collapse of the market for new homes in Riverside County, California, and the inability of homebuilders to obtain credit.

- Colt Loans. DTDF and the two other direct lenders who are DTDF's co-beneficiaries of a promissory note secured by a first trust deed on certain parcels and buildings comprising a portion of the overall Colt project have, through Connecticut counsel hired by the three, initiated a foreclosure action. The case is working its way through the Connecticut courts, but justice moves slowly, and foreclosure is not on the near horizon. Despite the pendency of the lawsuit, however, DTDF continues to work with potential lenders to Colt in an attempt to obtain a payout on both the first trust deed loan and the three additional advances by DTDF to Colt which are "undocumented," meaning that promissory notes and related security documentation were not formally signed by the parties involved. In late December, all of the various parties (including Colt) reached an agreement for the satisfaction of the various debts and other obligations. Unfortunately, the proposed new lender withdrew from the transaction for reasons unrelated to the Colt Gateway project. Negotiations are continuing with another lender, with DTDF playing a large role in trying to bring the parties together. In the meantime, though, the foreclosure action inches forward.

- The BySynergy Obligation. The softening of the overall real estate market places into question whether BySynergy will have any equity in the subject project (currently partially developed land in Sedona, Arizona that eventually will be sold as 105 single-family-residential lots) with which to pay the DTDF/USACM Trust loan. The project is pledged for a first deed of trust loan to an unrelated bank lender, which commenced foreclosure earlier this month. DTDF may initiate litigation, but the financial viability of the project may ultimately determine whether such litigation is worthwhile.

- Tree Moss Partners, LLC And The Marquis Villas. Lisa Poulin is chapter 11 trustee of Tree Moss. DTDF has a claim in excess of \$20 million against Tree Moss arising out of the Epic Resorts loan made by DTDF and the February 2006 transfer to Tree Moss of the 63 Marquis Villas condominiums in Palm Springs, California formerly owned by DTDF. Ms. Poulin has been marketing the Tree Moss property, and on October 15th, the bankruptcy court approved her motion to sell the 63 Marquis Villas

condominium units for \$10,829,625.00. No higher or better offers were made at the hearing, but Sunterra Corporation, the owner of the remaining 38 condominium units at the Marquis Villas, raised certain objections to the sale on the terms proposed by the Trustee. Although many of those objections were resolved, the winning bidder ultimately notified the trustee that the winning bidder did not intend to complete the purchase, even though the winning bidder's earnest money deposit of \$750,000 would be forfeited to Tree Moss. Sale negotiations and discussions have continued, and Ms. Poulin recently signed a Letter of Intent with a buyer. Ms. Poulin's goal is to file sale approval pleadings in the near future, and to seek Judge Riegler's approval of the sale at a hearing on March 25th. If no sale transaction is consummated, however, litigation may ensue.

- USA Investors VI ("Investors VI"). Lisa Poulin also is the chapter 11 trustee of Investors VI, which owned the Hotel Zoso (which is located in Palm Springs across the street from the Marquis Villas condominiums). DTDF has a large unsecured claim against Investors VI on account of Milanowski/Hantges shenanigans relating to the sale of the former Sheraton Hotel located at the Salt Lake City airport. In a sale that closed in mid-November, the Hotel Zoso was sold for \$25,117,500. No higher or better offers were made at the hearing. The Hotel Zoso is encumbered by a direct lender loan serviced by the USACM Trust. The balance on that loan is in excess of \$20 million. An additional \$3 million in default interest is owing, but Ms. Poulin and the USACM Trustee reached agreement to a reduced amount of default interest in connection with the Investors VI plan of liquidation, which was confirmed by order entered on February 7, 2008. Such agreement should result in the distribution of the sales proceeds of the Hotel Zoso, net of the direct lender loan, sales expenses and administrative claims in the Investors VI case, to DTDF and other creditors in the late spring or early summer of 2008. We do not yet have the information as to the amount of money available to be distributed to unsecured creditors such as DTDF, or the amount that DTDF can expect to receive, but will provide that information in the next letter to investors if it is available at that time.

- The HMA Chapter 11 Case Relating To The Royal Hotel. The prior letters recount the extensive litigation with respect to this matter, and should be consulted for any desired details. DTDF continues to work with Ms. Poulin and her counsel to collect additional sums relating to the Royal Hotel. Recent activity involves the pursuit of Alan Abolafia, who received in excess of \$1,000,000 of the proceeds of the Royal Hotel.

- Disputes Concerning DTDF's Claims Against USACM. DTDF asserts a claim in excess of \$100 million against USACM. In addition, the parties assert other claims against one another. The various disputed claims are very complex. A mediation session before a visiting bankruptcy judge in December 2006 proved fruitless. Thereafter, rather than fight one another about the claims, the two former debtors cooperated in the filing and prosecution of the involuntary bankruptcy cases of Investment Partners, Milanowski and Hantges in an attempt to increase the pool of assets available for both estates. Last November, the parties met for the better part of a day in an attempt to work out their differences. The meeting did not produce an agreement, but

both sides agree that progress was made. DTDF anticipates further discussions, but in the meantime, both the USACM Trust and DTDF have focused their efforts on collecting assets for their respective constituencies. Moreover, professionals employed by the USACM Trust have devoted a great deal of time to waves of objections to the hundreds of millions of dollars of claims filed against USACM by direct lenders. DTDF stands to gain by the success of such objections, which reduce the size of the creditor body and render the DTDF claim larger in relation to other claims. DTDF and USACM plan to resume settlement negotiations during the first week of March.

- Litigation Against Third Parties. DTDF professionals have worked with professionals employed by the USACM Trust to investigate claims that DTDF and the USACM Trust may have against third parties who, prior to the April 2006 chapter 11 filings, provided advice to DTDF and to USACM or had close relationships and engaged in numerous transactions with them. Potential targets include accountants, attorneys and others. Details of such investigations, of course, are highly confidential.