

**Item 1. Cover Page**

PART 2A OF FORM ADV UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION

FIRM BROCHURE

FOR

**COLONY CAPITAL, LLC**

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This brochure provides information about the qualifications and business practices of Colony Capital, LLC. If you have any questions about the contents of this brochure, please contact us at (310) 282-8820. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Additional information about Colony Capital, LLC also is available on the SEC's website at [www.advisorinfo.sec.gov](http://www.advisorinfo.sec.gov).

Colony Capital, LLC is registered as an investment adviser with the United States Securities and Exchange Commission ("SEC") pursuant to the Investment Advisers Act of 1940, as amended (the "Advisers Act"). Recipients of this Brochure should be aware that registration with the SEC does not in any way constitute an endorsement by the SEC of an investment adviser's skill or expertise.

Further, registration does not imply or guarantee that a registered adviser has achieved a certain level of skill, competency, sophistication, expertise or training in providing advisory services to its clients.

**Item 2. Material Changes**

Not applicable.

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#### Item 4. Advisory Business

- A. Colony Capital, LLC, a Delaware limited liability company, is a privately-held, independent global real estate and distressed debt investment firm which was founded by Thomas J. Barrack, Jr. in 1991. The advisory business of Colony Capital, LLC and its relying advisers (collectively, "Colony Capital") primarily consists of advising private investment funds, co-investment vehicles, and Colony Financial, Inc. ("CFI"), a real estate investment trust, whose investment strategies are focused on making direct investments in real estate and real estate-related assets, debt and distressed debt investments. Thomas J. Barrack Jr. is the principal owner and chief executive officer of Colony Capital.
- B. Colony Capital generally provides investment advice concerning (i) investments in operating companies that utilize or have a significant dependence upon real estate; (ii) investments in distressed situations; (iii) acquisitions of direct investments in real estate in a variety of sectors; and (iv) investments in select residential and commercial development opportunities. Colony Capital also provides investment advice regarding debt instruments related to real estate or issued by real estate or real estate-related entities, as well as in similar preferred equity instruments, and may also involve the acquisition of equity or an equity derivative, such as warrants, options, common stock, convertible debt, commercial mortgage-backed securities, residential mortgage-backed securities, real estate-related B-notes, mezzanine loans, bridge loans, debtor-in-possession loans, whole mortgage loans, bonds, a broad variety of primary or secondary purchases of debt instruments, and other real estate or corporate debt-related products.

Colony Capital also provides investment advice regarding (i) the origination or acquisition of mortgage loans or other real estate loans with the expectation of subsequently foreclosing on, or otherwise taking control of, the property securing the loan or investment; (ii) the acquisition of minority interests in commercial banks, the primary assets of which are commercial and residential loans; (iii) minority or blocking positions in fulcrum debt securities; and (iv) rescue capital loans to real estate operating companies, construction/rehabilitation loans, sale-leasebacks, and triple-net leases.

Colony Capital primarily provides investment advice with respect to investments located in North America, the Asia Pacific region, and Western Europe, as well as certain emerging markets including the Middle East, North Africa and Eastern Europe.

In addition, in connection with the consummation of certain investments on behalf of Clients (as defined below), Colony Capital may employ hedging techniques designed to protect the Client against adverse movements in currency or interest rates.

- C. Colony Capital tailors its advisory services to the individual needs of its clients, which are generally pooled investment vehicles that Colony Capital provides advisory management services to ("Colony Capital Funds," and together with CFI, "Clients"). It has full discretionary authority with respect to investment decisions made on behalf of each Client and it makes and manages each investment in accordance with the purposes, terms, restrictions and limitations set forth in the governing documents of each Client, consisting principally of the Client's limited partnership agreement or limited liability company operating agreement. Each Client that makes multiple investments is generally subject to certain diversification and geographic limitations, as well as restrictions on incurring indebtedness, making passive investments in pooled investment vehicles, and entering into certain affiliated transactions. Further, CFI is subject to certain investment restrictions for the purpose of preserving (i) its treatment as a real estate investment trust for federal income tax purposes and (ii) its exemption from registration under the Investment Company Act.
- D. Colony Capital does not participate in wrap fee programs.
- E. As of September 30, 2011, Colony Capital manages approximately \$8.3 billion in Client assets on a discretionary basis, and \$0 in client assets on a non-discretionary basis.

#### **Item 5. Fees and Compensation**

- A. For its investment advisory services, Colony Capital or its affiliates may be compensated by one or more of the following investment management fees:
  - (i) an investment management fee that is equal to a percentage of the Client's committed capital or Net Adjusted Commitments. "Net Adjusted Commitments" for a partner equals a partner's drawn capital commitments plus such partner's share of the equity portion of any investments for which capital commitments have not yet been drawn, less the portion of such drawn capital commitments utilized to acquire investments which have been disposed; and/or
  - (ii) performance-based fees (either as an incentive fee or carried interest) subject to the Client account achieving certain specified returns.

To the extent fees are based on capital gains or capital appreciation, Colony Capital complies with Rule 205-3 under the Advisers Act, which permits the payment of performance fees by clients that meet certain requirements. See Item 6 for a discussion of certain conflicts related to performance-based fees.

The types and amounts of, and the related limitations and restrictions on, fees charged by Colony Capital are not uniform among Clients and may be affected by the extent of services to be

provided or the size of the account. Therefore, Colony Capital does not maintain a fee schedule. The fees and expenses related to Clients offered pursuant to private securities offerings are fully specified in the offering materials of each Client. These materials are available from Colony Capital upon request. While fees related to Clients are generally not negotiable, such fees may include discounts based on the amount invested.

The timing of fee payments is set forth in the relevant Client offering documents. Asset-based fees generally are paid monthly or quarterly, and are calculated on the value of committed capital or Net Adjusted Commitments. The carried interest is distributed to Colony Capital and/or its affiliates after investments have been sold and proceeds are received.

Colony Capital may invest Clients' funds in liquid, short-term investments, such as bank and certificates of deposit or deposit such funds in a money market fund. Colony Capital estimates that the portion of its activities related to such non-real estate-related advisory services is not significant. However, a small portion of Colony Capital's compensation may be related to the management of cash and cash-equivalent investments held in connection with real estate advisory services and the amount of cash and cash-equivalent investments are generally included in the gross asset value of a Client's assets for the purpose of calculating investment management fees.

In many cases, Colony Capital's fees are based on the value and performance of the assets held in the Client account. Colony Capital may be charged with the responsibility to, or have a role in, determining such values. To the extent Colony Capital's fees are based on the value or performance of Client accounts, Colony Capital may benefit by receiving a fee based on the increased value of assets in an account. When valuing an asset, Colony Capital attempts, in good faith, to determine the fair value of the asset in question in a manner consistent with Colony Capital's then current valuation policies (unless otherwise specified by the Client). Colony Capital may also rely on valuations provided by third-party appraisals or on market quotations (when market quotations are available and deemed reliable) for the valuation of certain investments.

- B. The limited partnership agreements, limited liability company operating agreements or applicable operating agreements of the Clients generally provide that payment of management fees are paid solely from (i) capital contributions from investors in the Client, (ii) distributable proceeds from investments, or (iii) borrowings under credit facilities.
- C. Clients may be charged additional fees and expenses in connection with non-investment advisory services provided by Colony Capital. For example, Colony Capital or any of its affiliates may be engaged to provide real estate management services to a Client. The fee charged to the Client for such real estate management services is generally capped at a percentage of the capitalization per investment.

Any fees or other revenues of the Clients, including all acquisition, financing, break-up and other fees payable to the Clients, the general partners, or any affiliates of the general partners will be for the benefit of the Clients and may be applied by the general partners to pay or reserve for the payment of expenses of the Colony Capital Funds or to repay any credit facility drawdowns used to pay the same, with any balance distributed in accordance with the distribution waterfall or offset against management fees.

Clients bear all costs and expenses in maintaining their operations and investments, including legal and accounting expenses, fees for outside services, the cost of annual audits, custodial fees, insurance and litigation expenses, and taxes, fees, and other governmental charges.

D. Clients may not, nor are they required to, pay any fees in advance.

E. Neither Colony Capital nor any of its supervised persons accepts compensation for the sale of securities or other investment products.

#### **Item 6. Performance-Based Fees and Side-by-Side Management**

Each affiliate of Colony Capital that serves as general partner to a Client is generally entitled to receive from the relevant Client a carried interest distribution representing a percentage of the profits of such Client with respect to each portfolio investment. Fee arrangements with certain Clients include clawbacks on carried interest. Such clawbacks ensure that the general partner will not earn any more than its share of the carried interest over the entire life of the Client. Colony Capital and/or an affiliate is also entitled to receive a management fee in consideration of advisory services provided to the Clients.

The existence of the carried interest with respect to Clients may create an incentive for Colony Capital to make more speculative investments on behalf of the Clients than it might otherwise make in the absence of such performance-based compensation. The carried interest may also incentivize Colony Capital to dedicate increased resources and allocate more profitable investment opportunities to Clients who are charged a carried interest, as Colony Capital and its affiliates have the opportunity to receive carried interest distributions based on the success of portfolio investments. Further, Colony Capital is also incentivized to allocate investment opportunities to Clients who either pay higher carried interest percentages to their general partners or to Clients whose current performance does not require them to reimburse limited partners for losses attributable to prior unprofitable investments before distributing carried interest to their general partners.

The carried interest creates a potential conflict of interest for Colony Capital and/or its affiliates in valuing investments. For example, because carried interest distributions are generally calculated in a "deal-by-deal" waterfall, Colony Capital will not receive a carried interest until the partners of the



applicable fund receive distributions equal to their share of writedowns not taken into account in prior distributions. This creates an incentive for Colony Capital and/or its affiliates to avoid writing down the value of assets that are not readily marketable or difficult to value, because Colony Capital and/or its affiliate, as applicable, will be in a position to receive a higher carried interest.

The terms of the carried interest could also give Colony Capital an incentive to make decisions regarding the timing and structure of realization transactions that may not be in the best interests of investors. For example, Colony Capital would be in a position to receive carried interest distributions earlier if profitable investments are liquidated prior to investments that are not profitable because, at the time proceeds from such profitable investments are liquidated, Colony Capital would not be required to first distribute capital to limited partners to make up for prior losses associated with unprofitable investments. The above conflicts are mitigated by the fact that Clients generally require the general partner of such funds to deposit 50% of its after-tax distributions into a reserve account ("Reserve Account") that will be subject to reallocation and distribution to the partners to ensure that distributions to partners over the term of the Client are consistent with the distribution waterfall. However, the return of such distributions to the limited partners may be delayed until the end of the fund's term. Colony Capital has also agreed to limitations in the operating documents of certain Colony Capital Funds relating to the allocation of Client funds to investments (including restrictions on forming and directing capital to new co-investment or successor Colony Capital Funds), in each case, to seek to mitigate certain of the incentives described above.

With certain limited exceptions, valuations of current income and disposition proceeds with respect to investments will be determined by the general partner of the Client (which is generally a special purpose vehicle created and controlled by Colony Capital) and will be final and conclusive to all partners. If distributions are made in assets other than cash, the amount of any such distribution will be accounted for at the fair value of such assets, with certain limited exceptions, as determined by the general partner in accordance with procedures set forth in the Client's limited partnership agreement.

Certain of the Clients' investments will be investments for which there is no, or a limited, liquid market. The fair value of such investments may not be readily determinable. Because such valuations, and particularly valuations with respect to loans and securities of private companies, are inherently uncertain, may fluctuate over short periods of time, and may be based on estimates, the general partner's determinations of fair value may differ materially from the actual values obtainable in an arm's length sale of such investments to a third party. The Client's financial condition and results of operations could be adversely affected if Colony Capital's fair value determinations were materially higher than the values that the Client ultimately realizes upon the disposition of such investments. For example, Colony Capital may elect to use greater amounts of leverage on behalf of Clients if its fair value determinations are more favorable than the value the Client ultimately receives on disposition of investments, which could increase the potential risk of loss of invested capital.

## **Item 7. Types of Clients**

Colony Capital generally provides investment advice to pooled investment vehicles, co-investment vehicles and real estate finance companies, generally in the form of limited partnerships or limited liability companies and therefore does not have requirements for opening or maintaining accounts. However, there are generally conditions for investing in, including the minimum investment for, Colony Capital Funds, which are stated in their respective offering documents, partnership agreements and constituent documents. The offering documents generally note that the general partner has the discretion to reduce or waive the minimum investment amounts.

Each U.S. investor participating in the Colony Capital Funds is required to meet certain suitability and net worth qualifications, such as (i) an "accredited investor" within the meaning of Rule 501(a) of Regulation D promulgated under Section 4(2) of the Securities Act of 1933, as amended, (ii) a "qualified purchaser" within the meaning of Section 2(a)(51) of the Investment Company Act, (iii) a "qualified client" pursuant to Rule 205-3 of the Advisers Act, and/or (iv) a "knowledgeable employee" within the meaning of Rule 3c-5 of the Investment Company Act.

CFI is listed on the New York Stock Exchange and does not have a minimum investment amount.

## **Item 8. Investment Strategies, Methods of Analysis and Risk of Loss**

### **A. Investment Strategies**

Colony Capital's investment strategy is based on three related tenets: (i) cautious contrarianism, (ii) exploitation of inefficiencies, and (iii) value-added executions.

In order to execute the Clients' investment strategies, Colony Capital continually analyzes relevant market, property and company fundamentals in various sectors and locations. Colony Capital and its affiliates have established global investment teams, which are comprised of local professionals in specific markets. By establishing a strong market presence in each region, Colony Capital is able to quickly identify markets and sectors with attractive fundamentals and generate original market perspectives in order to produce investment opportunities before they become broadly known to competitors. Through this expansive, in-place global infrastructure, Colony Capital continues to see attractive, "off-market" investment prospects not generally available to the broader market.

### **General Methods of Analysis**

Colony Capital's investment approach is driven by a disciplined investment strategy focused on identifying areas with below market risk relative to the potential for above market returns. Colony Capital systematically makes its investment decisions by first identifying an asset class or country, then targeting specific markets, identifying experienced local partners and/or developing a local management team if applicable, and finally identifying appropriate investments in the market.

While pursuing these three investment objectives, Colony Capital continues to emphasize the analysis of basic fundamentals. Colony Capital's investment process considers and evaluates the following fundamental criteria and attributes when assessing the appropriateness of any opportunity:

- *Attractive pricing.* Considerable discount to replacement cost; existence of distressed (or disinterested) seller or distressed assets.
- *Sources of distinctive competitive advantage.* Previous exposure to, or knowledge of, markets or asset types; other market inefficiencies and informational arbitrage.
- *Appropriate risk and return relationship.* Understanding of capital structures, uniqueness of markets, and attendant risks within those markets and investment types; ability to minimize risks and maximize returns across global markets.
- *High quality of underwriting.* Solid investment and market analytics; consideration of availability of information and transparency thereof; commitment to disciplined and consistent standards.
- *Attractive capital structure.* Appropriate use of prudent leverage levels and flexibility of structure to achieve opportunistic exits as and when available; creation of return enhancement at appropriate risk levels.
- *Exceptional quality of partner / management.* Previous experiences with management; unique industry expertise; aligned interests and commitment to integrity of relationship.
- *Significant degree of complexity.* Can provide edge against lower cost of capital competitors; extract hidden or obscured value; utilize significant structuring and underwriting expertise for intricate transactions.
- *Appropriate degree of control.* Ability to determine or influence the direction of management, strategy, financing, and exit of the asset.
- *Acceptable legal environment.* Suitable legal jurisdiction to ensure negotiated transaction documents provide adequate protection and will be upheld in accordance with their legal and commercial terms.
- *Income generation.* Properties with actual or potential cash flow characteristics allowing enhanced risk-adjusted returns.
- *Opportunity to add value.* Focus on assets with inherent characteristics that allow value enhancement through expansion, repositioning, or application of Colony Capital's property, finance, and asset management expertise as well as its entrepreneurial skills.
- *Clarity of exit.* Ability to appropriately define reasonable exit(s) at the time of acquisition, identify multiple options and avoid reliance on public markets as only exit alternative.
- *Follow-on investment opportunity.* Depth and breadth of opportunity pool in specific industry and/or region.

In addition to the fundamental criteria outlined above, Colony Capital may apply additional investment criteria specific to each of the following investment types: (i) operating companies that

utilize real estate; (ii) distressed situations (e.g. assets divested by corporations due to corporate distress and portfolios of real estate assets and loans disposed of by financial institutions); (iii) direct investments in real estate; and (iv) select commercial and residential developments. The specifics of these investment criteria, where applicable, are included in the offering documents for the fund.

#### Investment Strategies for Debt Investments

Colony Capital's investment process in making real estate-related debt and distressed investments initially involves:

- identifying investment opportunities;
- assessing the opportunities to ensure that they meet preliminary screening criteria, i.e., suitability of the potential investment in light of the Client's investment guidelines; and
- reviewing the opportunities to determine whether to incur costs associated with more in-depth diligence.

If the decision is made to proceed with full-scale diligence, the next phase of the investment process involves assessing the risk-reward profile of the investment through, among other things:

- intensive data collection by Colony Capital's in-house acquisition, asset management and loan-servicing personnel and third party providers, including, as appropriate, financial, physical, legal and environmental due diligence of the assets underlying the investment opportunities;
- data consolidation and quantitative analyses of the key drivers affecting value, such as cash flows and collateral performance, lease analysis, and credit and prepayment risk; and
- thorough review of the investment capital structure, borrower and tenant analysis, servicer and originator information, legal structure and deal documentation.

In assessing the suitability of a particular investment for a Client's portfolio, Colony Capital will evaluate the expected risk-adjusted return relative to the expected returns available from comparable investments. With respect to each investment opportunity, Colony Capital will also consider Colony Capital's in-house asset management team's ability to extract excess value from the investment through active post-acquisition asset management. Based on the foregoing criteria, among others, Colony Capital will make an investment decision and, if the decision is made to proceed with an investment, will utilize proprietary modeling systems to establish an appropriate price for such assets.

Colony Capital may also apply the following criteria in acquiring debt instruments:

- capitalizing on asset level underwriting experience and market analytics to identify investments with pricing dislocations and attractive risk-return profiles that can be purchased at meaningful discounts to our estimates of intrinsic value;
- creating capital appreciation opportunities by resolving sub-performing or non-performing loans through repositioning, restructuring and active management of those assets;
- seeking to acquire assets held for sale that are undervalued as a result of the scarcity of credit available for financing commercial real estate;
- retaining control, where possible, over the formulation and execution of the management strategies with respect to our assets, including the restructuring of non-performing or sub-performing loans, the negotiation of discounted pay-offs or other modification of the terms governing a loan, and the foreclosure and intense management of assets underlying non-performing loans in order to reposition them for profitable disposition; and
- structuring transactions with a prudent amount of leverage, if any, given the risk of the underlying asset's cash flows, and attempting to match the structure and duration of any financing with the underlying asset's cash flows, including through the use of hedges as appropriate.

## B. Risk of Loss

Investment in Colony Capital Funds requires a long-term commitment with no certainty of return. Investors may lose all or a portion of the value of their investment and, as such, should not invest unless they can readily bear the consequences of such loss.

The investment strategies implement by Colony Capital on behalf of Clients involve significant risk of loss. The specific risks associated with a Client's investment strategy are described in each Client's private placement memorandum, subscription agreement, or risk disclosure statement, as applicable. However, the following risks are generally applicable to Colony Capital's Clients:

- *Nature of Investment.* Clients may make investments in assets and businesses that are experiencing or are expected to experience severe financial difficulties that may never be overcome. There may be little or no near-term cash flow available to investors in such Clients. Because Clients may only make a limited number of investments and because many of the investments may involve a high degree of risk, poor performance by a few of the investments could severely affect the total returns of investors.
- *Difficulty of Locating Suitable Investments.* The activity of identifying, completing, and realizing on attractive investments has from time to time been highly competitive, and involves a high degree of uncertainty. Colony Capital's Clients will be competing for investment opportunities with many other investment vehicles, as well as individuals, financial institutions (such as mortgage banks, pension funds, and real estate investment trusts), and other institutional investors. Over the past several years, an increasing number of funds have been formed with investment objectives similar to those of Clients. Other funds with similar

investment objectives may be formed in the future by other unrelated parties. There can be no assurance that Colony Capital will be able to locate and complete investments for its Clients that satisfy their respective rate of return objectives or realize upon their values or that Clients will be able to invest fully their available capital.

- *General Real Estate Risks.* Clients will be subject to the risks incident to the ownership and operation of real estate, including risks associated with the general economic climate, local real estate conditions, geographic or market concentration, competition from other space, the ability of the Client or third-party borrowers to manage the real properties, government regulations, the availability of financing, and fluctuations in interest rates. All real estate and real estate-related investments are subject to the risk that a general downturn in the regional or local economy will depress real estate prices. A Client may be unsuccessful in structuring its investments to minimize any detrimental impact that a recession may have on its investments. With respect to investments in the form of real property owned by a Client, such Client will incur the burdens of ownership of real property, which include the paying of expenses and taxes, maintaining such property and any improvements thereon, and ultimately, disposing of such property.

Additional risks include (without limitation): (i) lack of demand for commercial or housing space in a locale, (ii) changes in general economic or local conditions, (iii) changes in supply of, or demand for, similar or competing properties in an area, (iv) uncertainty of cash flow to meet loan and other fixed obligations, (v) changes in interest rates, (vi) unavailability of mortgage financing which may render the sale or refinancing of a property difficult, and (vii) changes in tax, real estate, environmental and zoning laws.

With respect to investments in mortgage loans, the Clients will in large part be dependent on the ability of third parties to successfully operate the underlying properties. In addition, certain of the mortgage loans may be structured so that all or a substantial portion of the principal will not be paid until maturity, which increases the risk of default at that time. The possibility of partial or total loss of capital will exist and investors should not subscribe unless they can readily bear the consequences of such loss.

- *Risks Pertaining to Non-Performing and Sub-Performing Commercial Mortgage Loans.* A portion of the Clients' investments currently is, and in the future may be, in the form of whole loan mortgages, including subprime commercial mortgage loans and non-performing and sub-performing commercial mortgage loans, which are subject to increased risks of loss. Such loans may already be, or may become, nonperforming or sub-performing for a variety of reasons, including, without limitation, because the underlying property is too highly leveraged or the borrower falls upon financial distress, in either case, resulting in the borrower being unable to meet its debt service obligations to the Clients. Such non-performing or sub-performing loans may require a substantial amount of workout negotiations and/or restructuring, which may divert the attention of the general partner and/or Colony Capital from other activities and entail, among other things, a substantial reduction in the interest rate, capitalization of interest payments and a substantial write-down of the principal of the loan. However, even if such restructuring were successfully accomplished, a risk exists that the borrower will not be

able or willing to maintain the restructured payments or refinance the restructured mortgage upon maturity.

In addition, certain non-performing or sub-performing loans that the Clients acquire may have been originated by financial institutions that are or may become insolvent, suffer from serious financial stress or are no longer in existence. As a result, the standards by which such loans were originated, the recourse to the selling institution, and/or the standards by which such loans are being serviced or operated may be adversely affected. Further, loans on properties operating under the close supervision of a mortgage lender are, in certain circumstances, subject to certain additional potential liabilities that may exceed the value of the Clients' investment.

In the future, it is possible that the Clients may find it necessary or desirable to foreclose on some, if not many, of the loans they acquire, and the foreclosure process may be lengthy and expensive. Borrowers may resist mortgage foreclosure actions by asserting numerous claims, counterclaims and defenses against the Clients including, without limitation, numerous lender liability claims and defenses, even when such assertions may have no basis in fact, in an effort to prolong the foreclosure action and force the lender into a modification of the loan or a favorable buy-out of the borrower's position. In some states, foreclosure actions can sometimes take several years or more to litigate. At any time prior to or during the foreclosure proceedings, the borrower may file for bankruptcy, which would have the effect of staying the foreclosure actions and further delaying the foreclosure process. Foreclosure may create a negative public perception of the related mortgaged property, resulting in a diminution of its value. Even if the Clients are successful in foreclosing on a loan, the liquidation proceeds upon sale of the underlying real estate may not be sufficient to recover the Clients' cost basis in the loan, resulting in a loss to the Clients. Furthermore, any costs or delays involved in the effectuation of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss. Any such reductions could materially and adversely affect the value of the commercial loans in which the Clients invest.

Whether or not the general partner and/or Colony Capital has participated in the negotiation of the terms of any such mortgages, there can be no assurance as to the adequacy of the protection of the terms of the loan, including the validity or enforceability of the loan and the maintenance of the anticipated priority and perfection of the applicable security interests. Furthermore, claims may be asserted that might interfere with enforcement of the Clients' rights. In the event of a foreclosure, the Client may assume direct ownership of the underlying real estate. The liquidation proceeds upon sale of such real estate may not be sufficient to recover the Clients' cost basis in the loan, resulting in a loss to the Clients. Any costs or delays involved in the effectuation of a foreclosure of the loan or a liquidation of the underlying property will further reduce the proceeds and thus increase the loss.

Whole loan mortgages are also subject to "special hazard" risk (property damage caused by hazards, such as earthquakes or environmental hazards, not covered by standard property insurance policies), and to bankruptcy risk (reduction in a borrower's mortgage debt by a bankruptcy court). In addition, claims may be assessed against the Clients on account of their position as mortgage holder or property owner, including responsibility for tax payments, environmental hazards and other liabilities, which could have a material adverse effect on Clients.

- *Risks Pertaining to CMBS Investments.* The commercial mortgage loans that the Clients acquire or originate and the mortgage loans underlying their CMBS investments are subject to the ability of the property owner to generate net income from operating the property as well as the risks of delinquency and foreclosure. The ability of a commercial mortgage borrower to repay a loan secured by an income-producing property, such as a multifamily or commercial property, typically is dependent primarily upon the successful operation of such property rather than upon the existence of independent income or assets of the borrower. If the net operating income of the property is reduced, the borrower's ability to repay the loan may be impaired. Net operating income of an income-producing property can be affected by, among other things, tenant mix, success of tenant businesses, property management decisions, property location and condition, competition from comparable types of properties, changes in laws that increase operating expense or limit rents that may be charged, any need to address environmental contamination at the property, the occurrence of any uninsured casualty at the property, changes in national, regional or local economic conditions or specific industry segments, declines in regional or local real estate values, declines in regional or local rental or occupancy rates, increases in interest rates, real estate tax rates and other operating expenses, changes in governmental rules, regulations and fiscal policies, including environmental legislation, acts of God, terrorism, social unrest and civil disturbances.

In addition, to the extent that the Clients originate loans, their ability to be paid principal and interest on a timely basis or at all will be dependent on the borrowers under such loans generating sufficient revenue to support their payment obligations to the Clients. If the borrower under such loans does not have sufficient financial resources to satisfy its payment obligations to the Clients, the Clients could be required to take ownership of the assets securing the loan in lieu of full repayment of the principal amount and accrued interest on the loan.

Most commercial mortgage loans underlying CMBS are effectively nonrecourse obligations of the borrower, meaning that there is no recourse against the borrower's assets other than the underlying collateral. In the event of any default under a mortgage loan held directly by the Clients, the Clients will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral (or their ability to realize such value through foreclosure) and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on the Clients. In the event of the bankruptcy of a mortgage loan borrower, the mortgage loan to such borrower will be deemed to be secured only to the extent of the value of the



underlying collateral at the time of bankruptcy (as determined by the bankruptcy court), and the lien securing the mortgage loan will be subject to the avoidance powers of the bankruptcy trustee or debtor-in-possession to the extent the lien is unenforceable under state law. Foreclosure of a mortgage loan can be an expensive and lengthy process, which could have a substantial negative effect on the anticipated return on the foreclosed mortgage loan.

- *Investments in Debt Securities of Commercial Real Estate Operating or Finance Companies.* The Clients' investments in loans, corporate bank debt and debt securities of commercial real estate operating or finance companies will be subject to the specific risks relating to the particular company and to the general risks of investing in real estate-related loans and securities, which may result in significant losses.

Some of the Clients' investments do not conform to conventional loan standards applied by traditional lenders and either will not be rated or will be rated as non-investment grade by the rating agencies. The non-investment grade ratings for these assets typically result from the overall leverage of the loans, the lack of a strong operating history for the properties underlying the loans, the borrowers' credit history, the properties' underlying cash flow or other factors. As a result, these investments have a higher risk of default and loss than investment grade rated assets. The Clients' also may invest in corporate bank debt and debt securities of commercial real estate operating or finance companies. These investments will involve special risks relating to the particular company, including its financial condition, liquidity, results of operations, business and prospects. In particular, the debt securities are often non-collateralized and may be subordinated to its other obligations. There are no limits on the percentage of unrated or non-investment grade rated assets the Clients may hold in their investment portfolios.

These investments will also subject the Clients to the risks inherent with real estate-related investments referred to in this memorandum, including the risks described with respect to commercial properties and similar risks, including:

- risks of delinquency and foreclosure, and risks of loss in the event thereof;
- the dependence upon the successful operation of, and net income from, real property;
- risks generally incident to interests in real property; and
- risks specific to the type and use of a particular property.

These risks may adversely affect the value of the Clients' investments in commercial real estate operating and finance companies and the ability of the issuers thereof to make principal and interest payments in a timely manner, or at all, and could result in significant losses, which could have a material adverse effect on the Clients.

- *Participation Interests.* The Clients may purchase participation interests in debt instruments which do not entitle the holder thereof to direct rights against the obligor. Participations held by the Clients in a selling institution's portion of a debt instrument typically result in a

contractual relationship only with such selling institution, not with the obligor. The Clients have the right to receive payments of principal, interest and any fees to which they are entitled only from the institution selling the participation and only upon receipt by such selling institution of such payments from the obligor. In connection with purchasing participations, the Clients generally will have no right to enforce compliance by the obligor with the terms of the related loan agreement, nor any rights of set-off against the obligor and the Clients may not directly benefit from the collateral supporting the debt instrument in which they have purchased the participation. As a result, the Clients will assume the credit risk of both the obligor and the institution selling the participation. In the event of the insolvency of such selling institution, the Clients may be treated as a general creditor of such selling institution, and may not benefit from any set-off between such selling institution and the obligor. Recent, well-publicized weaknesses in certain financial institutions may be indicative of increased counter-party risk with respect to, among other things, participation interests. Additionally, the transparency of financial statements used by such financial institutions, in particular, with respect to the value of complex financial assets, has been called into question. When the Clients hold a participation in a debt instrument, they may not have the right to vote to waive enforcement of any restrictive covenant breached by an obligor or, if the Clients do not vote as requested by the selling institution, they may be subject to repurchase of the participation at par. Selling institutions voting in connection with a potential waiver of a restrictive covenant may have interests different from those of the Clients, and such selling institutions may not consider the interests of the Clients in connection with their votes.

- *Issuer Default Risk.* Certain Client's income is expected to be derived largely from repayments of principal and interest received in respect of debt instruments. A wide range of factors may adversely affect an obligor's ability to make repayments, including: adverse changes in the financial condition of such obligor or the industries or regions in which it operates; the obligor's exposure to counterparty risk; systemic risk in the financial system and settlement; changes in law or taxation; changes in governmental regulations or other policies; natural disasters; terrorism; social unrest, civil disturbances or general economic conditions. Default rates tend to accelerate during economic downturns.

Any defaults may have a negative impact on the value of the applicable Client's investments and may reduce the return that such Client receives from its investments in certain circumstances. While some amount of defaults is expected to occur in Clients' portfolios, defaults in or declines in the value of the Clients' investments in excess of these expected amounts may result in breaches of covenants under the respective Client's financing arrangements, triggering credit enhancement requirements or accelerated repayment provisions and, if not cured within the relevant grace periods, permitting the finance provider to enforce its security over all the assets of the affected Client.

Where a Client does not hold senior first lien secured debt, in the event of insolvency, liquidation, dissolution, reorganization or bankruptcy of an obligor, holders of debt instruments ranking senior to such Client's investment would be entitled to receive payment in full before the Client receives any distribution in respect of its investment. After repaying the senior creditors, such obligor may not have any remaining assets to repay its obligations to the

Client. In the case of debt ranking equally with the loans or debt securities in which a Client invests, such Client would have to share on an equal basis any distributions with other creditors holding such debt in the event of an insolvency, liquidation, dissolution, reorganization or bankruptcy of the relevant investee company. Each jurisdiction in which Clients invest has its own insolvency laws. As a result, investments in similarly situated companies in different jurisdictions may confer different rights in the event of insolvency.

- *Fraudulent Conveyance Considerations.* Various federal and state laws enacted for the protection of creditors may apply to a Client's investments by virtue of the role of such Client as a creditor with respect to such investments. If a court, in a lawsuit brought by an unpaid creditor or representative of creditors of an obligor under a portfolio investment, such as a trustee in bankruptcy or the obligor as debtor-in-possession, were to find that the obligor did not receive fair consideration or reasonably equivalent value for incurring indebtedness evidenced by an investment and the grant of any security interest or other lien securing such investment, and, after giving effect to the incurring of such indebtedness, the obligor (i) was insolvent, (ii) was engaged in a business for which the assets remaining in such obligor constituted unreasonably small capital, or (iii) intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature, such court could invalidate, in whole or in part, such indebtedness and such security interest or other lien as fraudulent conveyances, subordinate such indebtedness to existing or future creditors of the obligor or recover amounts previously paid by the obligor (including to the Client) in satisfaction of such indebtedness or proceeds of such security interest or other lien previously applied in satisfaction of such indebtedness. In addition, in the event of the insolvency of an issuer or other obligor of an Investment, payments made on the investment could be subject to avoidance as a "preference" if made within a certain period of time (which may be as long as one year) before insolvency depending on a number of factors, including the amount of equity of the obligor owned by the Client and its affiliates and any contractual arrangements between the obligor, on the one hand, and the Client and its affiliates, on the other hand. The measure of insolvency for purposes of the foregoing will vary depending on the law of the jurisdiction which is being applied. Generally, however, an obligor would be considered insolvent at a particular time if the sum of its debts was greater than all of its property at a fair valuation or if the present fair saleable value of its assets was then less than the amount that would be required to pay its probable liabilities on its existing debts as they became absolute and matured. There can be no assurance as to what standard a court would apply in order to determine whether an obligor was insolvent after giving effect to the incurrence of the loan or that, regardless of the method of evaluation, a court would not determine that the obligor was "insolvent" upon giving effect to such incurrence. In general, if payments on investments are avoidable, whether as fraudulent conveyances or preferences, such payments can be recaptured either from the initial recipient (such as the Client) or from subsequent transferees of such payments, including limited partners.
- *Accounting and Disclosure Standards; Limited Information.* Accounting, auditing, financial, and other reporting standards, practices and disclosure requirements in countries in which Clients may invest are not equivalent to those in the United States and certain Western European countries and may differ in fundamental ways. Accordingly, information available to Clients,

including both general economic and commercial information and information concerning specific enterprises or assets, may be less reliable and less detailed than information available in more economically sophisticated countries. In addition, in certain instances, Clients may not receive access to all available information to determine fully the origination, credit appraisal, and underwriting practices utilized with respect to their investments, or the manner in which their respective investments have been serviced and/or operated. As a result, Clients' due diligence activities may provide less information than due diligence reviews conducted in more developed countries. The lower standards of due diligence in certain countries will increase the risk related to the investments in these countries. While each Client and its general partner will endeavor to conduct appropriate due diligence in connection with each investment, no guarantee can be given that they will obtain the information or assurances that an investor in a more sophisticated economy would obtain before proceeding with an investment.

- *Assignments.* The Clients may also purchase assignments, which are arrangements whereby a creditor assigns an interest in a loan to the Clients. The purchaser of an assignment typically succeeds to all the rights and obligations of the assignor of the loan and becomes a lender under the loan agreement and other operative agreements relating to the Investment. Assignments are, however, arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assignor of the loan.
- *Synthetic Securities.* Client investments may consist of synthetic securities such as swaps (including total return swaps and credit default swaps), over-the-counter transactions, collateralized loan obligations, commercial mortgage-backed securities and residential mortgage-backed securities ("CLOs", "CMBSSs" and "RMBSs," as applicable) and other derivative instruments. Investments through the purchase of synthetic securities present risks in addition to those resulting from direct purchases of the underlying securities or assets. With respect to synthetic securities, the Client will usually have a contractual relationship only with the counterparty of such synthetic security, and not the underlying obligor. Recent, well-publicized weaknesses in certain financial institutions may be indicative of increased counterparty risk with respect to, among other things, transactions involving synthetic securities. Additionally, the transparency of the financial statements issued by such financial institutions, in particular, with respect to the value of complex financial assets, has been called into question. The Client generally will have no right directly to enforce compliance by the underlying obligor with the terms of the underlying obligation nor any rights of set-off against the underlying obligor, nor have any voting or other consensual rights of ownership with respect to the underlying obligation. The Client will not directly benefit from any collateral supporting the underlying obligation and will not have the benefit of the remedies that would normally be available to a holder of such underlying obligation. In addition, in the event of the insolvency of the counterparty, the Client will be treated as a general creditor of such counterparty, and will not have any claim of title with respect to the underlying obligation. Consequently, the Client will be subject to the credit risk of the counterparty as well as that of the underlying obligor. As a result, concentrations of synthetic securities entered into with any one counterparty will subject the Client to an additional degree of risk with respect to defaults by such counterparty as well as by the underlying obligor.

- *Acquisitions of Portfolios of Investments.* Clients may seek to purchase entire portfolios or substantial portions of portfolios from market participants in need of liquidity or suffering from adverse valuations. Clients may be required to bid on such portfolios in a very short time frame and may not be able to perform normal due diligence on the entire portfolio. Such a portfolio may contain instruments or complex arrangements of multiple instruments that are difficult to understand or evaluate. Such a portfolio may suffer further deterioration after purchase by the Clients before it is possible to ameliorate such risk. As a consequence, there is substantial risk that the Clients and/or Colony Capital will not be able to adequately evaluate particular risks or that market movements or other adverse developments will cause the Clients to incur substantial losses on such transactions.
- *Investments in Subordinated Debt.* Certain of the Clients' investments may consist of loans or securities, or interests in pools of securities, that are subordinated or may be subordinated in right of payment and ranked junior to other securities issued by, or loans made to obligors. If an obligor experiences financial difficulty, holders of its more senior securities will be entitled to payments in priority to the Clients. Some of the Clients' asset-backed investments may also have structural features that divert payments of interest and/or principal to more senior classes of loans or securities backed by the same assets when loss rates or delinquency exceeds certain levels. This may interrupt the income the Clients receive from their investments, which may lead to the Clients having less income to distribute to limited partners.

In addition, it is anticipated that many of the obligors will be highly leveraged and many of the Clients' investments may be in securities which are unrated or rated below investment grade. Such investments are subject to additional risks, including an increased risk of default during periods of economic downturn, the possibility that the obligor may not be able to meet its debt payments and limited secondary market support, among other risks.

- *Investments in Smaller Private Companies.* Investments made in private companies involve a number of particular risks, including: (i) these companies may have limited financial resources and limited access to additional financing, which may increase the risk of their defaulting on their obligations, leaving creditors such as Clients dependent on any guarantees or collateral that they may have obtained; (ii) these companies frequently have shorter operating histories, narrower product lines and smaller market share than larger businesses, which render them more vulnerable to competitors' actions and market conditions, as well as general economic downturns; (iii) there may not be as much information publicly available about these companies as would be available for public companies and such information may not be of the same quality; and (iv) these companies are more likely to depend on the management talents and efforts of a small group of persons; as a result, the death, disability, resignation or termination of one or more of these persons could have a material adverse impact on these companies' ability to meet their obligations.
- *Market Recovery.* A Client's investment strategy for certain assets may rely, in part, upon local market recoveries during the term of the Client. No assurance can be given that any such markets will recover since this will depend, in part, upon events and factors outside the control of the general partner of the applicable Client and Colony Capital.

- *Development Activities.* Clients may invest in underdeveloped land and certain development properties. Undeveloped land and development properties may involve more risk than properties on which development has been completed. Undeveloped land and development properties do not generate operating revenue while costs are incurred to develop the properties, and may also generate certain expenses including property taxes and insurance. Development activities include the risks that development projects may be abandoned after expending resources, construction costs of a project may exceed original estimates, occupancy and rental rates at a newly completed property may be less than anticipated and construction and leasing of a property may not be completed on schedule. Development activities are also subject to risks relating to the inability to obtain, or delays in obtaining, all necessary zoning, land-use, building, occupancy, and other required governmental permits and authorizations. Contingencies in development activities beyond the control of the Clients could occur.
- *Investments in Securities.* Clients may invest in debt or equity securities of real estate-related companies which may be undergoing restructuring or require additional capital and active management. These securities are subject to various inherent risks, including that (a) equity and debt securities fluctuate in value, often based on factors unrelated to the issuer of the securities, and such fluctuations may be pronounced, (b) such investments generally may be subject to risks with respect to the issuer of the securities, (c) the market for these securities may be less liquid than that for other higher rated or more widely followed securities, (d) securities of some non-U.S. issuers are less liquid and more volatile than securities of comparable U.S. issuers, and (e) securities markets in some countries are fragmented, small, and less liquid than the securities markets of the U.S. and certain other developed countries. In addition, the securities markets in the countries in which Clients may invest have in the past experienced substantial price volatility which could have an adverse impact on the value of the investments. Periods of economic and political uncertainty may result in further volatility in the value of the investments. As a result, there may be greater volatility than the volatility that could be expected by investors in comparable securities traded in U.S. securities markets. There can be no assurance that such investments will not be sold at prices below their acquisition costs.
- *Troubled Originations.* Certain Clients may make substantial investments in non-performing or other troubled assets, which involve a degree of financial risk and are experiencing or are expected to experience severe financial difficulties that may never be overcome. Investments in certain instances may have been originated by financial institutions which are insolvent or in serious financial difficulty or are no longer in existence. As a result, the standards by which such investments were originated, the recourse to the selling institution, and/or the standards by which such investments are being serviced or operated may be adversely affected. Further, investments in properties operating under the close supervision of a mortgage lender are, in certain circumstances, subject to certain additional potential liabilities that may exceed the value of the investing Client's original investment therein. For example, under certain circumstances, lenders who have inappropriately exercised control of the management and policies of a debtor may have their claims subordinated or disallowed or may be found liable for damages suffered by parties as a result of such actions.
- *Control Issues.* In certain situations, Clients may only acquire a minority interest in a company or other assets in which they are investing, may rely on independent third-party management

or strategic partners with respect to the operation of a company or other assets in which they are investing, or may only acquire a participation in an asset underlying an investment, and, therefore, may not be able to exercise control over the management of such company or investment. Although an investing Client may not have complete control over such an investment and, therefore may have a limited ability to protect its position therein, such Client's general partner will expect that appropriate rights will be negotiated to protect the Client's interests. Nevertheless, such investments may involve risks in connection with such third-party involvement, including the possibility that third-party management or strategic partners may have financial difficulties resulting in a negative impact on such investment, may have economic or business interests or goals that are inconsistent with those of the investing Client or may be in a position to take action contrary to such Client's investment objectives. In addition, Clients may in certain circumstances be liable for the actions of third-party management or strategic partners. In instances where a Client invests with a Co-Investment Fund, such Client may not have absolute control over the management of such investment.

- *Liquidity Considerations.* Some of the investments made by Clients will be highly illiquid, and there can be no assurance that an investing Client will be able to realize on any such investment in a timely manner. Illiquidity may result from the absence of an established market for the investments, as well as legal or contractual restrictions on the investment's resale by the applicable Client. Investments by their nature are often difficult or time consuming to liquidate, and investments made in the form of securities present unique challenges. For example, buyers for minority interests may be difficult to secure, while transfers of large block positions may be subject to legal, contractual, or market restrictions. Interests in non-public entities by their nature may be illiquid as well.
- *Leverage and Interest Rates.* Many of the Clients' investments are likely to utilize a leveraged capital structure, in which case a third party would be entitled to cash flow generated by such investments prior to the investing Client's receiving a return. Fluctuations in interest rates may adversely affect the ability of the Clients to successfully acquire investments and may also adversely affect the performance of the Clients' investments. Use of borrowed funds to leverage acquisitions involves a high degree of financial risk and can exaggerate the effect of any increase or decrease in value of an investment and will increase the exposure of the investments to adverse economic factors, such as fluctuations in interest rates, downturns in the local economies in which the investments are located or deterioration in the condition of the investments.
- *Currency Rates.* Fluctuations in currency rates may adversely affect the ability of the Clients to successfully acquire non-U.S. assets and may also adversely affect the performance of Clients investments in such assets. Because non-U.S. securities or other non-U.S. assets may be purchased with and payable in currencies of countries other than the U.S., the value of these assets measured in U.S. dollars may be affected favorably or unfavorably by changes in currency rates and exchange control regulations. In addition to currency and exchange risks, these investments may be subject to additional risks relating to foreign political and regulatory risks, which may affect the liquidity of such investments. Additional risks include possibilities of instability of the local country's political and economic structures and less predictable means of dispute resolution and enforcement of local rights regarding investments.

Some countries in which certain Clients may employ managed exchange rate regimes which, in addition to other policies, may distort the results of, and returns on, the investments in such countries. Several countries, however, have been unable to sustain their exchange rates and have devalued their currency or shifted to floating exchange rate regimes. It is not possible over the life of any Client making such investments to assess the degree to which individual currencies will be permanently affected, but significant depreciation of any particular currency may adversely impact the investments in the applicable country and/or such Client's returns from such investments.

- *Environmental Considerations.* As is the case with any holder of real estate investments, Clients could face substantial risk of loss from environmental claims based on environmental problems associated with their investments.
- *Investments in Distressed Companies and Bankruptcy Considerations.* Investments in distressed companies may involve substantial risk. The level of analytical sophistication necessary for successful investment in distressed companies is particularly high. Operational, capital structure and management issues may be complex and difficult to successfully resolve. In addition, such investments may require active monitoring and direct management of the distressed company by Colony Capital personnel. Bankruptcy situations may be adversarial and are often beyond the complete control of the creditors. The rate of return on such investments will depend upon, among other factors, the duration of bankruptcy cases, which can only be roughly estimated.

Investments made in assets and companies operating in workout modes or under applicable bankruptcy laws could, if the investing Client inappropriately exercises control over the management and policies of the debtors, be subordinated or disallowed and, in such circumstances, such Client could be liable to third parties. Furthermore, under certain circumstances, payments to Clients in respect of such investments, and distributions to investors of such Clients, may be reclaimed if any such payment or distributions is later determined to have been a fraudulent conveyance or a preferential payment under concepts of applicable bankruptcy laws.

- *Risks Associated with Bankruptcy Cases.* Many of the events within a bankruptcy case are adversarial and often beyond the control of the creditors. While creditors generally are afforded an opportunity to object to significant actions, there can be no assurance that a bankruptcy court would not approve actions which may be contrary to the interests of the Client. Furthermore, there are instances where creditors and equity holders lose their ranking and priority as such if they are considered to have taken over management and functional operating control of a debtor.

Generally, the duration of a bankruptcy case can only be roughly estimated. The reorganization of a company usually involves the development and negotiation of a plan of reorganization, plan approval by creditors and confirmation by the bankruptcy court. This process can involve substantial legal, professional and administrative costs to the company and the Client; it is subject to unpredictable and lengthy delays; and during the process the



company's competitive position may erode, key management may depart and the company may not be able to invest adequately. In some cases, the company may not be able to reorganize and may be required to liquidate assets. The debt of companies in financial reorganization will, in most cases, not pay current interest, may not accrue interest during reorganization and may be adversely affected by an erosion of the issuer's fundamental values. Such investments can result in a total loss of principal.

United States bankruptcy law permits the classification of "substantially similar" claims in determining the classification of claims in a reorganization for purpose of voting on a plan of reorganization. Because the standard for classification is vague, there exists a significant risk that the Client's influence with respect to a class of securities can be lost by the inflation of the number and the amount of claims in, or other gerrymandering of, the class. In addition, certain administrative costs and claims that have priority by law over the claims of certain creditors (for example, claims for taxes) may be significant.

Furthermore, there are instances where creditors and equity holders lose their ranking and priority as such when they take over management and functional operating control of a debtor. In those cases where the Client, by virtue of such action, is found to exercise "domination and control" of a debtor, the Client may lose its priority if it can be demonstrated that the debtor's business was adversely impacted or other creditors and equity holders were harmed by the Client.

Investments in the debt of financially distressed companies domiciled outside the United States involve additional risks. Bankruptcy law and process may differ substantially from that in the United States, resulting in greater uncertainty as to the rights of creditors, the enforceability of such rights, reorganization timing and the classification, seniority and treatment of claims. In certain developing countries, although bankruptcy laws have been enacted, the process for reorganization remains highly uncertain.

- *Equitable Subordination.* In recent years, a number of judicial decisions in the United States have upheld the right of borrowers to sue lending institutions on the basis of various evolving legal theories, including equitable subordination (collectively termed "lender liability"). Generally, lender liability is founded upon the premise that the institutional lender has violated a duty (whether implied or contractual) of good faith and fair dealing owed to the borrower or has assumed a degree of control over the borrower resulting in the creation of a fiduciary duty owed to the borrower. The Client, as a creditor, may be subject to allegations of lender liability. Furthermore, the Client may be unable to control the conduct of the other lenders under a loan syndication agreement requiring less than a unanimous vote, yet the Client may be subject to lender liability for such conduct.
- *Over-the-Counter Trading.* The Client's hedging strategies may involve engaging in forward contracts, as well as credit default swaps and other derivatives. Unlike futures contracts, at present these instruments are not traded on exchanges and are not standardized. Banks and dealers act as principals in the markets for these instruments, negotiating each transaction on

an individual basis. These transactions are substantially unregulated, there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in these markets are not required to continue to make markets and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain contracts or have quoted prices with unusually wide spreads between the prices at which they were prepared to buy and those at which they were prepared to sell. Disruptions can also occur in any market in which the Partnership trades due to unusually high trading volume, political intervention or other factors. The imposition of controls by governmental authorities might also limit such trading to less than that which Colony Capital would otherwise recommend, to the possible detriment of the Client. Market illiquidity, trading disruption, market risk and credit risk to underlying assets as well as banks, dealers and other counterparties could result in significant losses to the Client.

- *Hedging Policies/Risks.* In connection with the consummation of certain investments, Clients may employ hedging techniques designed to protect such Clients against adverse movements in currency or interest rates. While such transactions may reduce certain risks, such transactions themselves may entail certain other risks. Thus, which a Client may benefit from the use of these hedging mechanisms, unanticipated changes in interest rates, securities prices, or currency exchange rates may result in a poorer overall performance for such Client than if it had not entered into hedging transactions.
- *Inflation.* Some countries in which certain Clients may invest have experienced substantial rates of inflation in recent years. Inflation and rapid fluctuations in inflation rates have had, and may in the future have, negative effects on the economies and securities markets of certain emerging economies. There can be no assurance that inflation will not become a serious problem in the future and have an adverse impact on the investments in these countries or Client's returns from such investments.
- *Restrictions on Repatriation of Capital and Profits.* Some countries in which certain Clients may invest control, in varying degrees, the repatriation of capital and profits that result from foreign investment. Capital markets, often opaque, continue to be highly regulated and will likely be subject to continuing government restrictions. There can be no assurance that Clients investing in such countries will be permitted to repatriate capital or profits, if any, from these countries.
- *Non-U.S. Economic, Political, Regulatory and Social Risks.* Investments by Clients may be subject to economic, political, regulatory, and social risks, which may affect the liquidity of such investments. The governments of certain of the countries in which Clients may invest have exercised and continue to exercise substantial influence over many aspects of the private sector. The availability of investment opportunities for Clients depends in part on governments continuing to liberalize their policies regarding foreign investment and to further encourage private sector initiatives. In certain jurisdictions, foreign ownership of assets and companies may be restricted, requiring Clients investing in such countries to share the applicable investments with local third-party partners or investors, and there may be significant local land use and permit restrictions, local taxes, and other transaction costs which adversely affect the returns sought by the investing Clients.

Clients do not intend to obtain political risk insurance. Accordingly, government actions in the future could have a significant effect on economic actions in such countries, which could affect private sector assets and real estate and real estate-related companies and the prices and yields of investments. Exchange control regulations, expropriation, confiscatory taxation, nationalization, political, economic, or social instability or other economic or political developments could adversely affect the assets of Clients that are held in particular countries.

Political changes or a deterioration of a particular country's domestic economy or balance of trade may indirectly affect the investments of Clients in a particular assets or company in such country. Moreover, the investments could be adversely affected by changes in the general economic climate or the economic factors affecting industries in which Clients have invested, changes in tax law or specific developments within such industries or interest rate movements. While the respective general partners of such Clients intend to manage these investments in a manner that will minimize investing Clients' exposure to such risks, there can be no assurance that adverse political or economic changes will not cause such Clients to suffer losses.

Any significant military action by the U.S. and/or its allies, terrorist attaches and/or the anticipation of any such actions or response to them may have a further adverse impact on worldwide economic stability. It is not possible to predict the severity of the effect that terrorist activity and/or military response will have on the economic situation of the countries in which certain Clients may invest. Nevertheless, any resulting economic instability or downturn could affect the returns sought by such Clients.

- *Undeveloped Infrastructure.* In certain countries where Clients may invest, capital and advanced technology are significantly limited. Delays in local postal, transport, banking or communications systems could cause investing Clients to lose rights, opportunities, entitlements or funds and expose such Clients to currency fluctuations.
- *Ability to Enforce Legal Rights.* Because of the effectiveness of the judicial systems in the countries in which Clients may invest varies, Clients may have difficulty in successfully pursuing claims in the courts of such countries, as compared to those of the U.S. or other developed countries. Further, to the extent that a Client may obtain a judgment but is required to seek its enforcement in the courts of one of these countries, there can be no assurance that such a court will enforce such a judgment.
- *Third Party Litigation.* Clients' investment activities may subject them to relatively increased third-party litigation risks, which may include risks with respect to lender liability, where a Client exercises control or significant influence over an investment. In connection with such actions, the applicable Client would be obligated to bear defense, settlement, and other costs (which may be in excess of coverage therefore provided by the Client at such Client's expense for such purposes), and the general partner and investment adviser of such Client and others may be entitled to indemnification under, and subject to the terms of, such Client's partnership agreement and/or certain other agreements entered into by such Client.

- *Allocation of Investment Opportunities.* With respect to potential conflicts that may arise relating to acquisition opportunities available to Clients and Co-Investment Funds, appropriate allocations of acquisition opportunities will be based upon the factors set forth in the applicable Client's offering documents. The investors in Co-Investment Funds may own properties or other assets operating in the same general area as a Client's investments and may be in competition with such Client for buyers and financings of assets and for tenants. It is possible that conflicts will also arise with respect to acquisition opportunities and other businesses run or owned by investors. If such conflicts do arise, allocation will be made by the general partner of the applicable Client and its affiliates in their discretion. For further details, see Item 10.C.
- *Service on Boards of Directors.* A principal or employee of Colony Capital or a related person may, from time to time, serve as a director or in another fiduciary role with respect to companies, the securities of which are purchased on behalf of a Client. In the event that Colony Capital or a related person (i) obtains material non-public information in such capacity with respect to any such company or (ii) is subject to trading restrictions pursuant to Colony Capital's internal policies, Colony Capital may be prohibited from engaging in transactions with respect to the securities or instruments of such company, which prohibition may have an adverse effect on its Clients.

Conflicts of interest may arise because Colony Capital's partners and principals (including Colony Capital personnel) will serve as directors of certain portfolio companies. In addition to any fiduciary duties the Colony Capital partners and principals owe to the Clients, as directors of portfolio companies, these Colony Capital partners and principals owe fiduciary duties to the shareholders of the portfolio companies and persons other than the Clients. In general, such director positions are often important to the Clients' investment strategy and may have the effect of enhancing the ability of Colony Capital to manage investments. However, such positions may have the effect of impairing the ability of Colony Capital to sell the related securities when, and upon the terms, it may otherwise desire. In addition, such positions may place the Colony Capital partners and principals in a position where they must make a decision that is either not in the best interests of the Clients or not in the best interests of the shareholders of the portfolio company. Should a Colony Capital partner or principal make a decision that is not in the best interest of the shareholders of a portfolio company, such decision may subject Colony Capital and any applicable Client to claims that they would not otherwise be subject to as an investor, including claims of breach of the duty of loyalty, securities claims and other director-related claims. In general, Clients will indemnify Colony Capital and its partners and principals from such claims. In addition, because of the potential conflicting fiduciary duties, Colony Capital may be restricted in choosing investments for Clients, which could negatively impact returns received by the Clients.

- *Investment with Prior Funds or Third Parties.* Clients may co-invest with third parties. These transactions potentially raise conflicts of interest. For example, a Client may co-invest with certain Colony Capital Funds, current limited partners of the Client or other market participants with which Colony Capital has important business relationships, and such

relationships could influence the decisions made by the Client's general partner and/or Colony Capital with respect to the purchase or sale of such investments. Further, such third parties could have interests that may be contrary to such Client's investment objective or which may conflict with the Client's interest. In those circumstances where such third parties involve a management group, such third parties may receive compensation relating to such investments, including incentive compensation arrangements. There can be no assurance that the foregoing will not have an adverse impact on the Client's ability to find, consummate and/or exit investments.

- C. Colony Capital provides advisory services to Clients which invest in the securities described in Item 4.B. The risks related to investments in such securities are described in Item 8.B

#### **Item 9. Disciplinary Information**

There are no legal or disciplinary events that are material to a Client's or prospective Client's evaluation of Colony Capital's advisory business or the integrity of its management.

#### **Item 10. Other Financial Industry Activities and Affiliations**

- A. Not applicable.
- B. Not applicable.
- C. Colony Capital and its affiliates serve as manager, general partner and managing member to Clients.

Colony Capital and its affiliates will devote such time as shall be necessary to conduct the business affairs of each of its Clients in an appropriate manner. However, personnel of Colony Capital and its affiliates will work on several projects at any time and, therefore, conflicts may arise in the allocation of personnel and other management resources. Colony Capital and its affiliates are not required to manage any one Client as its sole and exclusive function, and Colony Capital, its affiliates and their respective agents, officers, directors and employees may engage in or possess any interests in business ventures and may generally engage in other activities independently or with others, including the rendering of advice or services of any kind to other investors and the making or management of other investments or other investment Clients.

Not all investments which are consistent with the applicable Client's investment objectives will be presented to such Client. In some instances, real estate investments may be made available to and shared with other funds managed or advised by Colony Capital or its affiliates, and thus the entire investment opportunity relating to a potential real estate investment will not be available to the applicable Client. The allocation of investment opportunities among Clients for which such investment opportunities may be suitable is determined in accordance with the limited Client agreements of the relevant Clients.

From time to time Colony Capital may enter, or cause any Client to enter, into transactions with other affiliates. Colony Capital or the applicable Client and the other party to a particular transaction may have divergent interests. Moreover, there may be uncertainties regarding the valuation of investments that are subject to these transactions. Investors other than those represented on the applicable Client's advisory committee (if such Client has an advisory committee) may have no opportunity to participate in the evaluation of the terms or merits or valuation of any such transactions and will be bound by the consent of such advisory committee.

To the extent any matter relating to a Client involves a conflict of interest, as determined by the general partner, managing member, or investment manager of the Client in good faith, and is not otherwise provided for in the Client's limited partnership agreement, limited liability company operating agreement or other equivalent organizational document, such general partner, managing member or investment manager shall generally address such conflict by consulting with the Client's advisory committee, board of directors or, in certain cases, the limited partners of such Client. The general partners and managing members for Clients' limited partnerships or limited liability companies are special purpose vehicles formed and controlled by Colony Capital.

In addition, CFI's board of directors has adopted a policy regarding the approval of any "related person transaction," which is any transaction or series of transactions in which CFI or any of its subsidiaries is or are to be a participant, the amount involved exceeds \$120,000, and a "related person" (as defined under SEC rules) has a direct or indirect material interest. Under the policy, CFI's Audit Committee will decide, based on its consideration of all of the relevant facts and circumstances, whether or not to approve such transaction and will generally approve only those transactions that do not create a conflict of interest.

Colony Capital and its affiliates may enter into "side letters" with investors in certain Clients, which allow for certain additional rights in the event of tax, regulatory or legal circumstances applicable to such investors.

**A more detailed description of applicable conflicts of interest is set forth in the offering materials of each Client.**

Colony Capital's affiliated investment advisers are:

Investment Adviser	
Colony Investment Management, LLC	Provides real estate investment advisory services to various private pooled investment vehicles and separate accounts.
Colony Realty Partners, LLC	Provides real estate investment advisory services to various

	core-plus and value-add private pooled investment vehicles and separate accounts.
Colyzeo Investment Management Limited (UK Limited Company)	Provides real estate investment advisory services in Europe to various private pooled investment vehicles.
Colyzeo Investment Advisors Limited (UK Limited Company)	Provides real estate investment advisory services in Europe to various private pooled investment vehicles.
Colony Capital Asia Limited*	Provides real estate investment advisory services in Asia to various private pooled investment vehicles.
CCAP Korea, LLC*	Provides real estate investment advisory services in Asia to various private pooled investment vehicles.
Colony Capital S.a.r.l.*	Provides real estate investment advisory services in Europe to various private pooled investment vehicles.
Colony Italia S.r.l.*	Provides real estate investment advisory services in Europe to various private pooled investment vehicles.
Colony Financial Manager, LLC*	Provides real estate investment advisory services to a NYSE listed real estate finance company, CFI.

\* Colony Capital and its relying advisers are together filing a single Form ADV in reliance on the SEC's position as expressed in its no-action letter to the American Bar Association on January 18, 2012.

D. Not applicable.

#### **Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Colony Capital has adopted a written code of ethics that is applicable to all employees. Among other things, the code requires Colony Capital and its employees to act in Clients' best interests, abide by all applicable regulations, avoid even the appearance of insider trading, and pre-clear and report on many types of personal securities transactions. A copy of Colony Capital's code of ethics is available upon request.

Colony Capital, its principals or a related entity will generally have a material investment in a Client, often as the general partner of the Client. Therefore, Colony Capital may be considered to participate, indirectly, in transactions effected for those Clients. The foregoing relationships, fees and any other actual or potential conflicts of interest arising there from are disclosed in the Client's offering document.

Colony Capital's employees are not permitted to trade alongside Client accounts. The Chief Compliance Officer monitors employee trading, relative to Client trading, to ensure that employees do not engage in improper transactions.

Colony Capital maintains a watch list of securities that are being considered for Client accounts, as well as, an inventory of securities already held in Client accounts. Any proposed employee transaction involving securities on the watch list or already in inventory requires preclearance from the Chief Compliance Officer. The Chief Compliance Officer does not grant preclearance where it would appear that an employee's trading could disadvantage Clients.

Ethical walls and information barriers have been established between Colony Investment Management, LLC ("CIM"), a related party to Colony Capital, and Colony Capital and its affiliates (other than CIM) to separate persons who make investment decisions from others who might possess material non-public information that could influence such decisions. In the event that such ethical walls and information barriers do not effectively prevent the sharing of material non-public information, CIM or Colony Capital and its affiliates (other than CIM) could be restricted from engaging in transactions on behalf of the affiliated Colony Capital Clients and CIM's clients. Colony Capital and its affiliates (other than CIM) currently operate without ethical screens or information barriers that other firms implement to separate persons who make investment decisions from others who might possess material non-public information that could influence such decisions. In an effort to manage possible risks from Colony Capital's decision not to implement such screens, Colony Capital's Chief Compliance Officer maintains a list of restricted securities as to which Colony Capital and its affiliates may have access to material non-public information and in which affiliated Colony Capital Clients are not permitted to trade. In the event that employees of Colony Capital or its affiliates (other than CIM) obtain such material non-public information, Colony Capital may be restricted in acquiring or disposing investments on behalf of affiliated Colony Capital Clients, which could impact the returns generated for affiliated Colony Capital Clients.

Notwithstanding the maintenance of restricted securities lists and other internal controls, it is possible that the internal controls relating to the management of material non-public information could fail and result in Colony Capital, or one of its investment professionals, buying or selling a security while, at least constructively, in possession of material non-public information. Inadvertent trading on material non-public information could have adverse effects on Colony Capital's reputation, result in the imposition of regulatory or financial sanctions, and as a consequence, negatively impact Colony Capital's ability to perform its investment management services on behalf of the Client.

#### **Item 12. Brokerage Practices**

A. Not applicable.

B. Not applicable.



### **Item 13. Review of Accounts**

- A. Colony Capital continuously reviews its Client accounts for purposes of ensuring that each Client's investment objectives are satisfied as described in Item 4.C. Colony Capital carefully monitors its Clients investments and generally evaluates such investments on an ongoing basis. Quarterly and annual financial statements for each Client include an updated fair value for each investment held by such Client.
- B. Not applicable.
- C. Colony Capital Funds generally furnish audited financial statements annually to all limited partners. On a quarterly basis, each limited partner will be furnished with the unaudited financial statements of the relevant Colony Capital Fund. As part of the annual audited financial statements, the limited partners will also receive a report containing descriptive information regarding (i) the Colony Capital Fund's investments; and (ii) each limited partner's capital account and details of all transactions which flowed through such capital account.

### **Item 14. Client Referrals and Other Compensation**

- A. Not applicable.
- B. Colony Capital may enter into arrangements with, and compensate solicitors for Client referral activities. These solicitation arrangements will be fully disclosed to affected Clients and will comply with the requirements of Rule 206(4)-3 of the Advisers Act.

Colony Capital may engage, or cause Clients to engage, and compensate, placement agents to market and sell interests or shares in Clients to prospective investors. Colony Capital requires placement agents to have all appropriate licenses and registrations to conduct their business, including when applicable, to be registered as broker-dealers with the SEC and to be members of the Financial Industry Regulatory Authority.

In addition, Colony Capital may compensate placement agents for introducing investors to Clients. Subject to its duty to obtain best execution, Colony Capital may take such introductions into account as a factor in the selection of brokers to execute portfolio transactions for Clients.

### **Item 15. Custody**

Because Clients are generally limited partnerships or other pooled investment vehicles subject to annual audit by an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board and audited financial statements prepared in accordance with U.S. generally accepted accounting principles are distributed annually to investors within the prescribed time, Colony Capital is exempt from the custody rule requirement to deliver account statements to clients by a qualified custodian.

**Item 16. Investment Discretion**

Colony Capital has discretionary authority to manage securities accounts on behalf of clients. Limitations on this authority are described in Item 4.C. above. This authority is granted pursuant to the governing documents of each Client, including its limited partnership agreement or applicable governing documents.

**Item 17. Voting Client Securities**

Due to the nature of Colony Capital's investment programs and the types of investments made on behalf of its clients, Colony Capital would rarely, if ever, be requested to vote the proxies of traditional operating companies. Nonetheless, Colony Capital has adopted proxy voting policies and procedures designed to ensure that proxies are properly voted and that any conflicts of interest are addressed appropriately. The general policy is to vote proxy proposals as well as any amendments, consents or resolutions relating to client securities (collectively, "proxies"), in a manner that serves the best interests of client accounts, as determined by Colony Capital in its discretion, taking into account various factors, including, without limitation, the impact on the value of the securities. Clients may request a copy of Colony Capital's proxy voting policies and procedures and the proxy voting record relating to their account by contacting Colony Capital.

**Item 18. Financial Information**

- A. Not applicable.
- B. No financial condition is reasonably likely to impair Colony Capital's ability to meet contractual commitments to clients.
- C. Not applicable.