

Message

From: Chris Kirkpatrick [CK@haymancapital.com]
Sent: 12/4/2015 9:37:41 PM
To: David Whipple [WhippleDa@SEC.GOV]; Hunter, Keith J. [HunterK@SEC.GOV]
Subject: Letter to Whitley Penn
Attachments: Letter to Auditor (FINAL Dec 4 2015).pdf

David:

Attached are (i) the letter that we sent to Whitley Penn this afternoon concerning their resignation, (ii) an involuntary petition for bankruptcy filed by UDF III against a Buffington related entity (Lennar Buffington Stonewall Ranch, L.P.), and (iii) the original petition filed against, among others, Buffington and Starley, individually, and a Buffington entity and UDF IV.

Also, here's a link to the recent resignation of William Kahane, a director of UDF V's board of directors. http://www.sec.gov/Archives/edgar/data/1591330/000114420415068511/v425695_8k.htm. Kahane is affiliated with AR Capital, RCS Capital and Nick Schorsch. Although his resignation was announced on November 30th, it was effective on the same day that Whitley Penn resigned as UDF's auditor.

Let me know if you have any questions.

Best,

Chris

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December 4, 2015

Mr. Larry Autrey
Managing Partner
Whitley Penn LLP
8343 Douglas Avenue, Suite 400
Dallas, Texas 75225

Mr. James Penn
Mr. B. Glen Whitley
1400 West 7th Street, Suite 400
Fort Worth, Texas 76102

Gentlemen:

On November 24, 2015, United Development Funding III, L.P. (“UDF III”), United Development Funding IV (“UDF IV”), United Development Funding Income Fund V (“UDF V”), and United Mortgage Trust (“UMT”) (collectively, the “Companies”) each filed an 8-K with the Securities and Exchange Commission (“SEC”) stating that Whitley Penn, LLP “has declined to stand for reappointment as the Company’s independent registered public accounting firm,” and its declination was “accepted by the Company’s audit committee.” These 8-Ks further state that

(i) there were no disagreements between the [Companies] and Whitley Penn on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Whitley Penn, would have caused Whitley Penn to make reference to the subject matter of the disagreement in its report on the [Company]’s consolidated financial statements, and (ii) there were no “reportable events” as that term is defined in Item 304(a)(1)(v) of Regulation S-K.

Whitley Penn acknowledged the filings and agreed “with the statements concerning our firm contained therein.”

As you know, the Companies are affiliates of each other, externally managed or advised by the same principal group of related individuals, and generally engage in the business of unregulated lending to residential real estate developers, primarily in North Texas and to the same, small group of developers. A review of the Companies’ periodic filings (Forms 10-K, 10-Q, 8-K, proxy statements and offering documents, collectively, the “Filings”) filed with the SEC, a review of county property records (central appraisal districts and deed recordings) and visits to numerous project and development sites raises a number of serious questions about (i) the legitimacy of the financial and other relationships between affiliated entities and individuals and (ii) apparent accounting irregularities. In addition to potentially significant issues regarding the adequacy of the disclosures in the Filings, it also appears that there may be material misstatements in the audited financial statements for the fiscal years ending 2012, 2013 and 2014, as well as the interim quarterly filings for the same periods. These issues raise serious concerns about Whitley Penn’s prior audit work, but, more importantly, Whitley Penn’s specific representations to shareholders and the public market that there were no “disagreements between the [Companies] and Whitley Penn” and no “reportable events.” As discussed below, there are a number of apparent irregularities that give rise to questions as to (i) whether Whitley Penn had a reasonable basis for making the representations contained in the Companies’ Forms 8-K (which shareholders and the market have clearly relied upon) and (ii) whether Whitley Penn intentionally, recklessly or negligently ignored obvious red flags.

Entities:

Entity	Commission File Number	Corporate Address	Total Assets (Book Value)
United Mortgage Trust	000-32409	1301 Municipal Way, Suite 220 Grapevine, Texas 76051	\$182.3 million
United Development Funding III, L.P.	000-53159	1301 Municipal Way, Suite 100 Grapevine, Texas 76051	\$391.6 million
United Development Funding IV	001-36472	1301 Municipal Way, Suite 100 Grapevine, Texas 76051	\$684.1 million
United Development Funding Income Fund V	333-194162	1301 Municipal Way, Suite 100 Grapevine, Texas 76051	\$55.6 million
Total Assets			\$1.3 billion

Red Flags:

- The primary assets of the Companies are loans, and the book value of assets appear to be materially overstated, either because the loans have insufficient reserves or have inadequate collateral supporting them.
- Loans appear to accrue larger and larger balances for years (more than doubling in some cases) without ever generating any cash receipts, which lead to questions about the accounting treatment of these loans, including how income is recognized and later capitalized to long-term asset accounts. This raises serious questions about the carrying value of the loans and the potential for materially overstated book value of assets.
- Management fees are assessed on the value of assets under management. If the book value of the Companies' assets is materially overstated, the external manager may have improperly received inflated management fees.
- UDF IV is not accruing any provision for loan losses despite a material outstanding balance of past due loans (loans that have matured without being repaid or extended).
- UDF III, UDF IV and UMT are not reserving against certain loans that have a high probability of being impaired (e.g. loans that remain outstanding but that have not matured).
- UDF IV's largest borrower is a private real estate developer based in Farmers Branch, Texas which does business under the name of Centurion American through a complex web of affiliated entities, which are controlled by Dallas businessman, Mehrdad Moayedí ("Moayedí") (Moayedí, Centurion American entities and their affiliates are collectively referred to as "Centurion"). Loans to UDF IV's largest borrower, Centurion, do not appear to be arms-length transactions. These loans do not appear to be repaid upon maturity, and UDF IV does not appear to receive any compensation for such extensions.

- The largest borrower of UDF III represents 43% of loans. The largest borrower of UDF IV represents 67% of loans. The largest borrower of UDF V represents 62% of loans. While this loan concentration is disclosed individually for each of the Companies, it is not disclosed that the largest borrower of each of UDF III, UDF IV and UDF V is one and the same – Centurion – and that there exists an inherent default risk across the Companies associated with this concentration in a single borrower. As a consequence, each of the Companies’ financial condition appears to be affected by, and dependent on, one another, which also does not appear to be disclosed.
- The largest borrower of each of UDF III, UDF IV and UDF V may be insolvent. This concern is based on, among other information, the fact that (i) over 95% of the loans issued to Centurion by UDF IV are not repaid when the loans mature and become due; (ii) Centurion recently defaulted on a first lien loan due to a third-party lender and a second lien loan due to UDF IV that was secured by land in Denton County, Texas; (iii) several mechanics and materialman’s liens have been filed related to Centurion in various North Texas counties, and (iv) the apparent inability of this borrower to service \$585 million in debt (outstanding principal balance) owed to UDF III and UDF IV (exclusive of any other debts owed to other entities) as well as approximately \$75 million of contractually obligated annual interest expense.
- 100% of UDF IV loans are classified as fully collectable, which is likely a material misrepresentation if the largest borrower is insolvent.
- Material conflicts exist between executives/officers and Centurion, which appear to be negatively affecting shareholders. UDF III, UDF IV and UDF V fail to fully disclose the business relationships between their officers and directors and Centurion as required by Auditing Standard No. 18 – Related Parties.
- UDF III and UDF IV’s second largest “non-affiliated” borrower is a private real estate developer based in Austin, Texas, whose principal executive is Thomas Buffington (“Buffington”). Six UDF IV loans related to Buffington have matured without being extended or repaid based on disclosures in the Form 10-Q filed for the quarter ended September 30, 2015. Buffington appears to account for approximately 10% of UDF IV’s total loan assets and has past due loans owed to UDF III that represent approximately 25% of UDF III’s portfolio. The impact of this borrower appears to be material as it is the second largest “non-affiliated” borrower of both UDF III and UDF IV.
- On or about October 30, 2015, a lawsuit was filed in Travis County, Texas, against, among others, UDF IV, several Buffington entities and Buffington, individually. See *Hanna/Magee L.P. #1 v. BHM Highpointe Ltd., et al.* (Cause No. D-1-GN-15-004985). The complaint contains allegations of fraud, breach of contract, tortious interference and fraudulent transfer and also includes specific claims that multiple Buffington entities (that have received loans and currently have outstanding balances owed to UDF IV) are insolvent.
- On November 30, 2015, UDF III filed an involuntary bankruptcy petition against an entity controlled by Buffington in the United States Bankruptcy Court for the Western District of Texas. See *In re Lennar Buffington Stonewall Ranch, L.P.* (W.D. Texas 15-11548-hcm). The amount of the claim by UDF III against the entity controlled by Buffington was \$106.5 million, which represents approximately 25% of UDF III’s total assets. Buffington and/or his affiliates have had, and continue to have, a material amount of loans past due owed to both UDF III and UDF IV. It appears that neither UDF III, nor UDF IV have disclosed (i) the litigation, (ii) the reality of the poor financial condition of its second largest “non-affiliated” borrower or (iii) the material affect this bankruptcy filing may have on the financial conditions of UDF III and UDF IV.
- There are disclosure issues regarding the percentage of loans that appear to be secured by unimproved real property. UDF III and UDF IV’s largest borrower, Centurion, has received over 75 acquisition and development loans that typically bear interest at 13% or higher. In numerous instances, Centurion has not broken ground on the development for 2, 3, 5 and 10 years after having received the 13% loan. This leads to questions about the use of

the loan proceeds (and potential misappropriation if not used for developments) and the value of the underlying collateral.

- UDF V's principal business activity appears to involve issuing loans to specific Centurion entities that have (or had) loans due to UDF III and UDF IV. UDF V funds appear to be used to repay loans owed to UDF III and UDF IV by Centurion, which is not disclosed to UDF V shareholders. Similar to a Ponzi scheme, it appears that UDF V investor capital is being used to return capital to UDF III and UDF IV investors.
- UDF V loans are being issued to UDF III and UDF IV's largest borrower, Centurion, and the relationship between Centurion and UDF V's affiliates is not disclosed. UDF V's Filings include express statements that it will not make loans to, or participate in loans with, affiliates. However, it appears that UDF V's business activity contradicts these statements or, at the very least, contradicts the spirit of the disclosures as UDF V is indirectly, but effectively, refinancing past UDF III and UDF IV loans while not directly acquiring the loans from UDF III and UDF IV.
- Insiders have made loans to themselves through affiliates of UMT at interest rates below the 10-Yr US treasury rate in the form of unsecured deficiency notes and recourse obligations totaling \$73 million as of the quarter ended September 30, 2015. Insiders lend to themselves at an interest rate of 1.75% to the detriment of shareholders while the same form of unsecured deficiency notes issued to non-affiliated parties bear interest at 14%.
- UDF III had \$392 million of assets and \$10 million of debt as of the quarter ended September 30, 2015. Despite having a nominal amount of debt relative to its assets (which are principally interest bearing loans), UDF III consistently discloses that it has not made payments on its debt in a timely manner, including in the most recent quarter. This leads to obvious questions about the financial condition of UDF III.
- On November 30, 2015, UDF V released a Form 8-K disclosing that William Kahane, a director of UDF V's Board of Directors, had resigned. Kahane's resignation was effective as of November 24, 2015, which was the same day that UDF V and the other Companies each released a Forms 8-K disclosing that Whitley Penn would no longer be the Companies' auditor. It appears that Kahane is affiliated with AR Capital, RCS Capital and Nick Schorsch. AR Capital is or was a co-sponsor and external advisor of UDF V. RCS Capital raised capital as the dealer manager for UDF IV and is raising or was raising capital as the dealer manager of UDF V. Like Whitley Penn, UDF V's Form 8-K disclosing Kahane's resignation claimed that the resignation was "not a result of any disagreement with the Board or the Trust on any matter relating to the Trust's operations, policies or practices." The timing of Whitley Penn's resignation and Kahane's does not appear to be coincidental and further raises questions about the veracity of Whitley Penn's representations to shareholders and the market.

In summary, these red flags raise significant questions about (i) the legitimacy of the UDF structure, (ii) the financial condition of the Companies, (iii) Whitley Penn's prior audit work and (iv) the accuracy of the Companies' claims and Whitley Penn's acknowledgement regarding there not being any disagreements between Whitley Penn and the Companies and there not being any reportable events. Further questions are also raised about whether these or other red flags may have been willfully or otherwise ignored, whether deficient audits may have been conducted, and whether professional audit standards may have been violated. In the absence of any disagreements between the Companies and Whitley Penn or any reportable events, especially in light of the observations detailed above, it begs the question as to why Whitley Penn is not continuing as the auditor of the Companies.