Private Placement Memo No. _____ Offeree Name(s) ______________________________
(Check one) _______ **CA** _______ **Non-U.S.**

For the Personal Use of Offeree Only

CONFIDENTIAL
PRIVATE PLACEMENT MEMORANDUM

BDS Tidelands II, LLC
A California Limited Liability Company

Forty-Four Units – Total Offering $2,200,000

$50,000 per Investment Unit

Offering Available Exclusively to California Investors and Certain Non-U.S. Citizens

These materials are for the personal use of the Offeree whose name appears above and are not to be transferred or electronically forwarded to any other person.

BDS TIDELANDS II, LLC
CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM

Forty-Four Units of Limited Liability Company Interest - $2,200,000 Total

$1,100,000 "Class 1" Units Offered to California Investors Only

$1,100,000 "Class 2" Units Offered to Certain Non-U.S. Investors Meeting Requirements Under SEC Regulation S

Minimum Offering Amount $1,200,000 Combined Both Classes

$50,000 per Unit

BDS Tidelands II, LLC, a California limited liability company, with its principal place of business at 875 Orange Blossom Way, Danville, CA 94526 (the "Company"), is hereby offering Units of limited liability company interest (the "Units") at $50,000 per Unit. The Company was formed on May 11, 2011. The Managers of the Company ("Managers") are Frederick M. Bates, Tom deRegt and Scott Stringer. Unless a minimum of 24 Units offered hereby are sold and the purchase price therefore is received by the Company before June 30, 2011 (the "Minimum Funding Date") or in the Company's discretion not later than September 30, 2011, none of the Units will be sold and amounts received in consideration therefore will be promptly refunded, without interest, and without deduction, and the offering will be terminated. No Units will be sold after September 30, 2011 (the "Offering Termination Date"), unless the Managers in their sole discretion revive this Offering Officers, directors and employees of the Managers, the Company or their Affiliates may purchase Units pursuant to this Offering to satisfy the Offering Amount. The minimum investment is one Unit ($50,000). However, the Managers, in their sole discretion, may permit investments of fractional Units to facilitate an orderly conclusion of this Offering.

The Company will participate in the acquisition of a long-term option on real property which provides legal authority for the Company to improve and enhance existing development entitlements. The real property subject to the option is in the City of Alameda, California. The Managers expect to optimize the financial return on the option pursuant to this business plan. The Company is the administrative member of Encinal Marina Village II, LLC, a California limited liability company (the "Property LLC"). Property LLC has in turn entered into an option agreement to purchase real property (approximately 7.1 acres developable) located at 1551 Buena Vista Ave., Alameda (the "Property") from its present owner, Encinal Real Estate, Inc., a California corporation ("Owner').

The Managers presently expect to conclude this Offering shortly after raising the Minimum Offering Amount of $1,200,000 and raise the reminder to the permitted Maximum by renewing this Offering at a later date, consistent with the timing of its cash needs. However, the

Managers in their sole discretion may conclude this offering at any point up to or including the Offering maximum of $2,200,000.

Prior to this Offering there has been no public market for the Units and there is no assurance that one will develop. The offering price for Units was determined by the Managers and is not the result of an independent analysis or valuation.

THE SECURITIES DESCRIBED HEREIN HAVE NOT BEEN REGISTERED PURSUANT TO THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), NOR UNDER THE SECURITIES ACTS OF CALIFORNIA OR OTHER STATES. THIS OFFERING IS MADE UNDER SECTION (3) (a) (11) OF THE ACT AND BY RULE 147 (THE "INTRASTATE OFFERING EXEMPTION") AS ENACTED BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE ACT, AS WELL AS OTHER EXEMPTIONS FROM REGISTRATION REQUIREMENTS, INCLUDING SECTION 4(2) OF THE ACT AND SECTION 25102 (f) OF THE CALIFORNIA CORPORATIONS CODE.

ALL OFFERS TO PURCHASERS SHALL BE MADE ACCORDING TO ONE OF THE TWO FOLLOWING CRITERIA, AND NOT OTHERWISE:

CLASS 1 UNITS: INVESTORS MUST BE BONA FIDE CALIFORNIA RESIDENTS MEETING THE ADDITIONAL REQUIREMENTS SET FORTH HEREIN AND IN THE SUBSCRIPTION MATERIALS; AND,

CLASS 2 UNITS: INVESTORS MUST MEET THE REQUIREMENTS OF REGULATION S, ENACTED UNDER SECTION 5 OF THE SECURITES ACT OF 1933, INCLUDING BUT NOT LIMITED TO THOSE WITH RESPECT TO TRANSFERS OF UNITS.

NEITHER THE CALIFORNIA DEPARTMENT OF CORPORATIONS NOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION HAS PASSED UPON THE MERITS OF NOR GIVEN ITS APPROVAL TO ANY SECURITIES OFFERED OR THE TERMS OF THE OFFERING, NOR DO EITHER OF THEM PASS UPON THE COMPLETENESS OF THE PRIVATE PLACEMENT MEMORANDUM NOR OTHER SELLING LITERATURE. THESE AGENCIES HAVE NOT MADE AN INDEPENDENT DETERMINATION THAT THE SECURITIES OFFERED HEREUNDER ARE EXEMPT FROM REGISTRATION.

THE INVESTMENT OFFERED HEREBY INVOLVES A CERTAIN AMOUNT OF RISK. POTENTIAL PURCHASERS SHOULD NOT INVEST IN THESE SECURITIES UNLESS THEY CAN AFFORD THE LOSS OF THEIR ENTIRE INVESTMENT. SEE "RISK FACTORS". INVESTORS MUST MEET CERTAIN SUITABILITY STANDARDS. SEE "INVESTOR SUITABILITY STANDARDS."

THIS PRIVATE PLACEMENT MEMORANDUM DOES NOT CONSTITUTE AN OFFER TO BUY OR SELL ANY OF THE SECURITIES TO ANY PERSON IN ANY JURISDICTION WHERE SUCH OFFER OR SOLICITATION WOULD BE UNLAWFUL.

THIS MEMORANDUM CONSTITUTES AN OFFER ONLY TO THE OFFEREE NAMED IN THE SPACE PROVIDED ON THE COVER HEREOF. DELIVERY OF THIS MEMORANDUM TO ANYONE ELSE IS UNAUTHORIZED AND ANY TOTAL OR PARTIAL REPRODUCTION OF THIS MEMORANDUM OR DIVULGENCE OF ITS CONTENTS, WITHOUT THE PRIOR WRITTEN CONSENT OF THE COMPANY, IS PROHIBITED. BY ACCEPTING DELIVERY OF THIS MEMORANDUM, THE OFFEREE NAMED HEREIN AGREES THAT IF SUCH OFFEREE ELECTS NOT TO MAKE A PURCHASE OFFER OR THE PURCHASE OFFER IS REJECTED, SUCH OFFEREE WILL RETURN THIS MEMORANDUM AND ALL DOCUMENTS DELIVERED HEREWITH TO THE COMPANY.

PROSPECTIVE INVESTORS ARE NOT TO CONSTRUE THE CONTENTS OF THIS MEMORANDUM AS INVESTMENT, TAX OR LEGAL ADVICE. INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE COMPANY AND THE TERMS OF THIS OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED, IN MAKING AN INVESTMENT DECISION. THIS MEMORANDUM AND THE EXHIBITS HERETO, AS WELL AS THE NATURE OF THE INVESTMENT, SHOULD BE REVIEWED BY EACH PROSPECTIVE INVESTOR'S PROFESSIONAL ADVISOR(S), IF ANY, THE INVESTOR'S TAX OR OTHER ADVISORS, OR THE INVESTOR'S ACCOUNTANTS OR LEGAL COUNSEL.

THIS MEMORANDUM CONTAINS CERTAIN INFORMATION ABOUT THE COMPANY'S BUSINESS PROSPECTS AND PRO FORMA FINANCIAL PROJECTIONS. SUCH INFORMATION IS BASED UPON THE ASSUMPTIONS SET FORTH IN THIS MEMORANDUM. SUCH ASSUMPTIONS ARE SUBJECT TO MANY VARIABLES DISCUSSED IN THESE OFFERING MATERIALS AND SHOULD NOT BE RELIED UPON.

CERTAIN DEFINED TERMS ARE USED IN THIS PRIVATE PLACEMENT MEMORANDUM. DEFINITIONS ARE FOUND IN THE LIMITED LIABILITY COMPANY AMENDED AND RESTATED OPERATING AGREEMENT OF BDS TIDELANDS II, LLC, WHICH IS EXHIBIT 2 TO THIS OFFERING MEMORANDUM.

SECURITIES ESCROW INFORMATION: ***U.S. BANK NATIONAL ASSOCIATION IS ACTING ONLY AS AN ESCROW AGENT IN CONNECTION WITH THE OFFERING OF THE INTERESTS DESCRIBED HEREIN AND HAS NOT ENDORSED, RECOMMENDED OR GUARANTEED THE PURCHASE, VALUE OR REPAYMENT OF SUCH INTERESTS.***

The date of this Private Placement Memorandum is June 15, 2011.

	Price to Investors	Proceeds to Company[1,2]
Per minimum investment (1 Unit-fully paid in)	$50,000	$50,000
Total minimum offering - 24 Units fully paid in	$1,200,000	$1,200,000
Total maximum offering - 44 Units fully paid in	$2,200,000	$2,200,000

1 The Company may by written agreement pay compensation to certain California licensed real estate brokers in connection with the sale of Units pursuant to California Corporations Code § 25206, more specifically described in this Private Placement Memorandum. The Company may by written agreement also compensate bona fide "finders" for introduction of prospective investors, in compliance with applicable law.

2 Before deducting certain other expenses associated with the offering, including but not limited to legal, accounting, organization costs, and due diligence costs and other direct costs of forming the Company and marketing the Units, as well as a contingency reserve (see "Amended and Restated Operating Agreement" herein).

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SUMMARY OF OFFERING

The following is a summary of certain information contained elsewhere in this Private Placement Memorandum. Reference is made to, and this Summary is qualified in its entirety by, the more detailed information appearing elsewhere in this Private Placement Memorandum, together with the exhibits thereto.

The Company:	BDS Tidelands II, LLC was formed on May 11, 2011 under California law. Its "Founding Members" are Bates Properties, Inc., a California corporation, deRegt Development, Inc., a California corporation and The Stringer Company, Inc., a California corporation. Its Managers are Frederick M. Bates, Tom deRegt and Scott Stringer, the controlling shareholders of those corporations.
Securities Offered:	The securities offered hereby are Forty-Four Units of limited liability company interest in two classes: Class 1 (California investors) and Class 2 (certain Non-U.S. Investors) at a total sale price of $50,000 per Unit. The number of Units initially offered in each Class is $1,100,000. The Minimum Offering Date, by which the aggregate Minimum Offering Amount of $1,200,000 (both classes) must be sold, is June 30, 2011, which may be extended to September 30, 2011 at the discretion of the Managers. The Offering Termination Date is September 30, 2011.
Securities Escrow Account:	The securities escrow holder is U.S. Bank Trust, One California St., Ste. 1000, San Francisco, CA 94111. The escrowed investor funds will be held separate from, and not be commingled with, other funds. When and only when the Minimum Offering Amount ($1,200,000, both classes combined) is attained, the funds will be released for use by the Company. If the Minimum Offering Amount is not attained by June 30, 2011 (or, if extended by the Managers, no later than September 30, 2011) all investor funds will be returned to investors, without interest. The Managers may loan funds at its cost of interest on either a secured or unsecured basis to attain the equivalent of the Minimum Offering Amount and may borrow funds from third parties on the same basis to do so. However, such loans will be converted to Unit ownership if such Units are not sold by the Offering Termination Date, September 30, 2011.
Rights and Preferences:	The Company has two classes of Units, Class 1 Units and Class 2 Units. Both Classes have equal rights and preferences with the sole exception that Unit transfer rights are more closely regulated for Class 2 (non-U.S.) investors. Reference is made to the Amended and Restated Operating Agreement of the Company to the description at Section 6.1 B and "INVESTOR SUITABILITY STANDARDS" herein for a fuller explanation.

Offering Price: The Offering Maximum is Two Million Five Hundred Thousand Dollars ($2,200,000) based upon sale of Forty-Four Units at Fifty Thousand Dollars ($50,000) per Unit.

Minimum Investment; Fractional Units: One Unit equals Fifty Thousand Dollars ($50,000). The Managers may also sell fractional Units in their sole and absolute discretion in order to facilitate an orderly close of the Offering.

Orientation and Purpose of Offering: The Company, by and through Encinal Marina Village II, LLC, a California limited liability company (the “Property LLC”), intends to improve and enhance existing development entitlements for under-improved real property in the City of Alameda, California that will optimize financial return derived from same. The Company is the administrative member of the Property LLC, which has in turn entered into an option agreement expiring December 31, 2016 to purchase real property consisting of approximately 7.1 acres of developable property located at 1551 Buena Vista Ave., Alameda (the “Property”) from its present owner, Encinal Real Estate, Inc., a California corporation (“Owner’). The purchase price for the Property under the option is $9,710,000 (Nine Million Seven Hundred Ten Thousand Dollars).

Use of Proceeds: Investor funds will be used primarily for funding scheduled option payments to the Owner, for costs associated with professional studies, reports and otherwise related to the development entitlement process, and certain ordinary and typical costs of holding the Property required to be paid by the Property LLC, all pursuant to the terms of the Option to Purchase and Joint Escrow Instructions between the Property LLC and the Owner dated June 1, 2011 (copy provided herewith).

Suitability Standards: Only investors who satisfy certain suitability standards may purchase the Units offered hereby (See “Investor Suitability Standards”).

Offering Termination Date: Unless the Company receives and accepts subscriptions for twenty-four (24) Units by June 30, 2011 (the “Minimum Funding Date”), or to a date not later than September 30, 2011 if extended by the Manager, no investor funds will be accepted. No Units will be sold after September 30, 2011 (the “Offering Termination Date”) unless the Managers in their discretion renew this Offering.

Distributions:	When the option on the Property is sold or (if the option is exercised) the Property is sold, investors will receive the return of their cash Capital Contributions, then a Preferred Return of 15% per annum (compounded). If additional profits remain following return of capital and Preferred Return to both the Company and the Owner, the company receives 60% of the remaining profits and investors receive 15% of the Company's additional profits distribution, allocated pro Rata among the Members (See Operating Agreement (Article IV and Section 2.1 (Certain Definitions)) and "Business of the Company—General Explanation of Terms of Option and Joint Venture" for fuller explanation).
Managers' Expenses Reimbursed; No Compensation to Manager Until Liquidation:	The Managers will be reimbursed certain ordinary and typical reimbursements of expenses (in general, direct project expenses) from the Company, as well as formation-related expenses. However, the Managers will not receive compensation in the form of fees or a profits share until liquidation of its interest in the Property. See "Management Compensation and Reimbursement" herein, and the Company's Amended and Restated Operating Agreement at Sections 4.1 A and 4.5, for a fuller explanation.
Risk Factors:	The Units offered hereby are a speculative investment. Investors should consider the risk factors described in this Private Placement Memorandum (See "Risk Factors").
Lack of Liquidity:	An investment in the Units should be treated as a long-term investment. There can be no assurance that a holder of Units will be able to sell, transfer or otherwise dispose of his or her Units to the Company or to other parties (See "Risk Factors").
Glossary:	A Glossary of certain terms used in this Private Placement Memorandum is contained at Section 1.2 of the Company's Amended and Restated Operating Agreement. Those definitions are fully reincorporated into this Private Placement Memorandum.

INVESTOR SUITABILITY STANDARDS

THE PURCHASE OF UNITS BY CALIFORNIA INVESTORS INVOLVES CERTAIN RISKS AND IS NOT A SUITABLE INVESTMENT FOR ALL POTENTIAL INVESTORS. SEE "RISK FACTORS." THE UNITS WILL BE SOLD ONLY TO PERSONS WHO MEET THE FOLLOWING SUITABILITY STANDARDS:

Minimum Income and Net Worth for California Accredited Investors ("Class 1 Units")

With respect to California investors, the standard for "accreditation" (defined by the California Corporations Code and Commissioner's Regulations thereunder as incorporating the federal accreditation standards of Regulation D promulgated under the Securities Act of 1933) are as follows:

An Accredited Investor must satisfy the relevant definitions under Rule 501(a) of the Act and the relevant definitions of "excluded purchasers" or "accredited investors" under California securities laws. Generally, for an investor to be treated as an Accredited Investor, the person must meet at least one of the following standards:

1. Any private business development Company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

2. Any organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

3. Any director, executive officer, or Manager of the issuer of the securities being offered or sold, or any director, executive, officer or Manager of that issuer;

4. Any natural person whose individual net worth (or joint net worth with that person's spouse) at the time of his purchase exceeds $1,000,000 exclusive of equity in personal residence;

5. Any natural person who had an individual income in excess of $200,000 in each of the two most recent years (or joint income with that person's spouse in excess of $300,000 in each of those years) and has a reasonable expectation of reaching the same income level in the current year;

6. Any trust, with total assets in excess of $5,000,000 not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as defined in Rule 506(b)(2)(ii) of Regulation D under the Securities Act of 1999;

7. Any entity in which all of the equity owners are accredited investors; and

With respect to any investor which is an Employee Benefit Plan within the meaning of the Employee Retirement Security Act of 1974, such investor is considered accredited if any of the following apply:

8. The investor a Plan for which the investment decision is made by a plan fiduciary (as defined in Section 3(21) of such Act), which is either a bank, savings and loan association, insurance company or registered investment advisor;

9. The Employee Benefit Plan has total assets in excess of $5,000,000, or,

10. It is a self-directed plan in which investment decisions are made solely by persons who are accredited investors.

Minimum Income and Net Worth for California Non-Accredited Investors

Non-accredited investors purchasing a full Unit who are bona fide California residents must both demonstrate gross income of at least $150,000 per year *and* net worth in excess of $250,000 (exclusive of equity in home, home furnishings and automobiles), or **alternatively** (regardless of income) a net worth (exclusive of equity in home, home furnishings and automobiles) of at least $350,000, which is seven times the full paid-in Unit price of $50,000.

Please note: for purposes of both accredited and non-accredited definitions, net worth is calculated exclusive of home, home furnishings and automobiles.

Prospective investors will be required to complete the forms contained in the Subscription Package found herein in order to demonstrate either that they qualify as accredited investors or that they meet the foregoing standards for non-accredited investors. Prospective investors may also be required to provide the Company with additional information relating to investor suitability and qualification. The sale of Units to any prospective investors will be at the sole and absolute discretion of the Managers.

Investor Suitability Standards for Non-U.S. Citizens Investing Pursuant to Regulation S (Class 2 Units")

Non-U.S. citizens (individuals) who qualify for investment under SEC Regulation S, enacted under Section 5 of the Securities Act of 1933 must meet the same minimum financial suitability requirements as apply to California non-accredited investors, expressed in U.S. dollars at the exchange rate published in the Wall Street Journal and applicable on the date that the Subscription Agreement is executed.

Non-U.S. corporations, partnerships or LLC's who qualify for investment under Regulation S must either have $1,000,000 of total assets (regardless of liabilities) or all of their beneficial owners must satisfy one of the suitability Standards for California non-accredited investors.

Additional Conditions Applicable to Non-U.S. Citizens Investing Pursuant to Regulation S (Class 2 Units")

In order to comply with SEC Regulation S, the following restrictions apply to transfer of Units by Class 2 Unit holders (see Company's Operating Agreement, Sec. 6.1 B):

(a) The Units may not be offered or sold in whole or part to a "United States person" or for the account of benefit of a "United States person" (other than a distributor) for at least one year after the Offering Closing Date. As used herein, the term "United States person" means:

(i) any natural person resident in the United States;

(ii) any partnership or corporation organized or incorporated under the laws of the United States;

(iii) any estate of which any executor or administrator is a United States person;

(iv) any trust of which any trustee is a United States person;

(v) any agency or branch of a foreign entity located in the United States;

(vi) any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a United States person;

(vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organized, incorporated or (if an individual) resident in the United States;

(viii) any partnership or corporation if:

(aa) organized or incorporated under the laws of any foreign jurisdiction; and,

(bb) formed by a United States person principally for the purpose of investing in securities not registered under the Securities Act, unless it is organized or incorporated, and owned, by accredited investors (as defined in Rule 501 (a)), who are not natural persons, estates or trusts; **and,**

(b) The offer or sale of the Units in whole or part before the expiration of one year after the Offering Closing Date must meet all of the following conditions, as applicable:

(i) the purchaser must either certify that it is not a United States person and is not acquiring the securities for the account or benefit of any United States person, or that it is a United States person purchasing the securities in an exempt transaction;

(ii) the purchaser must agree: (A) that any resale will either be in accordance with Regulation S, after registration, or under a registration exemption; and (B) not to engage in hedging transactions for those securities, except in compliance with the Securities Act;

(iii) securities of a domestic issuer must contain a legend stating (A) that the transfer of the security is prohibited, unless the transaction (1) complies with Regulation S, (2) is after registration, or (3) is under a registration exemption; and (B) that hedging those securities is prohibited, unless done in compliance with the Securities Act; and,

(iv) the issuer must be required by contract or by a provision in its bylaws, articles of incorporation, or comparable document to refuse to register any transfer of the securities that is not made either in accordance with Regulation S, after registration, or under a registration exemption.

Ability to Accept Limitations on Transferability

Holders of Units may not be able to liquidate their investment in the event of an emergency or for any other reason because there is not now any public market for the Units and at this time there can be no assurance that one will develop.

Other Requirements

THE FOREGOING SUITABILITY STANDARDS REPRESENT MINIMUM REQUIREMENTS, AND NEITHER THE SATISFACTION OF SUCH STANDARDS BY A PROSPECTIVE INVESTOR NOR THE ACCEPTANCE BY THE COMPANY OF A PROSPECTIVE INVESTOR'S SUBSCRIPTION NECESSARILY MEANS THAT THE UNITS ARE A SUITABLE INVESTMENT FOR THE INVESTOR. THE FINAL DETERMINATION AS TO THE SUITABILITY OF AN INVESTMENT IN THE COMPANY CAN BE MADE ONLY BY A PROSPECTIVE INVESTOR AND HIS OR HER ADVISORS, IF ANY.

An investor will be required to represent in the Subscription Agreement, which is included within Exhibit “B”, that he or she satisfies the investor suitability standards above. The suitability for any particular investor of a purchase of Units will depend upon, among other things, such investor's investment objectives and ability to accept highly speculative risks, including the risk of total loss.

The Company has the right, in its sole judgment and discretion and at any time, to refuse any subscription for Units, in whole or in part, for any reason by written notice of such rejection accompanied by the return of any subscription funds deposited by such prospective investor, and without deduction.

None of the Units will be sold unless offers to purchase at least one Unit (including equivalent cash from any loan by the Managers), together with the properly completed Subscription Agreement therefore (in the form contained in this Private Placement Memorandum) are timely received. If less than 24 Units are sold and the proceeds in cash from Unit sales are not received by the Minimum Funding Date of June 30, 2011 (including any permissible extension thereof to and including September 30, 2011, the principal amount of all subscriptions to date, without interest, will be returned to investors as soon as practicable and the offering will terminate. The securities sold hereby, both Class 1 Units and Class 2 Units are Units of limited liability company interest, fully paid-up and entitled to all rights and privileges of participation, information, voting and dividends, and other privileges, without limitation, as other Units of the Company.

The purchase price of each Unit is $50,000. The minimum purchase by an investor is one Unit. The Company reserves the right, in its sole discretion, to reject any subscription in whole or in part. The Managers of the Company may, in their sole and absolute discretion, sell fractional Units to provide for an orderly close of the Offering.

The Managers may conclude this Offering at any time after attaining the Minimum Offering Amount. If the Managers renew the Offering at a later time, they may in their sole discretion offer Units carrying different rights, privileges and preferences than the Class 1 Units and Class 2 Units.

RISK FACTORS

PRIOR TO MAKING AN INVESTMENT DECISION, PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER, ALONG WITH ALL OF THE OTHER INFORMATION CONTAINED IN THIS PRIVATE PLACEMENT MEMORANDUM, THE FOLLOWING RISK FACTORS ATTENDANT TO THAT INVESTMENT, AND SHOULD CONSULT WITH THEIR OWN LEGAL AND FINANCIAL ADVISORS WITH RESPECT THERETO:

Risk Associated With Operating History

The Company was formed in 2011 to acquire an interest in an option to purchase real property in Alameda, California. While the Managers have extensive operating histories, the Company itself has no operating history.

Limited Capitalization; Further Borrowing

Although the Company has made a good faith effort to provide for reasonably anticipated problems and expenses in the development of its business plan, there remains a risk that occurrences neither foreseen nor foreseeable could seriously increase the Company's need for capital. This may for instance result from a longer development entitlement processing cycle than expected, additional and unexpected studies or reports required by the City of Alameda, unexpected opposition to proposed entitlements from special interest groups or a general or regional downturn in the economy. There is no assessment provision in the Company's Amended and Restated Operating Agreement to provide for those eventualities, and the burden of such events would require either additional borrowing by the Company or the raising of additional equity or debt capital, possibly on terms unfavorable to existing investors. While the Managers believe that adequate reserves and contingency strategies exist, and that this risk is unlikely in the present economy, the Company may not have revenues or borrowings available and therefore may not be able to complete implementation of its business plan. All real estate investment of this type is to one or another extent speculative and subject to market fluctuation.

Limited Income; Fixed Expenses

Operating expenses and payments of the Company must be met in all events. These include, but are not limited to, funding scheduled option payments to the Owner, costs associated with professional studies, reports and associated work related to the development entitlement process and certain other ordinary and typical costs of holding the Property required to be paid by the Property LLC under the terms of the Company's Amended and Restated Operating Agreement and Management Agreement. Control of expenses will rest with the Managers of the Company. There is no assurance that the option on the Property can be sold or leased as quickly as the Managers project. The Company expects to have a limited supply of working capital. If the working capital is depleted, the Company may be required to rely on borrowed funds or take other actions which could have an adverse affect on the Company's operations. Macroeconomic factors affecting the Company and the value and marketability of its real estate include the health of the national, state and regional economies and the cost and availability of future financing.

There can be no assurance that these factors will move positively for the company and its investors.

Risks of the Entitlement Process

The modification of existing entitlements, zoning or general plan designation inevitably involves multiple public hearings, negotiations with public officials and community groups, preparation of additional reports and studies or other significant administrative requirements. Additionally, the possibility of obstructive litigation initiated by project opponents, with or without perceived merit, cannot be ruled out. The Managers believe that the long experience and demonstrated skill of their personnel in navigating such requirements qualifies them well to handle this process. At the same time, however, such familiarity does not assure a positive outcome. Additionally, while the Managers and their retained consultants have invested considerable effort to date on due diligence tasks, particularly the review of the Owner's and city's files, there can be no assurance that the reports and studies contained in those files were fully accurate or currently applicable. Errors in reports and studies frequently cause time delays as corrections are required.

Risks Related to Financing and Leveraged Instruments

The loans encumbering the Property are presently cross-collateralized with the two other sites in the Owner's name. The lender and the Managers have agreed that, as a condition of the receipt of certain of the investors' funds by the lender (through the option payments), the cross-collateralization must be released. Before the Company and the Property LLC proposed the current business plan to the Owner, the secured financing on the Property was in default. The Company and the Property LLC have been able to obtain commitments from the lender to modify and extend the terms of the financing in a way that will enable the Property LLC to pursue its development entitlement objectives with the City of Alameda for what is currently believed to be a suitable period of time without the threat of foreclosure. However, if the entitlement process takes significantly longer than expected, there can be no assurance that additional loan modifications or forbearance from the lenders will be available. Until 2008, an abundance of choices existed for owners of investment real estate seeking to finance or refinance their assets, including property in the development "pipeline". The economic calamity of 2008 eliminated many financing sources and severely constricted most others. Despite the normal expectation that the lender would "work with" the Company while progress is being made on the project, the possible unavailability of needed lender accommodations could tie up Company capital for an uncertain period of time, perhaps depleting its reserves, and creating the possibility that the Company may have to raise additional funds, thus diluting the existing investors. Loan costs, points and related charges may also play a role in the financial calculus. In these events, foreclosure could potentially be a risk.

Environmental Risks

Prospective investors should understand that environmental issues in the renovation of property are frequently found and that such factors frequently limit and occasionally prevent altogether development which would otherwise be available and desirable. Federal and state laws in this category are zealously enforced by various agencies and numerous “watchdog” environmental groups are active.

The Managers have already performed extensive due diligence investigation on the Property, including review of substantial environmental investigation documents in the city’s files and in the Owner’s files and records, but conditions as undetected underground tanks and hazardous chemicals in the soil from remote owners may still occur, any of which may cost the Company substantial sums of money to remediate, or perhaps worse, significant delay before a project can proceed or Property be sold. A number of factors all fall within the definition of “environmental issues” which can be raised either by members of the general public or by specific “stakeholder” groups during the application and hearing process. The Property already has an approved tentative map, which significantly limits the possibility that new issues can be raised However, despite the Managers’ assessment that reasonably anticipated issues will be dealt with, there can be no absolute assurance that a new concern will not be brought forth, with the result that costs of ownership become unexpectedly expensive.

Risks Related to Owner and Property LLC

The “Property LLC”, Encinal Marina Village II, LLC, is an entity in which the “Owner”, Encinal Real Estate, Inc., retains a significant equity interest. Although the Company and its Managers will be responsible for most operating decisions, particularly those involving the entitlement process, Section 5.1 B of the Limited Liability Company Agreement of Encinal Marina Village II, LLC specifies 20 categories of “major decisions” requiring the Owner’s advance written consent. **Reference is made to the full text of this agreement, which is a supplement to the Private Placement Memorandum.** Prior written consent is required for, among other things, material revisions to the adopted business plan, material deviations from budget, transactions not in the ordinary course of business, entry into certain contracts, a financing or capital transaction involving all or part of the Property, entry into litigation or a settlement of a dispute involving the Property LLC or the real property, many modifications to the entitlements now governing the subject Property and the hiring of most professionals. There is a risk that a dispute could occur between or among the members and/or beneficial owners of the Property LLC. Such a dispute could deplete the Company’s reserves and make it considerably more difficult to raise additional capital from investors to either conclude the dispute or pursue completion of the business plan.

If such a dispute occurred, would in most instances be arbitrated under a provision of the above Limited Liability Company Agreement that provides for final and binding arbitration under the rules of the American Arbitration Association. However, conclusion of disputes through arbitration is not always faster or less expensive for the litigants, and the cost, risk and delay associated with dispute resolution may suggest a settlement of the matter at issue, with a less than optimal outcome for the Members.

Risks of Macro Real Estate Market and Local Market

This Private Placement Memorandum contains certain market information relating to the housing market in Northern California and in the East Bay. While there has been a general positive trend in the year preceding this Offering, continued price stabilization and appreciation for single family homes and land in the development "pipeline" cannot be assumed by any means. The core San Francisco Bay Area will more likely than not remain economically strong, but the financial and demand metrics that pull the Property into the entitlement and development stream may be interrupted or reversed by such events as national or international financial calamity (as 2008), runaway inflation or a significant earthquake. If any of these were to occur, the end market for the company's assets may be significantly diminished, with negative financial results for the Members.

Reliance on Key Personnel

The success of any venture is dependent upon the availability of skilled personnel, and the appropriate management philosophy and personalities for each phase of development. Construction management and property management are particularly important areas which will require appropriate staff. While the Company believes that it has adequate and proven resources to assure adequate supervision and performance of construction and property management tasks, there can be no assurance that all needs can be met this way. Lack of qualified personnel could damage the Company's ability to realize its goals under the business plan.

Skill of Management

The success of the Company depends on the skills and abilities of several key principals of the Managers, particularly Fred Bates, Scott Stringer and Tom deRegt in the development area and Katherine Fettke in the internal management and investor relations and communications area. If these individuals were to cease to be involved with the Company for any reason (including, but not limited to, death or termination of employment), the success of the Company would depend in part on the ability of the Company to engage new people of at least equivalent skill. There is no assurance that the Company will be able to replace any departed principal of Managers.

Concentration of Control

Following the completion of this offering, the Managers will remain in absolute control of the Company. The Managers, by and through their officers and members, exercises virtually total control over all aspects of the Company's business operations and procedures, save and except for a small number of voting decisions requiring the assent of owners of a two-thirds majority of Units. This means that purchasers of the Units will invest subject to the risks associated with not having control of the Company.

The Managers of the Company have complete discretion concerning all aspects of the Company, including almost complete control of business plan, selection of consultants and professional advisors and ongoing business operations. The Managers will continue to follow accepted business procedures and use their best efforts to implement this business plan. However, they retain discretion to modify this business plan within broad guidelines should business conditions or opportunities dictate.

Further, there is the possibility that unexpected negative events concerning either the Properties or the economy in general would alter investment conditions to the extent that dilution of existing investors is required in order to raise necessary capital. While the Managers have the right to loan additional capital to the Company, the Managers may not be in a position to do so. In such event, there can be no assurance that the current management team would remain in place or that the Company's business plan would not materially change as a result of a shift in control.

Repayment of Certain Distributions

Under the terms of the terms of the Beverly-Killea Limited Liability Company Act ("LLC Act"), California Corporations Code Section 17000 and following, and in particular Section 17355, a Member who receives the return of any part of his capital contribution even though the return was given in compliance with the terms of the Amended and Restated Operating Agreement and with California law, may be required at a later time to pay back all or any part of the capital so returned to the extent necessary to discharge the Company's liability to creditors who had extended credit to the Company prior to the return of capital contributions. A distribution to a Member is deemed to be a return of his contribution under the LLC Act to the extent that it reduces his share of the value of the Company's net assets below the amount of his returned contribution.

Contingent Liabilities of Key Persons

The principals of the Managers will, in addition to their responsibilities to the Company, have responsibilities to other investment programs and personal investments which may involve loan obligations to lenders, guarantees of loans and other contractual commitments. If the assets of the Company are insufficient to meet its obligations, creditors may look to the members of the Managers to provide either performance or credit support. If the resources of these persons were at any time inadequate to satisfy their creditors either in relation to this investment program or another, the integrity and security of the Company's position with its lender(s) may be significantly compromised. There can be no assurance that events arising from an unrelated covenant of Managers' personnel would not damage the Company's security or equity.

Competition with Other Ventures of the Managers and Their Members

The Managers and their principals own and/or sponsor other real estate investment properties and programs. These activities may compete for the time and resources of the Managers' personnel. Additionally, certain of the properties may compete with the Property for tenants. The Company will not have the legal right to compel the Managers' personnel to allocate their time in the Company's favor, nor to forego opportunities for the sale of the Company's interests.

Agreement Not at Arms' Length

As described under "Compensation of Managers and Affiliates", the Managers are allocated a defined, success-based share of the distributions of the Company as compensation.

The magnitude of this compensation has been determined without the benefit of arms'-length bargaining. However, in the opinion of the Managers, the fees and charges to be paid to the Managers and Affiliates under the circumstances presented are no less favorable than the charges which would be paid under the same or similar circumstances in the San Francisco Bay Area.

No Market for Units

There is presently no market for the Units and none is anticipated. There are substantial restrictions upon the sale of Units. The Company's exit strategy anticipates the eventual ability to sell its Properties, but it may take longer to liquidate them than anticipated. There can be no absolute assurance of the final liquidation date of the Company, nor a particular date upon which investments will be returned.

Units Eligible for Future Sale

The Units offered hereby are "restricted securities" as that term is used in the Securities Act of 1933, as amended (the "Act"). Such Units of stock are not eligible for sale to the public unless registered under the Act (and applicable state securities laws) or if sold in accordance with Rule 144 under the Act or pursuant to another exemption from registration. In general, under Rule 144, a person (or person whose securities holdings are required to be aggregated) who has beneficially owned such securities for at least one year, including a person who may be deemed an affiliate of the Company as the term "affiliate" is defined under Rule 144, is entitled to sell restricted securities. An "affiliate" may sell within any three-month period a number of Units that does not exceed the greater of one percent of the then outstanding Units of the same class of securities during the four calendar weeks preceding such sale. A person (or persons whose Units are aggregated) who is not deemed an "affiliate" of the Company (and has not been such for at least three months prior to the sale) and who has beneficially owned Units for at least one year is entitled to sell Units under Rule 144 without regard to the volume limitations described above.

Prior to this offering there has been no established market for the securities of the Company, and no prediction can be made as to the effect, if any, that market sales of Units or the availability of Units for sale will have on the market price prevailing from time to time. Nevertheless, sales of substantial amounts of Units of the Company in the marketplace or otherwise could adversely affect prevailing market prices of the Units, including the prices of the Units offered hereby.

Additional restrictions on resale of the Units are required for "Class 2" Units, which are those acquired by non-U.S. citizens domiciled abroad.

No Registration Under Securities Act of 1933; No Permit from California Department of Corporations

This offering has not been registered federally under the Securities Act of 1933, nor have the Managers obtained an offering permit from the California Department of Corporations. The Company is relying on certain exemptions from registration requirements contained in federal and California securities laws in making this offering. There is no assurance that the offering presently qualifies or will continue to qualify for the exemptions upon which the Company relies due to, among other things, the adequacy of disclosure and the manner of distribution or change in any securities law regulation governing this offering which is retroactive in its effect. If and to the extent that claims or suits for rescission are brought and successfully prosecuted for failure to register this offering or for acts or omissions constituting offenses under the federal securities laws or securities laws of any state, both the capital and assets of the Company could be adversely affected, jeopardizing the ability of the Company to operate successfully. Further, the capital of the Company could be adversely affected by its need to defend an action by enforcement authorities of the federal or state securities agencies, even if the Company is ultimately exonerated.

Arbitrary Offering Price

The offering price of $50,000 per Unit and the number of Units offered hereby have been determined arbitrarily by the Company. No independent opinion or other appraisal has been obtained in the determination of the value of the Company or offering price.

Federal Income Tax Risks

THE COMPANY HAS NOT OBTAINED A LEGAL OPINION CONCERNING THE TAX IMPLICATIONS OF AN INVESTMENT IN THE COMPANY. Investors are “accredited” as defined in federal and California law and are therefore presumed to have access to needed legal and tax advice**. Prospective purchasers of Units must consult their own tax advisors** as to their own tax situation prior to investment in the Company. The cost of such consultation could, depending on the amount thereof, materially increase the cost of investment in the Company and decrease any anticipated yield on the investment. A number of changes in the tax laws have been made and/or are under consideration, and such professional consultation is essential.

Risk of Audit

The Company's federal information returns may be audited by the IRS. Such audit may result in the challenge and disallowance of some of the deductions or increase in the taxable income described in such returns. No assurance or warranty of any kind can be made with respect to the deductibility or taxability of any such items in the event of either an audit or any litigation resulting from an audit.

Tax Classification of the Company

The Managers expect the Company to be taxed as a partnership for federal income tax purposes. If the Company were to be treated for tax purposes as a corporation, the tax benefits associated with an investment in the Company, if any, would not be available to the Members. The Company would, among other things, pay income tax on its earnings in the same manner and at the same rate as a corporation, and losses, if any, would not be passed through to, and deductible by, the Members. See "FEDERAL INCOME TAX DISCUSSION - Tax Consequences Regarding Company - Status as Partnership."

Certain Risks Related to “Dealer” Classification

Although the Company and Managers will take care to avoid “dealer” classification and the ordinary income treatment of taxable gain that it carries (See “Federal Income Tax Discussion for U.S. Citizens” — subsection titled “Sale or Other Disposition of Company Assets”), the tax risk must be mentioned. If the Company is found by the IRS to have acquired Property primarily for purposes of sale as opposed to acquisition for investment purposes or for use in a trade or business, it will be determined that the Company is a “dealer” in real estate for federal income tax purposes, and ordinary income treatment will apply. Ordinary income treatment for a Member’s reported share of taxable profits would depend upon the Member’s individual marginal tax bracket, presently from 10% to 35%. This rate would be higher than the 0% to 15% present federal tax rate for long term capital gains. The Managers intend to rely upon qualified tax advice in this regard.

USE OF PROCEEDS

ESTIMATED SOURCES AND USES OF PROCEEDS AS OF OFFERING TERMINATION DATE				
	24 Units Sold		**44 Units Sold**	
Sources	**Dollar Amount**	**Percentage of Proceeds**	**Dollar Amount**	**Percentage of Proceeds**
Offering Proceeds1	$1,200,000	50.00%	$2,200,000	100.00%
Later Offering or Company Borrowing	1,000,000	50.00		
Total Sources of Funds Phase I	**$2,200,000**	**100%**	**$2,200,000**	**100%**
Uses				
Offering-related expenses 2	$25,000	1.14%	$25,000	1.14%
Entitlement-related expenses 3	300,000	13.64%	300,000	13.64%
Option Payments 4	1,510,000	68.64%	1,510,000	68.64%
Operational Costs 5	100,000	4.53%	100,000	4.53%
Operating reserves through 2013 6	265,000	12.05%	265,000	12.05%
Total Uses of Funds Phase I	**$2,200,000**	**100%**	**$2,200,000**	**100%**

1 Difference between sale of 24 and 44 Units is shown for representative purposes as of close of Offering; Managers expect to defer sales of some Units until a later date when cash is actually needed; borrowing would be a contingency plan;

2 Attorney cost for preparation of Private Placement Memorandum and related documentation; includes related tax advice and support;

3 Fees to the City of Alameda, payments to civil, traffic, structural and soils engineers, architects, planners, environmental professionals and attorneys; payment for updates to environmental impact report; payments to City of Alameda; and similar charges;

4 Option payments are due $870,000 (June 15, 2011); $620,000 (June 15, 2012); and $10,000 (each of December 31, 2013 and 2014);

5 Insurance, marketing, broker commission and related;

6 Reserves include but are not limited to unforeseen holding costs, unbudgeted (additional) studies or tests and unforeseen legal or other professional expenses.

BUSINESS OF THE COMPANY

BDS Tidelands II, LLC

The Company is a limited liability company organized under California law. As organized, the Company provides the "pass-through" tax attribute characteristics of a partnership, while limiting the liability exposure of investors to the amounts invested in the same manner as a corporation. Effectively all management decisions and operational control of the Company are vested in the Managers (see section entitled "Management"). The Managers will be compensated through receipt of a "success-based" share of the sale proceeds of the company's assets at liquidation (see section entitled "Management Compensation").

The Managers of the Company are Frederick M. Bates, Tom deRegt and Scott Stringer. Its "Founding Members" are Bates Properties, Inc., a California corporation, deRegt Development, Inc., a California corporation and The Stringer Company, Inc., a California corporation.

Investment Strategy

The investment objective of the Company is to financially participate in a real estate purchase option held by Encinal Marina Village II, LLC, a California limited liability company (the "Property LLC"), of which the Company is the "administrative member." Property LLC has in turn entered into an option agreement to purchase real property consisting of approximately 7.1 developable acres located at 1551 Buena Vista Ave., Alameda, CA (the "Property") from its present owner, Encinal Real Estate, Inc., a California corporation ("Owner'). The Property LLC, by and through the Company's Managers, will improve and enhance existing development entitlements on the Property in order to optimize financial return. The forms of development to which the Property is now limited have been determined by the Managers to be unfeasible in the near term economic environment, unresponsive to the city's agenda and unpopular in the surrounding neighborhood. The strategy envisioned by the Company involves amendment of a previously-approved tentative map and related actions in order to reconfigure and redesign the eventual construction of small lot single family homes (many with marine views). This plan is expected to be both attractive to the community and attractive financially.

The Property

The Property, informally known as the Chipman Warehouse Site, is comprised of approximately 7.1 acres of developable property, and is adjacent to the alameda Yacht club and Marina on the North and Buena Vista Avenue on the South. The Del Monte Warehouse property, a landmarked historic brick structure, is located on the West side of the Property, and existing single family homes built by KB Homes are on the East side of the Property. The site is currently leased to a commercial user. The lease expires on December 31, 2013. The Property is part of the Northern Waterfront Planning Area, comprising approximately 110 acres, which has a completed General Plan Amendment and adopted Environmental Impact Report.

The Property's site location and characteristics provide superior opportunities for development of this type. The site's proximity to the Oakland/Alameda Estuary features the opportunity for a waterfront oriented community with access to surrounding harbor activities and access for the residents and surrounding neighbors to the waterfront. The Property will be designed to take advantage of these proximities. In planning for the site, increased opportunities for public access and enjoyment of the waterfront are extremely important. Higher density detached homes will allow the site to be optimally developed under near-term conditions, while maintaining compliance with the density provisions of Alameda's Measure A.

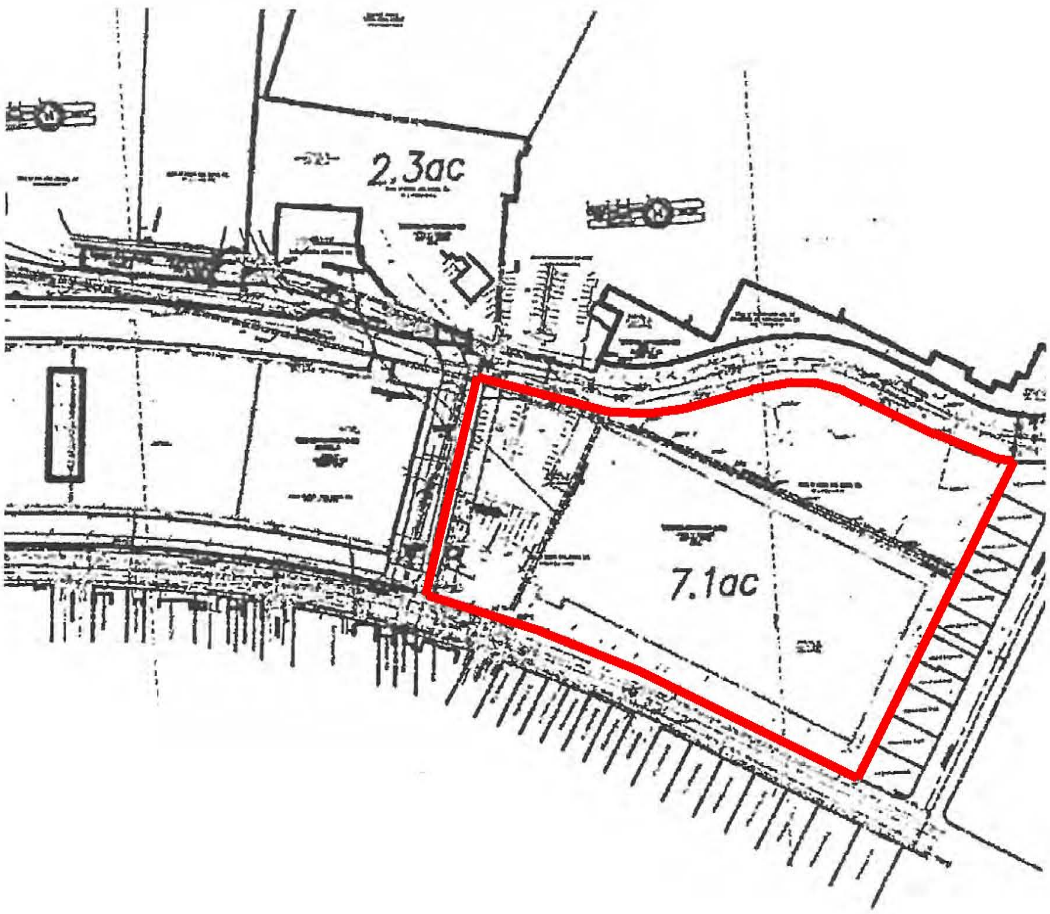
Additional Development Background

The Property is part of the Northern Waterfront Planning Area, which was authorized by the Alameda City Council for the creation of a plan to manage and direct redevelopment in the area. The Northern Waterfront Advisory Committee's recommended policies, as amended and adopted by the Alameda Planning Board and the Alameda City Council in 2002, establish the overall planning and regulatory framework that will guide redevelopment of the area. This new plan envisions the development of a variety of complementary uses to create a lively, pedestrian oriented environment containing a mixture of commercial, residential, office, waterfront, park, and open space uses. The Property is located within the already adopted Northern Waterfront Specific Plan, which also has completed an Environmental Impact Report for the Planning Area. These documents were supported and approved by the Northern Waterfront Advisory Committee, the City of Alameda Planning Board and the City of Alameda City Council. The City of Alameda is anxious to see a development plan for this property, and the subsequent redevelopment of the site. The City of Alameda Staff has expressed their desire to process the appropriate entitlement documents and plans in an expedient manner. The surrounding neighborhoods are also interested in the redevelopment of the site occurring in a timely manner to accommodate the removal of the existing heavy truck traffic caused by the tenants of the Property.

Entitlement Process

The entitlement process for the Property will not require the creation of a Master Plan due to the previous approval of a tentative map for the site. A revised Tentative Map and Development Plan will be submitted along with a Supplemental Environmental Impact Report which will focus on potential emission of greenhouse gases. The Development Plan will include elevations and floor plans of the proposed homes, as well as detailed information regarding parking and landscaping. These documents would be reviewed by City of Alameda Staff and then be forwarded to the Alameda Planning Commission and City Council for review and approval.

Property Diagram



General Explanation of Terms of Option and Joint Venture

The Company is the Administrative Member of the Property LLC. In turn, the Property LLC, as optionee, holds an option to acquire the Property obtained from the Owner of the Property. **Supplementing this Private Placement Memorandum as Exhibits "C", "D" and "E", respectively, are the Limited Liability Company Agreement of Encinal Marina Village II, LLC (the "Property Company"), the Option to Purchase and Joint Escrow Instructions for the Property, and the Management Agreement between the Company, as Manager, and the Property LLC. Managers strongly recommend that potential investors read these documents along with the Amended and Restated Operating Agreement of the Company. Managers will answer questions and provide clarification.**

The option price for the Property is $9,710,000.00. Generally, the option is structured and intended to provide sufficient option payments from the Property LLC to the Owner during the first two years to enable the owner to pay his debt service, taxes and other holding costs for the Property over and above the rents received from current commercial tenants. The Owner bears the risk of operating shortfall from the Property for this period of time. After two years, the Property LLC's option payments are minimized, but the Property LLC assumes responsibility for all carrying costs of the Property in excess of the rents received. The option payments are: $870,000 on June 15, 2011; $620,000 on June 15, 2012; $10,000 on each of December 31, 2014 and December 31, 2015. The option terminates on December 31, 2016. If the option to purchase the Property is exercised and the sale closed before expiration of the option period, all option payments are credited to the purchase price. The option period can be extended for one additional year upon payment of $500,000 which is not credited against the purchase price.

Within the Property LLC, the Owner and the Company each have agreed capital accounts corresponding generally to the sums they have invested in the Property. Upon the sale of the option to a third party or the sale of the Property itself, the Company first receives the return of its capital account, subject to any adjustments in the interim, plus a Preferred Return of 15% per annum, compounded. Next, the Owner receives the return of its capital account, subject to any adjustments in the interim, plus a Preferred Return of 15% per annum, compounded. The remaining profit is split 60% to the Company and 40% to the Owner (Property LLC Limited Liability Company Agreement, Section 4.1).

The Option to Purchase contains ordinary and typical protections to the Property LLC for property inspections, removal of non-customary title issues, provision for a non-disturbance agreement from the lender and certain representations and warranties from the Owner, including the absence of hazardous materials, lawsuits affecting title and violation of laws. A recorded Memorandum of Option will protect Property LLC's option rights as a matter of record. Subject to the above, the conveyance of the Property is to be on an "as-is" basis.

During the option period, the Property LLC is responsible for payment of all costs related to obtaining development entitlements, without exception, in addition to responsibility to make the periodic option payments.

Within the Property LLC, the Company has general day-to-day control and responsibility for activities of the Property LLC, but the Owner maintains power to approve a significant number of fundamental business decisions, notably material revisions of the business plan, material deviations from budget, transactions not in the ordinary course of business, expenses over a $50,000 threshold, additional financing or construction or entering into litigation (Property LLC Limited Liability Company Agreement, Section 5.1 C). The Company has the power to override the Owner in the event of disagreement in these matters (Property LLC Limited Liability Company Agreement, Section 5.1 D). However, the Owner has the power to remove the Company if it asserts that there has been (among other things) fraud, willful misconduct or material uncured breach of agreement by the Company, with a formula-based reduction in the cash distributions to the Company (Property LLC Limited Liability Company Agreement, Sections 7.2 A and B). In turn the Company can require arbitration of the issue of removal (Property LLC Limited Liability Company Agreement, Section 7.3).

The Owner has a 30-day "right of first offer" (Property LLC Limited Liability Company Agreement, Section 5.2 B) which can be exercised if the Company proposes that the option right held by the Property LLC, or alternatively the Property, should be sold. Under these terms, the Company must notify the Owner of "basic terms" under which the disposition would occur and the Owner would have 30 days within which to positively elect to acquire the assets on those terms. If Owner fails to so elect, the Company can then proceed to convey the assets on the terms described, or more favorable terms, within one year from the end of the election period. If the assets are not so conveyed, the Owner's right of first offer is renewed for subsequent proposals.

The distributions made to investors of this company are derivative from those received by the Property LLC and are more completely described in the section entitled Operation of the Company.

Investors should not rely upon the above general explanation for any specific point, but rather should refer to the full agreements provided as a Supplement to this Private Placement Memorandum. The above is provided only as a general guide.

The Company's Market

Reference note: Bracketed numbers [1] *through* [23] *inclusive appear in the sections below. These are references to sections of the Wikipedia articles and other online resources footnoted at the end of these topics and are provided to assist prospective investors with their own due diligence.*

Northern California(1)

The Company's focus will be entirely in the City of Alameda, which is in Alameda County and is centrally located in the San Francisco Bay Area. Particularly for non-U.S. investors, an overview of Northern California and the greater Bay Area is presented for background consideration. The region examined contains the San Francisco Bay Area, the cities of San Francisco, San Jose, Oakland, Sacramento (the state capital), and the Northern portion of the Central Valley, which although increasingly a residential area remains one of the world's most productive agricultural regions. Northern California continues to be a leader on the world's economic, scientific, and cultural stages. Northern California continues to pioneer new products and ways of doing business, most recently as the center of biotechnology and social networking. The longstanding intellectual incubator that is Northern California shows no signs of abating and entrepreneurs and skilled workers continue to be attracted to the area.

San Francisco Bay Area

General:(2) The **San Francisco Bay Area ("Bay Area")** is generally described as the metropolitan region that surrounds the San Francisco and San Pablo estuaries. It encompasses the metropolitan areas of San Francisco (12th largest in the country) and San Jose (31st largest in the country), as well as four other smaller, surrounding metropolitan areas. Overall, the Bay Area consists of nine counties, 101 cities, and 7,000 square miles.[3] The nine counties are Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, and Sonoma.[3][4]

The Bay Area when defined as a Combined Statistical Area, is the sixth largest in the country, with approximately 7.4 million people.[5] Within the Bay Area are numerous small and large municipalities, military bases, airports, and associated regional, state, and national parks, connected by a massive network of roads, highways, railroads, bridges, tunnels and commuter rail. The combined urban area of San Francisco and San Jose is the 50th largest urban area in the world.

San Francisco is the cultural and financial center of the Bay Area, and has the second highest population density of any major city in North America after New York City.[6] San Jose is the largest city in terms of population, land area, and industrial development, and is the center of Silicon Valley, a well-known high technology region. Oakland is a major manufacturing and distribution center, rail terminus/hub, and has the fourth largest container shipping port in the United States. Largely because of San Francisco and Silicon Valley, the Bay Area presently ranks second only to the much larger New York City region in number of Fortune 500 company headquarters (April 2010 Fortune Magazine).

Demographics:(2) According to the 2007 American Community Survey, the Bay Area's population was 6.958 million, up from 6.784 million in 2000. In 2000 the racial makeup of the 9 County Bay Area was 58.10% white, 19.01% Asian, 0.54% Pacific Islander, 7.53% black, 0.64% Native American, 9.24% from other races, and 4.93% from two or more races. 19.39% of the population was Hispanic or Latino of any race. 27.36% of the population was foreign born; of this, 51.31% from Asia, 32.46% came from Latin America, 11.39% from Europe, 4.84% from other parts of the world.

In 2007 the population density, believed to be not significantly different today, was 1,057 people per square mile. There were 2,499,702 housing units with an average family size of 3.3. Of the 2,499,702 households, approximately one-third were renter occupied housing units, while two-thirds were owner occupied housing units. 12.7% had a female householder with no husband present, 11.6% of households had someone 65 years of age or older, and 27.4% of households were non-families.[12]

Among the 114 Combined Statistical Areas in the United States, San Jose-San Francisco-Oakland has the second highest educational-attainment in both bachelor’s and master's degree attainment, and the second highest median household income after Washington-Baltimore-Northern Virginia.[13][14]

Affluence:[(2)] The San Francisco Bay Area is one of the wealthiest regions in the U.S. due to the economies of San Francisco and Silicon Valley. The Bay Area has approximately 123,621 millionaire households.[17] Among medium-sized cities, Pleasanton has the highest household income in the country, and Livermore the third highest. However, disposable income is very comparable with the rest of the country, primarily because the higher cost of living offsets the increased income.[18]

While only 26% of households nationwide boast incomes of over $75,000 a year, 48% of households in the San Francisco Bay Area enjoy such incomes.[19] The percentage of households with incomes exceeding the $100,000 mark in the Bay Area was double the nationwide percentage. Roughly one third (31%) of households in the San Francisco Bay Area had a six figure income, versus less than 16% at the nationwide level.[20] In June 2003, a study by Stanford University reviewing US Census Bureau statistics determined the median household income in the San Francisco Bay Area to be roughly 60% above national average.[19] Overall the largest income bracket in the Bay Area were households making between $100,000 and $150,000 annually, who constituted roughly 18% of households.[19] On a national level the largest income bracket were households with incomes between $30,000 and $40,000 who constituted 13% of all households nationwide.[20]

Six of the top ten California communities with the highest per capita income are in the San Francisco Bay Area (Belvedere, Atherton, Woodside, Portola Valley, Diablo). Of the 100 highest income counties by per capita income in the United States, six are in the San Francisco Bay Area (Marin, San Mateo, San Francisco, Santa Clara, Contra Costa, Alameda). According to *Forbes Magazine*, published in 2005, 12 of the top 50 most expensive Zip Codes are in the Bay Area (Atherton, Ross, Diablo, Belvedere-Tiburon, Nicasio, Portola Valley, Los Altos-Los Altos Hills, Los Gatos-Monte Sereno, the Cow Hollow-Marina District of San Francisco, Alamo, and Burlingame-Hillsborough).[21]

A study by Claritas indicates that in 2004, 5% of all households within the San Francisco and San Jose metropolitan areas held $1 million in investable assets.[23]

As of 2007, there were approximately 80 public companies with annual revenues of over $1 billion a year, and 5-10 more private companies. Nearly 2/3 of these are in the Silicon Valley section of the Bay Area. According to the May 2009 Fortune Magazine analysis of the US "Fortune 500" companies, the combined San Francisco-San Jose metropolitan region ranks second nationally (along with metro Chicago and Houston) with 29 companies (May 4, Fortune Magazine). Additionally, when the combined total revenue of the Fortune 500 list companies is considered, the San Francisco-San Jose region again ranks second nationally after New York with $884 billion (May 4, Fortune Magazine). As of 2010, the San Francisco-San Jose region ranks second only to New York City (and ahead of Chicago and Houston) as the number of Fortune 500 companies has increased to 31 companies (April 2010 Fortune Magazine). The Managers believe that this data has not significantly changed in the interim.

Alameda and Contra Costa County Data:[(3)] Footnoted below are links to extensive published data on demographics, market data and community conditions in both Contra Costa and Alameda Counties, assembled by a primary online aggregator of such information. **The**

Managers believe such data to be reasonably accurate but have not independently verified it. Such data may not be entirely current. Prospective investors should utilize their own information sources as well as those presented to evaluate the acceptability of these markets as compared to their own investment objectives. Embedded within the links below are specific databases related to each city within the county. **The Managers strongly recommend that prospective investors carefully study the data and trends of both counties and cities before making an investment decision.**

Housing & Mortgage Data:[(4)] Home sales in the San Francisco Bay Area bucked the trend of the state increasing 10.3 percent year-to-year in the first quarter of 2010, well above the growth rate of the state. All counties except Solano and Sonoma counties, where inventories of distressed properties remained constrained, registered sales increases when compared to the same quarter of last year. Contra Costa and Marin showed significant gains in sales activity year-over-year in excess of 50 percent growth, mainly due to the problems in jumbo financing a year ago that seriously hampered sales of the first-quarter 2009. The median price for the Bay Area grew at a strong rate of 28.9 percent to a median of $518,170 in the first quarter of 2010. Alameda, San Mateo, and Santa Clara all posted annual price gains in excess of 20 percent, while the other areas posted moderate gains ranging from 5.3 percent in Solano to 16.2 percent in Contra Costa.

Indicators of market distress continue to move in different directions. Foreclosure activity remains high by historical standards but below peak levels reached over the last two years. Financing with multiple mortgages is low, down payment sizes are stable, and non-owner occupied buying is above-average, MDA DataQuick reported.

	Sales Volume			**Median Price**		
County	**Apr-09**	**Apr-10**	**%Chng**	**Apr-09**	**Apr-10**	**%Chng**
Alameda	1,457	1,319	-9.50%	$289,197	$350,000	21.00%
Contra Costa	1,699	1,635	-3.80%	$225,000	$273,000	21.30%
Marin	174	245	40.80%	$585,000	$659,000	12.60%
Napa	99	104	5.10%	$315,000	$335,000	6.30%
Santa Clara	1,606	1,656	3.10%	$405,000	$489,000	20.70%
San Francisco	402	428	6.50%	$628,500	$692,500	10.20%
San Mateo	444	556	25.20%	$520,000	$580,000	11.50%
Solano	717	591	-17.60%	$180,000	$202,000	12.20%
Sonoma	541	469	-13.30%	$290,000	$318,000	9.70%
Bay Area	7,139	7,003	-1.90%	$304,000	$370,000	21.70%

Source: MDA DataQuick Information Systems, www.DQNews.com

Mortgages above the old conforming loan limit of $417,000 made up nearly 60 percent of all Bay Area home purchase loans before the credit crunch hit in August 2007. By April 2010, $417,000-plus loans made up 31.6 percent.

Use of adjustable-rate mortgages (ARMs) remains far below historically normal levels, too. ARMs made up just 11.1 percent of Bay Area purchase loans during April, 2010. While that is the highest since ARMs were 7.1 percent of purchase loans in September 2008, it is a fraction of the monthly ARM average of nearly 50 percent since 2000. Meanwhile, federallyinsured FHA loans have kept the entry-level market humming. The low-down-payment loans, which are popular with first-time buyers and some move-up buyers, made up 25.6 percent of Bay Area purchase loans during April, 2010. That was down from 25.8 percent a year ago but up from 14.4 percent two years ago. In April, 2010 absentee buyers – mostly investors – purchased 18.2 percent of all Bay Area homes sold, paying a median $249,500. That is up from 17.0 percent in March, 2010 and up from 17.3 percent a year ago. The monthly absentee buyer average over the past decade is 13.0 percent. Buyers who appeared to have paid all cash – meaning there was no corresponding purchase loan found in the public record – accounted for 25.5 percent of sales in April, 2010, paying a median $260,000.

References:

1. http://en.wikipedia.org/wiki/Northern_California (Wikipedia provided reference brackets [ ] have been retained to allow for easy reference look-up.)
2. http://en.wikipedia.org/wiki/San_Francisco_Bay_Area (Wikipedia provided reference brackets [ ] have been retained to allow for easy reference look-up.)
3. http://www.city-data.com/county/ContraCostaCounty-CA.html & http://www.city-data.com/county/AlamedaCounty-CA.html
4. http://www.car.org/marketdata/trendsarchives/markettrendsapril2010/
5. http://www.dqnews.com/Articles/2010/News/California/Bay-Area/RRBay100520.aspx

MANAGEMENT

Bates Properties, Inc. a California corporation**,**

Bates Properties, Inc. a California corporation ("BPI"), was formed in 1989. Its sole shareholder is Frederick M. Bates. Since its formation, BPI has developed over 30 projects encompassing a variety of project types, including master planned communities (some with golf course and lake features), urban infill and multi-family projects. Most of the projects have been in California, Colorado, Arizona, Nevada and Florida. Most of these projects have been done in joint venture with the two other Founding Member corporations below. BPI is a general partner of New Cities Development Group, which in turn acts as managing general partner in many of the ventures. BPI emphasizes value creation by taking into account the needs of the community, market positioning skills, identification of superior locations and highly experienced project management. Realizing that most of the value realization in a project lies in skillful entitlement and project design, BPI and its co-venturers have increasingly emphasized this segment of the investment curve, which also maximizes gain and mitigates risk for investors. BPI has California projects currently pending in San Jose (Almaden Valley), Marin County, Salida (Stanislaus County), Monterey County and Dublin (Alameda County). Projects are also in process outside California, notably in Portland, OR.

Stringer Company, Inc., a California corporation

The Stringer Company, Inc., a California corporation, was formed in 1988. Its sole shareholder is Scott L. Stringer. The company's experience is largely parallel to that of Bates Properties, Inc., with which it has joint-ventured numerous projects in different states.

deRegt Development, Inc.

deRegt Development, Inc., a California corporation, was formed in 1990. Its sole shareholder is Thomas S. deRegt. The company's experience is largely parallel to that of Bates Properties, Inc., with which it has joint-ventured numerous projects in different states. deRegt Development's additional experience has included infill industrial development.

The Managers' Executive Officers and Key Personnel

Frederick M. Bates

Fred Bates, 67, has over 35 years of experience in real estate development and construction, encompassing most product types and a number of markets. An engineering graduate of Michigan State University, Mr. Bates has been responsible for virtually all aspects of the development business, including acquisition, entitlement, design, construction and finance. He resides in the Monterey, CA area.

Scott L. Stringer

Scott Stringer, 59, has over 30 years of experience in real estate and development throughout Northern California. His experience includes most aspects of residential real estate development, with specific skills in site identification, acquisition, entitlement, concept development and governmental relations. A graduate of University of California-Berkeley, Mr. Stringer holds a Bachelors of Science degree in Business. Following college, he played professional football for a time with the St. Louis Cardinals. He is a resident of the Danville, CA area.

Thomas S. deRegt

Tom deRegt, 54, has 22 years of experience as a principal in the development industry. His background includes a Bachelor’s degree in Business Administration from California Polytechnic State University at San Luis Obispo, CA. He is an active alumnus and a strong supporter of its Orfalea College of Business, particularly its Financial Analysis Resource Center. His professional career after college and before formation of his own company included positions with Security Pacific National Bank, Crocker Mortgage Company, Security Pacific Mortgage Corporation and Koll Realty Advisors/Weyerhauser Mortgage Company. There, he was Regional Vice President, with responsibility for nine Bay Area Counties. He is a licensed real estate agent and holds leadership positions in a number of community and professional organizations.

Additional Disclosure

Within the past five years, one entity in which Bates Properties, Inc. and deRegt Development, Inc. were principals filed for protection under Chapter 11 of the Bankruptcy Act. The entity, Pasadera Country Club, a development in the Monterey, CA area, exited the Chapter 11 proceeding and then sold its assets to an offshore group.

MANAGEMENT COMPENSATION AND REIMBURSEMENT

Reimbursement of Certain Expenses

Certain expenses borne by the Founding Members and/or the Managers for the benefit of the Company during the period before attaining the Minimum Funding Amount are subject to reimbursement by the Company. These include legal, consulting, property investigation, inspections and similar costs necessarily involved in negotiating the Option Agreement between the Property LLC and the Owner; also, legal costs associated with preparation of this Private Placement Memorandum and costs of the securities escrow. To the extent that such costs, or the ordinary and necessary costs of Company operation (including the allocable cost share of office and bookkeeping/accounting personnel) are initially borne by the Founding Members and/or the Managers for the benefit of the Company, these will likewise be subject to reimbursement. See generally Section 4.5 of Operating Agreement.

Distributions to Founding Members and Investors

The Managers are not paid fees or distributions on account of the Company, or on account of the Property LLC, other than described below. The Company's Distributable Cash is derivative of its share of same from the Property LLC (see "General Explanation of Terms of Option and Joint Venture", above) and is first allocated to the Investor Members (Classes 1 and 2) until their Invested Capital is fully recouped. The next allocation is also to Investor Members, until realization of their Preferred Return (15% per annum, compounded). Thereafter, the remaining Distributable Cash is allocated 75% to the Founding Members (owned corporations of Managers), ten percent to the Syndicated Investor Member, and 15% to the Investor Members, Pro Rata.

OPERATION OF THE COMPANY

Rights of Members

In general, and subject to their voting rights set forth in Section 5.10, Members may not take part in the control or operation of the Company.

Operational Management

The Managers will control and operate the Company, subject to the voting rights of the Members. Any necessary management decision respecting the Company may be made by any two of the three Managers. The Managers may delegate and assign specific categories of tasks, including but not limited to financial management and entitlement processing, amongst themselves as they deem appropriate. The Members do not participate in such decisions.

Meetings of Members and Voting Rights

The Company will report regularly to its Members (investors) at appropriate intervals, expected to be not less than annually. The Company's annual meeting, which may be telephonic or otherwise "virtual", will take place each year at a time and place determined by the Managers, at which time the results of the prior year will be reviewed and the business plan for the current year will be described. Members (investors) have limited voting rights, restricted to the following categories of decisions: (a) by Super-Majority, a dissolution of the Company, (b) a sale of all or substantially all of the assets of the Company, except that such sale, if falling within the description in Section 5.2A(4) of the Operating Agreement, must be approved by a Super-Majority plus any two of the Managers; (c) a merger or other reorganization of the Company (other than a merger or reorganization the sole purpose of which is to change the jurisdiction of organization or the type of entity of the Company); (d) election of a new Manager within 90 days of the date upon which all three Managers no longer serve; (e) by Super-Majority, removal of any Manager for fraud, gross negligence or willful misconduct and, (f) those events enumerated in Section 5.2A of the Operating Agreement and not appearing above. Each of these votes, except as may require a Super-Majority, shall require the approval of a Majority of the Investor Members.

Reports to Members

The Members will receive unaudited annual reports and income tax Form K-1's within 90 days after the close of the Company's tax (calendar) year.

Distributions

The Company's Distributable Cash is derivative of its share of same from the Property LLC (see "General Explanation of Terms of Option and Joint Venture", above) and is first allocated to the Investor Members (Classes 1 and 2) until their Invested Capital is fully recouped. The next allocation is also to Investor Members, until realization of their Preferred Return (15% per annum, compounded). Thereafter, the remaining Distributable Cash is allocated 75% to the

Founding Members (owned corporations of Managers), ten percent to the Syndicated Investor Member, and 15% to the Investor Members, Pro Rata.

Distributable Cash, if any, will be distributed within 90 days of receipt unless in the Managers' sole business judgment good cause exists to maintain a reserve.

Rights of Members

In general, and subject to their voting rights under Section 5.10 of the Operating Agreement, Members may not take part in the control or operation of the Company.

Resale or Other Assignment of Units

Resale or assignment of Units by Members owning Class 1 Units is generally prohibited by Section 6.1 A of the Amended and Restated Operating Agreement except where the resale or assignment is approved in advance by the Managers, in their sole and absolute discretion. "Class 2" (non-U.S.) investors are subject to certain additional restrictions respecting sale of Units back into the U.S. for a certain time following the closing of the Offering pursuant to Section 6.1 B. Certain transfers of rights to receive Distributable Cash only are allowed, and reference is made to Section 6.1 of the Operating Agreement for a fuller explanation.

FEDERAL INCOME TAX DISCUSSION FOR U.S. CITIZENS

The following discussion applies only to U. S. citizens purchasing Class 1 Units directly from the Company. U. S. income tax consequences for purchasers of Class 2 Units (non-U.S. citizens domiciled abroad) are discussed later in this section. We do not undertake to discuss the tax consequences of an investment in this Company under the laws of any jurisdiction other than the U.S., and prospective purchasers of Class 2 Units must obtain such information in their own country of domicile. Prospective purchasers of Units should not view the following analysis as a substitute for careful tax planning, particularly since the income tax consequences of an investment in limited liability companies such as the Company are often uncertain and complex. Also, the tax consequences will not be the same for all taxpayers. The following discussion necessarily condenses or eliminates certain details that might affect some prospective purchasers of Units. **Also, the following discussion is not a legal opinion and may not be relied upon by any prospective investor.**

This discussion also assumes that the "Property LLC" in which the Company participates does not exercise its option to purchase the Property and own it directly, but rather holds and eventually sells its option position. If title to the Property were actually acquired by the Property LLC, the tax consequences of ownership could change in a number of respects. Since at this time it is reasonable to expect that this will not occur, those issues are not discussed.

No assurance can be given that the tax positions described in this section would be sustained by a court, if contested, or that legislative or administrative changes or court decisions will not be forthcoming that would significantly modify the statements and opinions expressed herein. Any such changes may or may not be retroactive with respect to transactions prior to the date of such changes.

The discussion of the tax aspects contained in this Private Placement Memorandum is based on law presently in effect. Nonetheless, investors should be aware that new legislative, administrative or judicial action could significantly change the tax aspects of the Company. Congress is currently analyzing and reviewing proposed changes to the Federal income tax laws. The extent and effect of any such changes, if any, is uncertain.

Counsel will not prepare or review the Company's income tax information return, which will be prepared by management and independent accountants for the Company. The Company will make a number of decisions on such tax matters. Such matters will be handled by the Company, often with the advice of independent accountants retained by the Company, and will not usually be reviewed with counsel.

As of the date of this Private Placement Memorandum, the legislative climate is volatile and there are a variety of proposals to amend the Internal Revenue Code. It is impractical to attempt to list them or to predict which may be enacted into law, and prospective investors are cautioned to consult their own tax advisors on specific questions concerning pending or proposed legislation. This pertains to, among other things, the tax rates attributable to ordinary and capital gain. For that reason, we do not discuss the topic. Because of this uncertainty, which affects certain of the tax aspects discussed herein, there can be no assurance that some of the deductions claimed or positions taken by the Company will not be challenged by the IRS. An audit of the Company's information return may result in an increase in the Company's gross income, in the disallowance of certain deductions and in an audit of the income tax returns of the Members, which could result in adjustments to non-Company items of income, deduction or credit. Final disallowance of such deductions could adversely affect the Members. In addition, state tax authorities may audit the Company's tax returns, which could result in unfavorable adjustments for Members. Investors should not purchase Units for the purpose of obtaining tax shelter for income from sources other than the Company because it is unlikely that an investment in the Company will provide significant tax shelter. Prospective purchasers of Units are urged to consult their own tax advisors as to the tax consequences to them of purchasing Units.

Terminology Note – Use of the Term "Partnership": From time to time, this Discussion references the company as a "partnership". This is because the Company, while an LLC, will be treated as a partnership for purposes of federal and state tax laws. The term "partnership" is used because it is consistent with the Code and for no other reason.

Tax Consequences Regarding the Company

Status as Partnership: Treasury Regulations have been issued which provide that a limited liability company will be classified as a partnership for federal income tax purposes as long as an election is not made to treat the limited liability company as an association taxable as a corporation. The Managers have represented that no election to be treated as a corporation has been or will be made. Therefore, the Managers believe that the Company will be treated as a partnership for federal income tax purposes. The Code, as amended to date, and current Treasury Regulations, could be amended in ways which could adversely affect the conclusion reached by the Managers. If the Company were treated as a partnership for federal income tax purposes, each Member would be required to include in income his distributive shares of income, gain, deductions and loss of the Company. Consequently, each Member would be subject to tax on his distributive share of Company income, whether or not the Company actually distributes cash in an amount equal to the income. If for any reason the Company were treated as a corporation for tax purposes, it is likely to be deemed to have contributed all of its assets subject to all of its liabilities to a newly formed corporation in exchange for the corporation's stock. The stock of the corporation is treated as being distributed to the Members in a complete liquidation of the Company. The income and deductions of the Company would be reflected only on its income tax return instead of being passed through to the Members, and the Members would be treated as corporate shareholders for tax purposes. In such event, the Company would be required to pay income tax at the corporate tax rates on its taxable income, thereby reducing the amount of cash available for distribution to Members. In addition, any distribution by the Company to the Members would be taxable to them as dividends, to the extent of current and accumulated earnings and profits, or treated as gain from the sale of their Company interests, to the extent such distributions exceeded both current and accumulated earnings and profits of the Company and the Member's tax basis for his Units.

Limitations on Losses from Passive Activities: A material percentage of the Losses generated from the Property will probably be "passive" in nature. Losses from passive trade or business activities generally may not be used to offset "portfolio income," i.e., interest, dividends and royalties, or salary or other active business income. Deductions from passive activities may generally be used to offset income from passive activities. Interest deductions attributable to passive activities are treated as passive activity deductions, and not as investment interest. Thus, such interest deductions are subject to limitation under the passive activity loss rule and not under the investment interest limitation. Credits from passive activities generally are limited to the tax attributable to the income from passive activities. Passive activities include: (1) trade or business activities in which the taxpayer does not materially participate which would include holding an interest as a Member; and (2) rental activities. Thus, a Member's share of the Company's Profits and Losses will constitute income and loss from passive activities and will be subject to such limitation.

Losses (or credits that exceed the regular tax allocable to passive activities) from passive activities that exceed passive activity income are disallowed and can be carried forward and treated as deductions and credits from passive activities in subsequent taxable years. Disallowed losses from an activity, except for certain dispositions to related parties, are allowed in full when the taxpayer disposes of his entire interest in the activity in a taxable transaction.

In certain instances involving material active participation of a taxpayer in real estate operations, there are exceptions to the above passive income rules that enable a taxpayer to benefit from the application of passive losses in excess of passive income. This is not expected to occur in the Company, as Members are limited in their participation rights under the Company's Operating Agreement.

It is quite possible that significant amounts of passive income will be generated by the Company under its business plan, and that a substantial portion of the passive losses will be carried forward to be realized as offsets to passive income in future years.

Allocations of Profits and Losses: Profits and Losses will be allocated as set forth in the Operating Agreement. Although such allocations are permitted under partnership law, the Code and Treasury Regulations require that such allocations satisfy certain requirements. Section 702 of the Code provides that, in determining income tax, a partner must take into income his or her "distributive share" of the Company's income, gain, loss, deduction or credit. The partners may specially allocate their distributive shares of such profits and losses, thus redistributing tax liability, by provision in the operating agreement. However, the IRS will disregard such an allocation, and will determine a partner's distributive share in accordance with the partner's interest in the Company, if the allocation lacks "substantial economic effect."

Treasury Regulations on the allocation of items of partnership income, gain, loss, deduction and credit under Section 704(b) of the Code are concerned with whether an allocation of partnership tax items has "substantial economic effect." Under the Treasury Regulations, an allocation has economic effect only if, throughout the term of the partnership, the partners' Capital Accounts are maintained in accordance with the Treasury Regulations, liquidation proceeds are to be distributed, generally speaking (but subject to payment of applicable fees) in accordance with the partners' Percentage Interests, and any partner with a deficit Capital Account following the distribution of liquidation proceeds is required to restore the amount of that deficit to the Company for payment to creditors or distribution to partners in accordance with their positive Capital Account balances. If the partners' obligation to restore deficit Capital Account balances is limited, the operating agreement must contain a "qualified income offset" provision, as described in the Treasury Regulations.

The Treasury Regulations also require that the economic effect of the allocation be "substantial." In general, the economic effect of an allocation is "substantial" if there is a reasonable possibility that the allocation will affect substantially the dollar amounts to be received by the partners from the partnership (in this case limited liability company), independent of tax consequences. The economic effect of an allocation is not substantial, however, if, at the time the allocation becomes part of the operating agreement, (1) the after-tax economic consequences of at least one partner may, in present value terms, be enhanced compared to such consequences if the allocation were not contained in the operating agreement, and (2) there is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to such consequences if the allocation were not contained in the operating agreement. In determining the after-tax economic benefit or detriment to a partner, tax consequences that result from the interaction of the allocation of such partner's tax attributes that are unrelated to the partnership (limited liability company) will be taken into account.

The Treasury Regulations Provide that allocations of loss or deduction attributable to non-recourse liabilities of a partnership ("non-recourse deductions") cannot have economic effect because, in the event there is an economic burden that corresponds to such an allocation, the creditor alone bears that burden. Thus, non-recourse deductions must be allocated in accordance with the partners' interest in the partnership. Allocations of non-recourse deductions are deemed to be made in accordance with the partners' interests in the partnership if, and only if, the following conditions are satisfied:

(i) Throughout the full term of the partnership (here, the "Company"), the partners' (here, the "Members'") Capital Accounts are maintained in accordance with the Treasury Regulations, and upon liquidation of the partnership, liquidating distributions are required to be made in accordance with the positive Capital Account balances of the partners;

(ii) Beginning in the first taxable year in which there are non-recourse deductions and thereafter throughout the full term of the partnership, the operating agreement provides for allocations of non-recourse deductions among the partners in a manner that is reasonably consistent with allocations, which have substantial economic effect, of some other significant partnership item attributable to the property securing non-recourse liabilities of the partnership;

(iii) Beginning in the first taxable year of the partnership in which the partnership has non-recourse deductions and thereafter throughout the full term of the partnership, the operating agreement contains a "minimum gain chargeback," as defined in the Treasury Regulations; and,

(iv) All other material allocations and Capital Account adjustments under the operating agreement are recognized in accordance with the Treasury Regulations.

The Operating Agreement (and Exhibit B, "Certain Tax and Accounting Matters") requires that, from a tax reporting standpoint, the Members' Capital Account balances be maintained in accordance with the Treasury Regulations, and that accounting and reporting for taxable profits and losses and allocations of cash liquidation proceeds are treated consistently in order that there will be no inconsistency between them, or amongst Members. The Operating Agreement contains a "minimum gain chargeback" provision and non-recourse deductions are to be allocated under the Operating Agreement in a manner that is reasonably consistent with allocations, i.e., in accordance with allocations of Profits. Members are required to restore a deficit Capital Account balance. The Operating Agreement also contains a "qualified income offset" provision. Therefore, the Managers believe that all requirements of the Code and Treasury Regulations are satisfied. Cash liquidation proceeds are first to be distributed to Members in accordance with their Adjusted Invested Capital, then to Members holding Class 1 and Class 2 Units in the amount of their cumulative Preferred Return, then the remainder 75% to the Founding Members, 10% to the Syndicated Investor Member, and 15% to Members holding Class 1 and Class 2 Units, the latter in proportion to their Investor Member Company Percentages.

Transfers of Units: For federal income tax purposes, items of income, gain, loss, deduction or credit of a Company may be allocated to a Member only if they are received, paid or incurred by the Company during that portion of the year in which the Member is treated as a Member of the Company for tax purposes.

If any Member's interest in a Company changes at any time during the Company's taxable year, each Member's share of each item of Company income, gain, loss, deduction and credit is to be determined by using any method prescribed by Treasury Regulations that takes into account the varying interests of the Members in the Company during the taxable year, as chosen in the sole and absolute discretion of the Managers.

The legislative history concerning this provision indicates that a monthly convention should be used, pursuant to which Members admitted to the Company on or after the 16th day of a month would begin to be allocated Profits and Losses as of the first day of the following month, and those admitted to the Company prior to the 16th day would be allocated Profits and Losses as of the first day of the month. This is a general rule, however, and there are certain exceptions where, for instance, the nature of events suggests that there is a tax avoidance motive for picking a certain entry date.

When Units are transferred (and subject to stringent conditions upon transfer in the Operating Agreement), the timing principle in the previous paragraph is also followed. A new or substituted Member or acquirer of a Member's Economic Interest will be required to realize and report Profits and Losses under the above principle whether or not there has been a corresponding distribution of cash by the Company to offset the effect of the allocation. Should transfers of Units, or issuance of new Units occur in the future, both the Managers and Members should be mindful of the above.

Calculation of Member's Adjusted Basis (See Operating Agreement for specific definitions of initially capitalized terms): Each Member's adjusted basis in his Units will be equal to such Member's initial Invested Capital increased by (i) the amount of allocable share of the Profits of the Company and (ii) his share of non-recourse indebtedness, if any, to which any Company Property is subject. A Member's share of Nonrecourse Liabilities is the sum of: (a) the Member's share of Company Minimum Gain; (b) the amount of any taxable gain allocated to the Member under Section 704(c); and (c) the Member's share of the excess Nonrecourse Liabilities.

A Member's basis in his Units is reduced, but not below zero, by (x) the amount of his allocable share of Company's Losses and expenditures which are neither properly deductible nor properly chargeable to Capital Account and (y) the amount of cash distributions received by the Member from the Company. For purposes of calculating a Member's adjusted basis in his Units, any reduction in the amount of Company non-recourse indebtedness (if any) will be treated as a cash distribution to such Member in accordance with his allocable share of such indebtedness and accordingly will reduce the basis in such Member's Units.

The Treasury Regulations employ an economic risk of loss analysis to determine whether a Company liability is a recourse or non-recourse liability and to determine the Members' shares of any liability of the Company. Under the Treasury Regulations, a Company liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability. A Member's share of any recourse liability of a Company equals the portion, if any, of the economic risk of loss for such liability that is borne by the Member.

A Member bears the economic risk of loss for a Company liability to the extent that the Member (or a related person) would bear the economic burden of discharging the obligation represented by that liability if the Company were unable to do so (reduced by any right of reimbursement). In the case of most limited liability companies, a Member generally will not bear the economic risk of loss for any Company liability because the Member has no obligation to contribute additional capital to the Company.

If no Member bears the economic risk of loss for a Company liability, the liability is a non-recourse liability of the Company. An exception to this rule applies in the case of a Member (or related person) who makes a non-recourse loan to the Company. In such a case, the lending or related partner is considered to bear the economic risk of loss for such liability. Another exception applies, as here, to the extent that an assessment provision in the Operating Agreement is applied and Members contribute pursuant to an assessment demand.

To the extent that a Member's allocable share of Company's Losses exceeds the adjusted basis of such Member's Units at the end of the Company year in which such event occurs, such excess Losses cannot be utilized in that year by the Member for any purpose, but is allowed as a deduction at the end of the first succeeding Company taxable year, and subsequent Company taxable years, to the extent that the adjusted basis of such Member's Units at the end of any such year exceeds zero (before reduction by such excess Losses from a prior year).

Treatment of Cash Distributions from the Company: Distributions to a Member may take the form of either actual distributions or so-called "deemed distributions" arising from a reduction of his share of partnership liabilities that are included in his basis. A deemed distribution is treated as a cash distribution and generally can result from either a reduction in a Member's profits interest or from repayment by the partnership of all or a part of the liabilities that are included in the Member's basis. For example, partnership income is generally allocated in accordance with cash distributions. Similarly, a deemed distribution would result from the reduction in Members' profit share that would follow from the admission of additional partners to the partnership or the transfer of ownership Units.

Distributions generally do not generate taxable income to a partner (here, “Member”). However, if the amount of cash actually distributed or deemed to be distributed to a Member exceeds his adjusted tax basis in his partnership interest, the distribution is treated as a sale or exchange of his partnership interest, and the Member recognizes gain to the extent of the excess distributions. The character of this gain as capital or ordinary is governed by the rules applicable to the sale of a Member's interest but normally would qualify for taxation at long-term capital gain rates so long as all Members receive pro rata distributions. A distribution generally will not generate tax losses for the recipient unless it is a liquidating distribution.

An actual or deemed distribution could generate taxable income to a Member if prior Company losses and actual and deemed distributions had reduced his basis in his Units to a point that it was less than the actual or deemed distribution in question. Deemed distributions thus could create income for Members even though no cash is actually distributed to them. Distributions generally create no deductions for the distributing partnership (e.g., the Company).

Profits in Excess of Cash Distributions: It is possible but unlikely that a Member’s share of the Company Profits may exceed cash distributed to him with respect to his Units and such Member’s tax liability on that share may even exceed such distributions.

Treatment of Liquidating Distributions: The Managers are cognizant of “deemed liquidation” rules contained within the Code and will endeavor to avoid unintentionally triggering dissolution of the Company for tax purposes. Generally, upon liquidation or termination of the Company, gain will be recognized by a Member only to the extent that cash is distributed (including his share of any reduction in Company non-recourse liabilities) in excess of such Member’s adjusted tax basis in his Units at the time of distribution.

Treatment of Gain or Loss on Disposition of Units: It is not expected that any public market will develop for the Units. Furthermore, Members may not be able to liquidate their Units promptly at reasonable prices since a Unit may be Transferred (Article VI, Operating Agreement) only with the consent of all Managers, and since the holders of Class 2 Units are subject to further restrictions upon transfer.

Any gain or loss realized by a Member upon the sale or exchange of Units will generally be treated as capital gain or loss, provided that such Member is not deemed to be a “dealer” in such securities (an unlikely instance under present facts). However, any portion of the gain that is attributable to unrealized receivables (which includes, for these purposes, depreciation recapture on real property owned by the Company) or inventory items of the Company that have substantially appreciated in value will generally be treated as ordinary income. If the Member’s holding period for the Units sold or exchanged is more than one year, the portion of any gain realized that is capital gain will be treated as long-term capital gain.

In determining the amount realized upon the sale or exchange of Units, a Member must include, among other things, his share of Company indebtedness. Therefore, it is possible that the gain realized on a Member's sale of Units may exceed the cash proceeds of the sale, and, in some cases, the income taxes payable with respect to the gain realized on the sale may exceed such cash proceeds.

Treatment of Gifts of Units: Generally, no gain or loss is recognized for federal income tax purposes as a result of a gift of property. However, in the event that a gift (including a charitable contribution) of a Unit is made at a time when a Member's share of the Company's non-recourse indebtedness exceeds the adjusted basis of his Units, such Member may recognize gain for income tax purposes upon the transfer. Such gain, if any, will generally be treated as capital gain except for the portion of any such gain attributable to any unrealized receivables (which includes, for these purposes, depreciation recapture attributable to real property sold by the Company) or inventory items of the Company that have substantially appreciated in value, which will generally be treated as ordinary income. Gifts of Units may also be subject to a gift tax imposed pursuant to the rules generally applicable to all gifts of property (please note that gifts of Units are also considered as Transfers pursuant to Article VI of the company's Operating Agreement, and if Class 2 Units are also subject to transfer restrictions imposed upon those Units).

Sale or Other Disposition of Company Assets: In general, if an asset constitutes a "capital asset" in the hands of the Company, any profit or loss realized by the Company on its sale or exchange (except to the extent that such profit represents depreciation recapture taxable as ordinary income) will be treated as capital gain or loss under the Code. Capital gain will be taxed to individuals at varying rates based on length of holding period. If however, it is determined that the Company is a "dealer" in real estate for federal income tax purposes or that the assets sold constitute "Section 1231 assets" (such assets are capital assets involuntarily converted and depreciable business property held for more than 12 months), the gain or loss will not be capital gain or loss.

The Managers are mindful of these distinctions in formulating the company's business plan. The fact that the Property LLC (from which the company derives its rights) holds an option to acquire to the subject real property and not fee title itself, and the fact that the Owner holds substantial veto power over a number of key operational decisions, are helpful factors. On the other hand, the contrary argument is that there should be a "look-through" of the option to the actual operations being controlled. These tests are used by the IRS to determine whether "dealer" treatment should be imposed:

Number, Frequency and Continuity of Sales: Leading cases have suggested that this is one of the most important considerations. Most cases which have held "dealer" status and therefore ordinary income treatment of gain have been cases where the number and regularity of sales suggested that the disposition of properties amounted to an ongoing business. In this case, consistent with the Company's business plan, there is expected to be a single sale, at the conclusion of the company's expected business cycle.

Substantiality of Sales: The substantiality of the dollar amount of sales compared to the other activity of the taxpayer may be considered as a factor. Here, the Managers expect there to be a single sale constituting 100% of the taxable gain from the disposition of the option.

Purpose for Acquisition and Reason for Which the Property is Held: While the original intent in acquiring the asset is considered, the intent at time of disposition is considered more determinative. The Company's initial intent is to acquire an interest in the Property LLC, which holds a purchase option, and to add value to that asset over a period of years, eventually selling it in a single transaction. The Company does not intend to sell individual lots or build houses, and will therefore take the logical position, if challenged, that the business plan evidences an eventual liquidation intent, i.e., the sale of a single option and not a change in business purpose.

Development Activities: Physical development activities such as installation of infrastructure improvements can attract "dealer" characterization, particularly if coupled with regular and substantial sales of properties. The Property LLC does not presently expect to do material physical improvements, specifically development-related improvements, to the option property.

Sales Activities: There is a high correlation between those cases holding for "dealer" characterization and the presence of orchestrated selling activities, i.e., extensive use of brokers and agents, or substantial personal use of time by the taxpayer or its principals.

Duration of Ownership: A long ownership term is not a guarantee of capital gains treatment, but a notably short ownership period is predictably likely to attract negative attention. "Long" and "short" in this context are highly situational terms. The Managers expect that the Property LLC will hold its option for several years, depending upon the speed of the entitlement process and conditions in the local real estate market generally. If the option were held for a substantially lesser time, there might be a greater degree of uncertainty about this test. However, it can be fairly said that the duration of the program is in line with the average term of ownership of much commercial real estate whose disposition is routinely treated as capital gain. There is a "safe harbor" five year holding period for avoiding "dealer" classification contained in Code Section 1237 (a), but this is not likely to apply here since the business plan calls for the sale of the option or other disposition of the Property within a shorter period.

The foregoing discussion cannot be considered an assurance of future capital gain treatment for the Company's realized gain. Among other things, there can be changes in the law or changes in the company's business plan that would alter the future application of the above tests.

In determining the amount realized upon the sale, exchange or other disposition of the Property, the Company must include, among other things, the amount of any liability to which the Property is subject. Furthermore, the Company may carry back purchase money obligations as part of the consideration for the sale of the Property. The Company may attempt to structure any such sale so as to qualify as an "installment sale" for federal income tax purposes, but there can be no assurance that any such sale could or would so qualify. Unless such sale qualifies as an "installment sale," the Company would generally be deemed to have received as proceeds of such sale the fair market value of such purchase money obligations. Thus, the Company's gain on the disposition of any such property may exceed the cash proceeds, if any, of such disposition, and in some cases the income taxes payable by the Members with respect to such gain may exceed the cash proceeds, if any.

Company Termination for Tax Accounting Purposes: The Company will terminate for tax purposes if, within a 12-month period, 50% or more of the Capital and Profits interests in the Company are sold or exchanged. Termination of the Company for tax purposes would not cause a Member to recognize gain unless such Member's share of the Company's cash (or cash deemed distributed as a result of relief of indebtedness) exceeded the adjusted basis of his Units. Nor would it cause a Member to recognize loss unless the Company's assets at the time of termination consisted solely of cash or certain unrealized receivables or substantially appreciated inventory and the Member's share thereof was exceeded by his adjusted basis. The Company's Operating Agreement contains significant protections enabling the Managers to protect the Company and Members from such unintended consequences.

Dissolution: Dissolution of the Company pursuant to state law prior to expiration of its term should not by itself create tax consequences for the Members unless the dissolution is followed by a liquidation of the Company. Such dissolution and liquidation might create adverse tax and economic consequences for the Company. For example, if, as a result of dissolution, the Company were required to liquidate the Property during a limited period of time, the Company might sustain substantial economic losses based on the original cost of the Property. Nevertheless, the Company might realize substantial taxable gain on such disposition as a result of the use of borrowing in connection with acquisition of the Property. See "Sale or Other Disposition of Company Property" under this heading.

Tax Elections: The Company may make certain elections for federal income tax reporting purposes that could result in various items of Company income, gain, loss, deduction and credit being treated differently for tax and Company purposes than for accounting purposes.

In the event that the Property LLC acquired title to the option property, the Code provides for optional adjustments to the basis of its real property (a portion of which would flow through to the Company and its Members) for purposes of measuring both depreciation and gain upon distributions of Company property (Section 734) and transfers of Units (Section 743) provided that a Company election has been made pursuant to Section 754. The general effect of such an election is that transferees of Units are treated, for purposes of computing depreciation and gain, as though they had acquired a direct interest in the Company assets, and the Company is treated for such purposes, upon certain distributions to partners, as though it had newly acquired an interest in the Company assets and therefore acquired a new cost basis for such assets. Any such election, once made, is irrevocable without the consent of the IRS.

Deductibility, Capitalization and/or Amortization of Interest and Start-Up Expenses

Section 195 of the Code provides taxpayers with an election to amortize start-up expenditures ratably over a period of at least 60 months commencing with the month in which the new business begins. A start-up expenditure eligible for such amortization must be paid or incurred in connection with investigating the creation or acquisition of an active trade or business or paid or incurred in connection with creating an active trade or business. Such amounts must also be of a type which, if paid or incurred in connection with the expansion to an existing trade or business in the same field, would be allowable as a current deduction in the year paid or incurred. In the case of a Company, the eligibility for the new election to amortize is made at the Company level.

Organization and Syndication Expenses

Expenses paid or incurred in connection with the organization and syndication of a partnership (limited liability company) must be capitalized. Expenses of organizing the Company may be amortized over a period of not less than 60 months. However, syndication expenses may not be deducted currently nor amortized. The determination as to whether expenses are organization or syndication expenses is a factual determination which will initially be made by the Company.

Depreciation and Cost Recovery

The Property LLC does not presently intend to take fee ownership of the option property. However, in the event that such occurs, the following will apply. Current federal income tax law permits the Property LLC, and derivatively the Company, as an owner of improved real property held for investment or used in a trade or business to take depreciation deductions based on its share of the entire cost of the depreciable improvements, even though such improvements are financed in part with borrowed funds. If however the purchase price of the Property and the nonrecourse liabilities to which the Property is subject are in excess of the fair market value of the Property, the Company will not be entitled to take depreciation deductions to the extent that the deductions are derived from such excess. Under the Modified Accelerated Cost Recovery System enacted by Congress in 1986, and since amended, property which is commercial in nature is eligible to be depreciated on a 39-year basis, typically using a straight line method. Certain components of the Property may be eligible for depreciation over shorter periods of time. The Property LLC would determine which method on balance best suits its needs and the Company and its Members and will make any required election accordingly.

Depreciation deductions can only be claimed for that portion of real property which is depreciable. Since land is not depreciable, an allocation must be made between the value of improvements on real estate and the underlying land. The allocation of purchase price between depreciable and non-depreciable items is a question of fact, and if the amount allocated by the Company to depreciable items is decreased and the amount allocated to non-depreciable items such as land is increased, Company losses for federal income tax purposes will be decreased.

Tax-Exempt Use Property

Units may be sold to both taxable and certain tax-exempt entities. In relation to tax-exempt entities, the following discussion applies. Section 168(h)(6) of the Code provides that in certain instances where an entity taxed as a partnership has as partners both tax-exempt entities and persons or entities not exempt from taxation, a portion of the property owned by the Company, to the extent depreciable, will be deemed tax-exempt use property and will be required to be depreciated over the greater of 40 years or 125% of any long-term lease. Under Section 168(h)(6) of the Code, unless the Company's allocation of Company tax items is determined to be a qualified allocation, *any* property owned by the Company will be deemed to be tax-exempt use property to the extent of the tax-exempt entities' proportionate share of the Company. One of the requirements to have a qualified allocation is that the allocations of Company items in the Company must have substantial economic effect under Section 704(b)(2) of the Code. Based upon the nature of the investment program, it is unlikely that this risk will arise. However, if a portion of the Property is required to be depreciated over 40 years, depreciation deductions to all Members will be decreased accordingly.

Investment by Qualified Plans and Individual Retirement Accounts

Qualified plans (i.e., any pension, profit sharing or stock bonus plan that is qualified under Section 401(a) of the Code), tax exempt entities, including individual retirement accounts, although generally exempt from federal income taxation under Section 501(a) of the Code, nevertheless are subject to tax to the extent that their unrelated business taxable income ("UBTI") exceeds $1,000 during any tax year. An allocation of income from property that is "debt financed property" will result in UBTI. Debt financed property is generally defined to mean any property as to which there is "acquisition indebtedness." If the Company had directly invested in the option property (that is, if the Property LLC held fee ownership), such ownership could possibly have generated UBTI.

However, the Company’s participation is structured as a participation in an option, not direct ownership. Apart from that fundamental difference from the operating assumptions of applicable law, there are two key factors distinguishing the structure of this transaction from those in which the “debt-financed property” application of UBTI applies, and these are found in direct application of the definition of “debt-financed property” in the Internal Revenue Code. *The Code sets two requirements for application: first, that the property must be held to produce income;* <u>and</u> *second, that the property must be one with respect to which there is an acquisition indebtedness*. In this instance, there is some authority suggesting that in a development context, the property (as here) may under its unique circumstances be viewed as not being held for the production of income. Additionally, while there is debt on the option property, the debt is not being assumed by the optionee, which is the Property LLC. The Property LLC is simply paying option payments to the Owner, at least for the first period of ownership. It is possible that the shift of financial obligations concerning the option property to the Property LLC after the initial period may alter this analysis, particularly since the Property LLC will pick up responsibility for debt service. However, the arrangement is still an option, not fee ownership, and both of the prongs of the test must be met in order for the income to be characterized as from “debt-financed property.”

While the explanation above may be encouraging, there can be no assurance that the IRS will see the situation through the same lens, and ERISA-governed investors must be cognizant of the risks. The following additional information should be considered.

Qualified plans (but not individual retirement accounts or other tax-exempt entities) may, under a special rule set forth in Section 514(c)(9)(E) of the Code, avoid the characterization of their distributive share of income from debt-financed property of an entity taxed as a partnership as UBTI unless any of the following factors apply: (1) the price for the acquisition or improvement of the real property is not a fixed amount determined as of the date of the acquisition or the completion of the improvements; (2) the amount of indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payments of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived from such real property; (3) the real property is at any time after its acquisition leased to the person selling such property or certain persons related to the seller; (4) the real property is acquired from, or is at any time after the acquisition leased to, certain related persons; (5) any person described in clause (3) or (4) provides financing in connection with the acquisition or improvements; or (6) none of the following is true: (a) all of the partners are "qualified organizations"; (b) each allocation to a partner which is a qualified organization is a "qualified allocation"; or (c) the "fractions rule" in Section 541(c)(9)(E) of the Code is met. A partnership or limited liability company treated as a partnership will still comply with the rules under Section 514(c)(9)(E) if financing is obtained from the seller of the property as long as the terms of the financing are on "commercially reasonable terms."

For certain other entities - charitable remainder trusts and charitable remainder unitrusts (as defined in Section 664 of the Code) - the receipt of any UBTI may have extremely adverse tax consequences. For example, if such a trust or unitrust received any UBTI during a taxable year, all of its taxable income from all sources will be taxable.

In considering an investment in the Company of a portion of the assets of a qualified plan, a fiduciary should consider the factors discussed in "Investments By Qualified Plans and Individual Retirement Accounts."

Unrelated Business Taxable Income

A contingent and remote risk may exist later in the investment program for ERISA-regulated investors (chiefly self-directed IRA's and Keough plans) that "unrelated business taxable income" might be realized by these investors due in part to the fact that the Property is debt-financed. The Company will participate in an option to purchase the Property. According to the terms of the option, nothing would occur during the first 24 months which would suggest this risk. After 24 months, the Company must fund the Property's "Excess Carrying Costs" (as defined in the Limited Liability Company Agreement of the Property LLC and the Option Agreement), which invites the possibility that the IRS may take the position that it can "look through" the option as if the Property LLC owned the Property itself. As the transaction documents provide, this should not typically occur because the Property LLC is never to receive income from the Property's operations unless it exercises the purchase option. If the Property LLC did exercise the option (although not currently in the business plan), it would then receive income and could potentially generate “unrelated business taxable income” at a material level, particularly as the result of secured financing of the Properties. Such unrelated business taxable income could have an adverse tax effect upon IRA’s, Keoghs, SEP plans and other tax-exempt entities. *Tax-exempt entities are strongly advised to consult with their own tax experts regarding potential issues affecting them before making an investment decision.*

Company Tax Returns: The federal income tax returns of the Company may be audited by the IRS and such an audit may result in adjustments to the’ various items reported by the Company. For example, various deductions claimed by the Company on its returns of income could be disallowed in whole or in part on audit, thereby resulting in an increase in the Profits or a reduction in the Losses of the Company. The disallowance of such deductions in whole or in part could increase a Member’s taxable income without the receipt of any additional cash distributions from the Company.

The IRS has shifted the focus of its audits from the partner level to the Company level. Members may be bound by actions taken by the Managers at the Company level during the course of an audit.

Payments to the Managers and Affiliates: The Managers and its Affiliates will receive various fees described elsewhere in this Memorandum. The tax treatment of the significant fees is set forth below.

The Managers will treat the expenses of the Offering as non-amortizable syndication cost, and these costs will be capitalized. These costs consist of Unit selling costs, legal and accounting fees related to syndication, engineering and other costs and expenses directly related to the Offering. Organization fees and professional costs related to organization will either be capitalized or amortized over a 60 month period as maybe most advisable.

Under the terms of the agreements with the Owner, the Company cannot have any responsibility for property management fees until at least the third year of the option. Even so, it is not certain that it would happen. If it did occur, property management fees (attributable to ordinary residential and commercial leases) should be deductible as an ordinary and necessary business expense to the extent that the fee represents an ordinary and necessary expense and do not exceed the reasonable value of the services for which they are paid. Because the determination of whether these fees qualify as ordinary and necessary business expenses is inherently factual, there is no assurance that this determination may not be challenged by the IRS or that this determination would be upheld if challenged by the IRS. However, in the event the management fees are not currently deductible, they should be a capital expenditure related to the Property.

The Managers’ distributive share at liquidation is expected to be reflected as capital gain on the Manager’s tax return and as a distribution of Profits of the Company not detrimentally affecting any Member.

The Company will reimburse the Managers for actual costs incurred in furnishing certain administrative services and facilities to the Company according to the Operating Agreement.

The allocation of such costs between deductible expenses and nondeductible expenses will depend upon a determination to be made when such costs are actually incurred in the future, and counsel has expressed no opinion on the deductibility of such costs.

General Considerations

At-Risk Rules: A Member that is an individual or closely held corporation will be unable to deduct his distributive share of Company Losses, if any, to the extent such Losses exceeds the amount such Member has "at risk." A Member's initial amount at risk will equal the sum of: (i) the amount of money invested by the Member in the Company; (ii) the basis of any property contributed by such Member to the Company; and (iii) the amount of borrowed funds used in Company activities to the extent that the Member is personally liable with respect to such indebtedness.

A Member can include in the amount at risk such Member's share of qualified non-recourse financing in the event the Company holds real property. A Member's amount at risk will be reduced by the amount of any cash distributed to such Member and the amount of Losses allocated to such Member, and will be increased by the amount of Profits allocated to such Member. Losses not allowed under the at-risk provisions may be carried forward to subsequent taxable years and used when the amount at risk increases.

Alternative Minimum Tax: Taxpayers may be subject to the alternative minimum tax in addition to the regular income tax. The alternative minimum tax applies to designated items of tax preference.

The laws on alternative minimum tax may change in Congress in the near future. For further information concerning tax preferences and the alternative minimum tax, prospective Members are strongly advised to consult their individual tax advisors.

Activities Not Engaged in for Profit: Under Section 183 of the Code, certain losses from activities not engaged in for profit are not allowed as deductions from other income. The determination of whether an activity is engaged in for profit is based on all the facts and circumstances, and no one factor is determinative, although the Treasury Regulations indicate that an expectation of profit from the disposition of property will qualify as a profit motive. Section 183 contains a presumption that an activity is engaged in for profit if income exceeds deductions in at least three out of five consecutive years. Although it is reasonable for a prospective Member to conclude that he can realize a profit from an investment in the Company as a result of cash flow and appreciation of the Company's property, there can be no assurance that the Company will be found to be engaged in an activity for profit due to the fact that the applicable test is based on the facts and circumstances existing from time to time.

The IRS is paying increased attention to the application of Section 183 to entities classified as partnerships. Moreover, the Tax Court has accepted the argument by the IRS that Section 183 applies to the activities of a Company (rather than the partner) and that the provisions of Section 183 are applied at the Company level. The Company intends to conduct all operations in a businesslike manner in order to generate a profit from operations and sale of the

Property. In the event Section 183 were applied with respect to the Units of a Member, a substantial portion of the tax benefits associated with this Offering would be eliminated.

Tax Shelter Registration and Investor Lists

The organizer of a "tax shelter" must register the tax shelter with the IRS. The Managers believe that, based on the intended operations of the Company, the Company will not satisfy the definitional requirements for a "tax shelter" and will not be registered with the IRS. Consequently, the Company and the Members may be subject to penalty in the event the IRS determines that the Company was required to register as a tax shelter.

State and Local Taxes

In addition to the federal income tax consequences described above, prospective investors should consider the state tax consequences of an investment in the Company. A Member's distributive share of the taxable income or loss of the Company generally will be required to be included in determining his reportable income for state and local tax purposes.

United States Income Tax Considerations for Foreign Investors

The federal income tax treatment applicable to a nonresident alien or foreign corporation investing in the Company is highly complex and will vary depending on the particular circumstances of such investor and the effect of any applicable income tax treaties. Each foreign investor should consult his own tax advisor as to the advisability of investing in the Company. This Memorandum does not address the United States income tax considerations for foreign investors. **THEREFORE, INVESTORS ARE URGED TO CONSULT THEIR OWN TAX COUNSEL REGARDING BOTH THE U.S. TAX CONSEQUENCES OF THIS INVESTMENT IN UNITS AND THE NON-U.S. TAX CONSEQUENCES OF THIS INVESTMENT IN UNITS.**

In general, non-U.S. investors (holders of "Class 2" Units) should consider the following matters when seeking professional guidance. First, any money and the fair value of any property received by a "non-resident alien" or foreign corporation in exchange for an interest in all or part of an interest in a partnership (including the Company) is treated, to the extent attributable to U.S. real property interests, as an amount received from the sale or exchange in the U.S. of that property. Since the company is not publicly traded, the rule applies without exception.

FIRPTA (Foreign Investment in Real Property Tax Act) is a United States tax provision that imposes income tax on foreign persons disposing of United States real property interests. Tax is imposed at regular tax rates for the type of taxpayer on the amount of gain considered recognized. Purchasers of real property interests (including Units in the Company) are required to withhold tax on payment for the property. Withholding may be reduced from the standard 10% to an amount that will cover the tax liability, upon application in advance of sale to the Internal Revenue Service. FIRPTA overrides most nonrecognition provisions as well as those remaining tax treaties that provide otherwise. The Code requires that all persons, whether foreign or domestic, must pay income tax on dispositions of interests in U.S. real estate (U.S.

real property interests). Domestic persons are subject to this tax as part of their regular income tax.

Foreign persons are taxed only on certain items of income, including effectively connected income and certain U.S. source income. FIRPTA treats gain on disposition of an interest in United States real property as effectively connected income subject to regular tax. In order to ensure tax collection from foreign taxpayers, FIRPTA requires buyers of U.S. real property interests to withhold 10% of the sales price. The seller may apply to the IRS to reduce this 10% to the amount of tax estimated to be due. The IRS routinely and quickly approves such seller applications.

FIRPTA applies in virtually all cases where a foreign owner of a U.S. real property interest disposes of such interest. Provisions of the law which would prevent recognition of gain generally do not apply unless the seller receives a U.S. real property interest in a qualifying nonrecognition exchange.

Foreign persons are generally exempt from U.S. tax on capital gains. Under FIRPTA, however, foreign persons are subject to tax on gains from disposition of U.S. real property interests (USRPIs), which includes interests (Units) in the Company. **Real property** is land, buildings, and land improvements. Generally, whether property is or is not real property is determined under U.S. tax law concepts, not state law. Holders of Class 2 Units (non-U.S. citizens domiciled abroad) should assume that a sale of the option held by the Property LLC in the subject real property will invoke FIRPTA treatment, that is, plan conservatively. However, the application of these rules may depend considerably on events between now and the disposition date or other liquidity event, and no assurance can be given that FIRPTA rules will or will not apply as a result.

Taxpayers generally must recognize gain upon disposition of property. Where the proceeds are received in more than one year, the gain is recognized proportionately over the years received.

Under general U.S. tax principles, applicable to FIRPTA, gain is the excess of the amount of money or fair market value of property received over the basis of the property exchanged. Where the amount received is subject to a contingency, the amount is not recognized until the contingency is resolved. FIRPTA gain is subject to tax as effectively connected income. Nonresident alien individuals are subject to tax on such income at normal ordinary income and capital gains tax rates, as they may apply. However, the deduction for personal exemptions, certain adjustments to gross income, and most itemized deductions are not allowed. Foreign corporations are subject to tax on such income at regular corporate income tax rates. Branch profits tax may apply, subject to the branch termination exception. The Alternative Minimum Tax may apply.

Buyers of U.S. real property interests are required to withhold 10% of the full sales price on ANY purchase of a USRPI, subject to only four exceptions. Withholding is not required in several specific instances not expected to apply here. Reference is made to the full text of FIRPTA, and to the guidance provided by the Internal Revenue Service at http://www.irs.gov/businesses/small/international/article/0,,id=105000,00.html for a fuller explanation.

To the extent withholding is required, the amount of withholding may be reduced below 10% of the full price only upon certification by the IRS that a reduced amount applies. Such certification is permitted only if the seller applies to the IRS for reduced withholding by filing Form 8288-B no later than the closing date of the sale. The certification will specify the proper amount of withholding, subject to the stated closing price. Penalties apply to a purchaser who fails to withhold, file Form 8288 with the IRS, or pay the required withholding within 20 days of the sale.

INVESTMENT BY QUALIFIED PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS

In considering an investment in the Company of a portion of the assets of a qualified plan, a fiduciary, taking into account the facts and circumstances of such qualified plan, should consider, among other things: (i) whether the investment is in accordance with the documents and instruments governing such qualified plan, (ii) the definition of plan assets under the Employee Retirement Income Security Act of 1974 ("ERISA"), (iii) whether the investment satisfies the diversification requirements of Section 404(a)(1)(C) of ERISA, (iv) whether, under Section 404(a)(1)(B) of ERISA, the investment is prudent, considering the nature of an investment in and the compensation structure of the Company and the fact that there is not expected to be a market created in which the fiduciary can sell or otherwise dispose of the Units, (v) that the Company has had no history of operations, (vi) whether the Company or any affiliate is a fiduciary or a party in interest to the qualified plan and (vii) that an investment in the Company may cause the qualified plan to recognize UBTI. See "Risk Factors - Unrelated Business Taxable Income." The prudence of a particular investment must be determined by the responsible fiduciary (usually the trustee, plan administrator, or investment manager) with respect to each qualified plan, taking into account all of the facts and circumstances of the investment.

ERISA provides that Units may not be purchased by a qualified plan if the Company or affiliate is a fiduciary or party in interest (as defined in Sections 3(21) and 3(14) of ERISA) to the plan unless such purchase is exempt from the prohibited transaction provisions of Section 406 of ERISA. Under ERISA, it is the responsibility of the fiduciary responsible for purchasing the Units not to engage in such transactions. Section 4975 of the Code has similar restrictions applicable to transactions between disqualified persons and qualified plans or individual retirement accounts, which could result in the imposition of excise taxes on the Company, unless and until such a prohibited transaction is corrected.

In the case of an individual retirement account ("IRA"), if the Company or Affiliate is a disqualified person with respect to the IRA, the purchase of a Investor Unit by the IRA could instead cause the entire value of the IRA to be taxable to the IRA sponsor.

The Department of Labor ("DOL") has promulgated final regulations ("DOL Regulations"), 29 C.F.R. Section 2510.3-101, that define what constitutes "Plan Assets" in a situation in which a qualified plan invests in a limited liability company, or other similar entity.

If assets of the Company are classified as Plan Assets, the significant penalties discussed below could be imposed under certain circumstances.

Under the DOL Regulations, if a qualified plan, invests in an equity interest of an entity that is neither a publicly offered security nor a security issued by an investment company registered under the Investment Company Act of 1940, its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless it is established that the entity is an "operating company" or equity participation in the entity by benefit plan investors is not "significant."

The Units will not qualify as publicly offered securities and will not be issued by an investment company registered under the Investment Company Act of 1940.

Nonetheless, if one of the exceptions described below is satisfied, the Company's assets may avoid being classified as Plan Assets. The Company's assets may be excluded from Plan Assets under the DOL Regulations if the Company is considered an "operating company." The term "operating company" includes both an entity that is a "real estate operating company" and a “venture capital operation company” as defined in the DOL Regulations. Under the DOL Regulations, an entity is a "real estate operating company" if:

(i) for any day during a 90-day annual valuation period at least 50% of its assets, valued at cost (other than short-term investments pending long-term commitment or distribution to investors), are invested in real estate which is managed or developed and with respect to which such entity has the right to substantially participate directly in the management or development activities; and

(ii) the entity, in the ordinary course of its business, is engaged directly in real estate management or development activities. Example (8) in the DOL Regulations indicates that an entity may still qualify as a "real estate operating company" when management of the entity's real estate may be done by independent contractors if the entity retains certain control over the independent contractor and frequently consults with and advises the independent contractor.

The Managers cannot assure investors that the Company would satisfy the definition of an operating company, particularly because of the numerous questions of fact regarding future activities. Further, it should be noted that it is possible the Company would not qualify as a real estate operating company in each year of their existence. That is, the fact that the Company satisfies the real estate operating company rules in one year has no bearing on its ability to satisfy such rules in later years.

If the Company is classified as a "real estate operating company," an investment by a qualified plan in the Company should be treated only as an investment in an equity interest in the Company and not as an investment in an undivided interest in each of the Company's assets.

A “venture capital operating company” must satisfy two requirements:

(i) at least 50% of the company's assets (valued at cost) must be invested in "venture capital investments" or "derivative investments" as defined in the DOL Regulations. For this purpose, a 'venture capital investment' is defined as an investment in an operating company such that the investing entity has or obtains management rights. A company is deemed to have management rights when it has direct contractual rights to substantially participate in or substantially influence the conduct of the management of the operating company. The DOL explains that management rights in this instance must run directly from the operating company to the venture capital operating company. A "derivative investment" is either a venture capital investment in which the investment management rights have ceased in connection with a public offering; or, an investment acquired in connection with certain forms of merger, reorganization or public offering to which the existing investment relates; and,

(ii) the entity must obtain and exercise "management rights", as that term is defined in the Regulations (see above), in connection with one or more of its operating company investments.

Although the application of venture capital operating company classification to the Company would require additional analysis and characterization of how the Company and its Managers applied and exercised their management authority under the terms of other agreements, first impression of these standards is that they may well be applicable to the Company.

If the Company does not qualify as one of the above an "operating companies" under DOL Regulations, a qualified plan's investment in the Company will be treated as an investment in an equity interest in the Company, and not as an investment in an undivided interest in each of the underlying assets, only if equity participation in the Company by benefit plan investors (i.e., qualified plans and individual retirement accounts) is not "significant." Under the DOL Regulations, equity participation in the Company by benefit plan investors would be "significant" on any date if, immediately after the most recent acquisition of any equity interest in the Company, 25% or more of the total value of the Units is held by benefit plan investors. In determining whether the 25% benefit plan investors ownership is exceeded, the ownership of any person with discretionary authority with respect to Company assets is disregarded.

The Operating Agreement does not contain a specific limitation on the percentage of Units acquired by benefit plan investors, but the "safe harbor" of 25% maximum will be a reliable guide unless the managers obtain additional specific comfort that one of the operating company exemptions is likely to apply. Therefore, assuming that less than 25% of the Units are in fact owned by benefit plans, the Company's assets should not be treated as Plan Assets. However, it is possible that future sales of Units will result in benefit plan investors owning 25% or more of the total value of the Units. In that event, the exemption from the DOL Regulations afforded to entities in which benefit plan participation is not "significant" would not be available.

In the event that the Company is deemed to hold Plan Assets, additional issues relating to the Plan Assets, and "prohibited transaction" concepts of ERISA and the Code arise. Anyone with discretionary authority with respect to the Company's assets could become a "fiduciary" of the qualified plans within the meaning of ERISA. As a fiduciary, such person would be required to meet the terms of the qualified plan regarding asset investment and would be subject to prudent investment and diversification standards. Any such fiduciary could be a defendant in an ERISA lawsuit brought by the DOL, a qualified plan participant or another fiduciary to require that the Company's assets and the investment and stewardship thereof meet these and other ERISA standards.

In addition, if the Company is deemed to hold Plan assets, investment in the Company might constitute an improper delegation of fiduciary responsibility to the Managers and expose the fiduciary of a qualified plan investor to co-fiduciary liability under ERISA for any breach by the Managers of their ERISA fiduciary duties.

Section 406 of ERISA and Section 4975(c) of the Code also prohibit qualified plans from engaging in certain transactions with specified parties involving Plan Assets. Code Section 4975(c) also prevents IRAs from engaging in such transactions.

One of the transactions prohibited is the furnishing of services between a plan and a "party in interest" or a "disqualified person." Included in the definition of "party in interest" under Section 3(14) of ERISA and the definition of "disqualified person" in Section 4975(e)(2) of the Code are "persons providing services to the plan." If the Managers or certain entities and individuals related to the Managers have previously provided services to a benefit plan investor, then the Managers could be characterized as a "party in interest" under ERISA and/or a "disqualified person" under the Code with respect to such benefit plan investor. If such a relationship exists, it could be argued that the Affiliate of the Managers is being compensated directly out of Plan Assets rather than Company assets for the provision of services, i.e., establishment of the Company and making it available as an investment to the qualified plan. If this were the case, absent a specific exemption applicable to the transaction, a prohibited transaction could be determined to have occurred between the qualified plan and the Company.

If the Company's assets are treated as Plan Assets, a prohibited transaction would also occur if a party with whom the Company enters into a transaction is a "party in interest" or "disqualified person" with respect to a qualified plan.

Another type of transaction prohibited by ERISA and the Code is one in which fiduciaries of a qualified plan or the person who establishes an individual retirement account engage in self-dealing or in co-investment with the plan or account. Accordingly, Affiliates of the Managers are not permitted to purchase Units with assets of any benefit plan investor if they (i) have investment discretion with respect to such assets or (ii) regularly give individualized investment advice which serves as the primary basis for the investment decisions made with respect to such assets. In addition, no fiduciary of a qualified plan or owner of an individual retirement account should purchase Units both individually and with assets of the benefit plan investor. The Managers will take particular care to assure that it does not become a plan fiduciary.

If the Company's assets are treated as Plan Assets and if it is determined by the DOL that the acquisition of a Unit or another transaction between the Company and *a* party in interest by a qualified plan constitutes a prohibited transaction, then any party in interest, which may include a fiduciary or sponsor of a qualified plan, that has engaged in any such prohibited transaction could be required to: (i) restore to the qualified plan any profit realized on the transaction; (ii) make good to the qualified plan any losses suffered by the qualified plan as a result of such investment; (iii) pay an excise tax equal to 15% of the amount involved (i.e., the amount invested in the Company), for each year during which the investment is in place; and (iv) eliminate the prohibited transaction by reversing the transaction and making good to the Company any losses resulting from the prohibited transaction. Moreover, if any fiduciary or party in interest is ordered to correct the transaction by either the IRS or the DOL and such transaction is not corrected within a 90-day period, the party in interest involved could also be liable for an additional excise tax in an amount equal to 100% of the amount involved (i.e., the amount invested in the Company), for each taxable year commencing with the year in which the 90-day period expires and ending with the year in which the prohibited transaction is corrected. Also, the DOL could assert additional civil penalties against a fiduciary or any other person who knowingly participates in any such breach.

With respect to an investing IRA, the tax-exempt status of the account could be lost if the investment constitutes a prohibited transaction under Section 408(e)(2) of the Code by reason of the Company engaging in the prohibited transaction with the IRA or the individual who established the IRA or his beneficiary. If the IRA were to lose its tax-exempt status, the entire value of the IRA would be considered to be distributed and taxable to the IRA sponsor. Finally, if the Company's assets were determined to be "Plan Assets," fiduciaries of such qualified plans and IRAs might under certain circumstances be subject to liability for actions taken by the Managers or their Affiliates. In addition, certain of the transactions described in the Private Placement Memorandum in which the Company may engage, including certain transactions with Affiliates, might constitute prohibited transactions under the Code and ERISA with respect to such qualified plans and IRAs, even if the acquisition of Units did not constitute a prohibited transaction. Moreover, fiduciaries with responsibilities to qualified plans and/or IRAs subject to ERISA's fiduciary duty rules might be deemed to have improperly delegated their fiduciary responsibilities to the Managers in violation of ERISA.