

U.S. SECURITIES AND EXCHANGE COMMISSION



Matter of

UNITED DEVELOPMENT FUNDING III, L.P.,
UNITED DEVELOPMENT FUNDING IV, *and*
UNITED DEVELOPMENT FUNDING INCOME
FUND V,

Respondents.

A.P. No. 3-18832

SEC Mail Processing

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Washington, DC

ANSWER

Respondents by their undersigned counsel answer the Division of Enforcement's ("Division") allegations in the Order Instituting Proceedings ("OIP") as follows:

1. Admit that United Development Funding III, L.P. ("UDF III") is a Delaware limited partnership headquartered in Grapevine, Texas; that its limited partnership units are registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act ("Exchange Act") and are not listed on any exchange; and that UDF III has been unable to file periodic reports following its 11/16/2015 filing of its Form 10-Q for the period ended 9/30/2015. Respondents deny the Division's remaining allegations in Paragraph 1 of the OIP.

2. Admit that United Development Funding IV ("UDF IV") is a Maryland real estate investment trust headquartered in Grapevine, Texas; that its common shares are registered with the Commission pursuant to Section 12(g) of the Exchange Act; that UDF IV has been unable to file periodic reports following its 11/9/2015 filing of its Form 10-Q for the period ended 9/30/2015; that UDF IV's common shares traded on the NASDAQ Global Select Market under the symbol "UDF" beginning on 6/4/2014; that NASDAQ halted trading on 2/18/2016, suspended trading on 10/19/2016, and filed Form 25 with the Commission on 5/18/2017; and that as of 8/22/2018 UDF IV's common stock was quoted on OTC Markets Inc. under the symbol "UDFI" and had four market makers. Respondents refer to Exchange Act Rule 15c2-11(f)(3) for its terms and meaning. Respondents deny the Division's remaining allegations in Paragraph 2 of the OIP.

3. Admit that United Development Funding Income Fund V ("UDF V") is a Maryland real estate investment trust headquartered in Grapevine, Texas; that its common shares are registered with the Commission pursuant to Section 12(g) of the Exchange Act and are not traded on any exchange; and that UDF V has been unable to file periodic reports following its

11/13/2015 filing of its Form 10-Q for the period ended 9/30/2015. Respondents deny the Division's remaining allegations in Paragraph 3 of the OIP.

4. Admit that Respondents have been unable to file periodic reports following their 11/9, 11/13, and 11/16/2015 filings of their Forms 10-Q for the period ended 9/30/2015, as stated above. Respondents deny the Division's remaining allegations in Paragraph 4 of the OIP.

5. Respondents refer to Exchange Act Section 13(a) and to Rules 13a-1 and 13a-13 thereunder for their terms and meaning. Respondents deny the Division's remaining allegations in Paragraph 5 of the OIP.

6. Admit that Respondents have been unable to file periodic reports following their 11/9, 11/13, and 11/16/2015 filings of their Forms 10-Q for the period ended 9/30/2015, as stated above. Respondents deny the Division's remaining allegations in Paragraph 6 of the OIP.

AFFIRMATIVE DEFENSES

7. Respondents request the Commission to consider the following facts and circumstances by way of affirmative defense and mitigation, and in support of a determination that suspension or revocation of registration is not necessary or appropriate.

A. CIRCUMSTANCES BEYOND RESPONDENTS' CONTROL MADE PERIODIC REPORTING IMPOSSIBLE UNTIL NOW

8. On 11/9, 11/13, and 11/16/2015, Respondents filed Form 10-Q periodic reports for the period ended 9/30/2015. At that time, Respondents were current in their periodic reporting.

9. At a meeting some weeks before these filings, the Division showed Respondents' external auditor Whitley Penn LLP ("Whitley Penn") a proforma cash flow spreadsheet prepared by an Austin, Texas borrower (the "Austin Borrower"), the maker of a note in UDF III's portfolio, and a revised version of the same spreadsheet prepared by Respondents and given to Whitley Penn. The Division told Whitley Penn that Respondents had misled Whitley Penn about the spreadsheet, but prohibited Whitley Penn from asking Respondents about the spreadsheet. Following this meeting, Whitley Penn proceeded with its review of Respondents' pending Forms 10-Q, but added six enhanced procedures to its review process.

10. Three days after the last of Respondents' Form 10-Q filings, on 11/19/2015, Whitley Penn notified Respondents of Whitley Penn's determination not to stand for reappointment as Respondents' external auditor, as confirmed by letter on 11/20/2015. Respondents then filed an 11/24/2015 Form 8-K disclosure that attached a copy of Whitley Penn's 11/24/2015 letter to the Commission.

11. Whitley Penn's letter to the Commission agreed with the Form 8-K's statement that its audit reports for both 2013 and 2014 "did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles." Whitley Penn's letter further agreed that, for the eleven quarters from 1/1/2013 through 9/30/2015, "(i) there were no disagreements between the Company and Whitley Penn on any matters of accounting principles or practices, financial statement disclosure or auditing scope or procedure, ... and (ii) there were no 'reportable events' as ... defined in Item 304(a)(1)(v) of Regulation S-K," dealing with internal control deficiencies, ability to rely on management representations, and unresolved issues materially impacting prior financial statements, among other things.

12. Respondents promptly began a search for a new audit firm. Over the next two months, Respondents approached EY, PwC, KPMG and Grant Thornton. Based on these contacts, Respondents determined to proceed with Grant Thornton as their new auditor. Grant Thornton thereupon met extensively with Respondents and assembled an engagement team in preparation for being formally engaged as auditors.

13. However in the weeks following Respondents' 11/9-11/16/2015 Form 10-Q filings and their 11/24/2015 Form 8-K announcing that the auditor Whitley Penn would not be continuing, Hayman Capital Management L.P. ("Hayman Capital"), a Dallas-based hedge fund led by short seller J. Kyle Bass, began attacking Respondents in a series of anonymous internet posts containing false and misleading information. The anonymous posts were part of an unlawful "short and distort" campaign targeting Respondents for the express purpose of downwardly manipulating UDF IV's stock price, and included an anonymous letter sent to Whitley Penn challenging Respondents' financial condition and Whitley Penn's prior audit work.

14. After hiring a professional marketing firm to create a special tabloid-style website called "www.UDFexposed.com," Hayman Capital claimed responsibility for the anonymous posts. Hayman Capital used this new website to publish additional false information and purported analysis to investors. Before publishing its anonymous posts and launching the "www.UDFexposed.com" website, Hayman Capital failed to disclose that it held a very large short position in UDF IV, which Hayman Capital continued to quietly grow from over 1.2 million shares short on 3/31/2015 to over 3.4 million shares short on 12/10/2015 (nearly \$60 million). Hayman Capital also marketed a Distressed Opportunity Fund designed to acquire Respondents' assets and assets of Respondents' largest borrower.

15. During 2015 and continuing into early 2016, Hayman Capital had meetings with the Federal Bureau of Investigation ("FBI"), including one lasting five hours. In addition, Hayman Capital sent the FBI over 30 emails for the express but undisclosed purpose of instigating action against Respondents, and thus downwardly manipulating UDF IV's market price. And as short interest in UDF IV spiked, Hayman Capital continued its attacks on Respondents through a series of false posts on its www.UDFexposed.com website and elsewhere. These included posts on 2/2/2016 and 2/16/2016 calling UDF IV a Ponzi-like real estate scheme and a "billion dollar

house of cards,” and stating that there was a “significant bankruptcy risk” for UDF IV, and that in the event of bankruptcy, UDF IV’s shares would be “virtually worthless,” among other highly inflammatory allegations.

16. On 2/18/2016, the FBI executed a search warrant at Respondents’ headquarters in Grapevine, Texas (near Dallas), and served grand jury subpoenas for document production by individuals associated with Respondents. The FBI raid on Respondents’ offices was broadly covered by the Dallas and national press. The next day, the Division served subpoenas for investigative testimony over the following six weeks from over ten of Respondents’ officers and employees.

17. The independent trustees on UDF IV’s audit committee had already in December 2015 retained law firm Thompson & Knight, assisted by independent forensic accountants from PwC, to conduct an independent investigation into Hayman Capital’s allegations. This extensive and detailed investigation, involved individual interviews, analysis of thousands of relevant documents, searches of 1.7 million emails, and analysis of financial reporting. After four months of work, the investigators concluded, among other things, that there was no evidence of fraud or misconduct by UDF IV, its management or its advisor; no evidence to substantiate Hayman Capital’s allegations concerning a Ponzi Scheme; no evidence of deception; no evidence that Whitley Penn was misled; and no evidence of efforts to defraud investors. Thompson & Knight and PwC presented these findings to the Division on 4/12 and 4/26/2016, and to the FBI and U.S. Attorney on 5/11/2016.

18. Following the FBI’s 2/18/2016 raid and pending substantial completion of the UDF IV audit committee’s independent investigation, Respondents’ ability to complete its engagement of a new audit firm was delayed. In April 2016, Grant Thornton told Respondents that it had determined not to move forward with the steps it had taken to become Respondents’ auditor. Respondents thereupon proceeded to contact Crowe Horwath and other audit firms for possible engagement. This effort was ultimately successful, and in June 2016 Respondents engaged EisnerAmper as their new auditors, and disclosed the engagement on Form 8-K.

19. However, in the following months and throughout the summer and fall of 2016, Hayman Capital continued to post false statements concerning Respondents on its www.UDFexposed.com website. Hayman Capital particularly stressed its Ponzi-like allegations. These Hayman Capital claims were also reported in the Dallas news media. Hayman Capital also continued to interfere with Respondents’ audit process through anonymous and other submissions directly to Respondents’ new auditors EisnerAmper, which had the effect of impeding the audit. Hayman Capital also used its professional marketing firm to craft a negative digital campaign targeting “accounting/audit firm employees” through social media in the Dallas area.

20. On 9/29/2016, the Division issued Wells notices, including both scienter and non-scienter based provisions of the Securities Act and the Exchange Act, to UDF III, UDF IV and

seven individuals associated with Respondents, and a Wells notice to another individual on 10/14/2016. As noted above, NASDAQ suspended trading in UDF IV on 10/19/2016.

21. EisnerAmper thereupon informed Respondents that EisnerAmper would not move forward with its audit work until after it had reviewed and fully considered the Wells submissions then being prepared. In addition, EisnerAmper wanted Respondents to engage a third party to review a select number of portfolio loans, together with historical loan narratives, on a quarterly basis from 12/31/2014 forward. This included assembling all loan underwriting documentation for that time period. In October 2016, Respondents engaged Riveron Consulting as the third party to perform this additional work. The scope of the Riveron Consulting engagement was later expanded to include the entire loan portfolio.

22. The Division determined on 11/9/2016 to provide Respondents with certain materials as pre-Wells discovery. After reviewing these materials, Respondents filed their Wells submission on 12/23/2016. On 4/17/2017, the Division advised that, after considering Respondents' Wells submission, it still intended to proceed with some form of enforcement recommendation.

23. Over the next month, on 4/20, 4/22 and 5/22/2017, the Division and Respondents discussed a non-scienter settlement charging Securities Act §§17(a)(2) and (3), with no officer-and-director bars or suspensions, and including UDF III, UDF IV and five individuals. The Division indicated that it was prepared to recommend such a non-scienter resolution, and Respondents thereupon indicated that they were ready to settle, without admitting or denying, on this non-scienter basis.

B. WITH THE ENFORCEMENT CASE JUST CONCLUDED RESPONDENTS CAN NOW OBTAIN AN AUDIT

24. On 6/2/2017, after reaching bilateral commitment to a non-scienter settlement, as part of Respondents' continuing efforts to become current in their periodic reporting, Respondents met with EisnerAmper's Risk Management Office and its General Counsel's Office to discuss the Division's proposed non-scienter settlement. At this meeting, EisnerAmper advised that it was prepared to proceed, and that it would be able to rely on management's representations in connection with the audit, but only if the Division's charges remained non-scienter and did not ultimately result in any officer or director bars.

25. The Division discussed the non-scienter settlement terms and language with Respondents on 7/5/2017. Both sides then continued to work toward finalizing a settlement. On 8/31/2017, to facilitate completion of the settlement and as requested by the Division, UDF III and UDF IV executed tolling agreements extending the statute of limitations four months, to 12/26/2017. The Division indicated that it was planning to send its settlement recommendation to the Commission during the week of 12/20/2017. Thereafter, as requested, Respondents agreed to further toll for an additional eight months, to 3/26/2018, to 6/19/2018, and to 8/20/2018.

26. Between October and December 2017, EisnerAmper received audit materials. It believed that the audit for UDF V would be less complex than the audits for UDF III and UDF IV. All that remained was for the Division to obtain the Commission's approval of the proposed non-scienter settlement, to file the settled case with the court, and to obtain entry of judgment confirming the settlement. Respondents learned the settlement was accepted on 6/18/2018, and the Division thereupon filed the case on 7/3/2018 and promptly moved for entry of judgment.

27. On 7/31/2018, on the Division's motion, the court entered the consent judgment settling the Commission's non-scienter charges. In the weeks since the court's entry of judgment, the Division has invited Respondents to make a further detailed presentation concerning undisclosed short seller Hayman Capital's activities referred to above. Earlier in 2018, a Dallas state court had allowed Respondents to obtain preliminary discovery in their civil damages suit against Hayman Capital, and after reviewing Respondents' submissions and holding a five-hour evidentiary hearing, the court on 6/12/2018 found that Respondents had set forth a prima facie case of intentional business disparagement and tortious interference by Hayman Capital.

28. Thus, with the Division's case now finally resolved, Respondents are, for the first time since late 2015, able to obtain an audit. Both EisnerAmper and Riveron Consulting remain engaged and ready to proceed. And both have already been at work.

C. RESPONDENTS' PLAN TO COME INTO FULL COMPLIANCE WITH PERIODIC REPORTING REQUIREMENTS

29. As requested by EisnerAmper, the independent consultants at Riveron Consulting have worked with Respondents to assemble comprehensive loan packages for every loan in UDF IV's and UDF V's respective portfolios. These loan packages comprise voluminous and detailed contemporaneous analyses, information and documentation. Efforts to compile auditable loan-related documentation were hampered by the FBI's seizure of documents during its 2016 execution of a search warrant at Respondents' headquarters, as described above.

30. Riveron Consulting has already examined the documentation for all 158 loans in the UDF IV portfolio, including the 59 loans outstanding as of 12/31/2017. This thorough and time-consuming work required Riveron to prepare a consistent loan review package for each loan that includes loan agreements and modifications, appraisal reports, condensed loan timelines, loan rollforward, cash flows, and investment committee notes.

31. Additionally, Riveron Consulting will now be proceeding to prepare the same loan review packages for UDF V. This is expected to take considerably less time, as UDF V had only 8 loans, of which 5 loans were outstanding as of 12/31/2017. Riveron Consulting has also been providing and will continue to provide assistance with technical accounting matters and financial reporting, as needed.

32. EisnerAmper has not previously been able to audit Respondents in view of the facts and circumstances described above. However, EisnerAmper now has in place a team that is already working on this engagement. Next steps for EisnerAmper are continued planning of audits and related quarterly reviews with management and the EisnerAmper audit team for both UDF IV and UDF V; planning meeting with the audit committee for UDF IV; field work for audits and reviews for UDF IV and V; finalizing procedures and reaching conclusions; coordination with management regarding review of SEC filings for UDF IV and UDF V; further meeting with UDF IV audit committee; and finalizing the audit and issuing opinions for both UDF IV and UDF V.

33. It will also be necessary for Respondents' outside disclosure counsel to confer with staff in the Division of Corporation Finance to resolve a number of questions to assure that the approach Respondents use to become compliant in an expeditious manner is one that is deemed appropriate. Respondents will propose the filing of an "omnibus" Form 10-K for the year ended 12/31/2017, which would necessitate obtaining the staff's guidance as to prior periods. Respondents will also seek guidance on determining the date of termination for UDF IV's status as an accelerated filer, which will impact EisnerAmper's need to opine on internal controls.

34. As is evident from the foregoing, Respondents take their reporting responsibilities seriously and have been, are and will be working diligently with EisnerAmper, Riveron Consulting and disclosure counsel. In addition to completing the detailed loan packages, Respondents' management team is also prepared to complete the Form 10-K disclosure items required by Reg. S-K. These disclosures depend in large part on each company's final financial statements and related accounting judgments. Respondents' management team will therefore continue working closely with EisnerAmper and disclosure counsel to finalize the required disclosures. Based on consultation to date with EisnerAmper and others involved in the foregoing process, including in-person consultation at Respondents' offices this week, Respondents expect to be able to file UDF IV's and UDF V's omnibus Form 10-Ks for 2017 and prior periods on or before 3/31/2019. Respondents expect to be able to file UDF IV's and UDF V's Form 10-Qs and Form 10-Ks for 2018, as well as Form 10-Qs for the first quarter of 2019, on or before 6/30/2019. These filings would succeed in bringing UDF IV and UDF V into current compliance with the periodic reporting requirements on or before that date.

35. Respondents will also work to bring UDF III into current compliance at their earliest opportunity. In addition to the resources being prioritized to update reporting for the other two funds, UDF III presents additional issues, including the Division's allegation in the settled enforcement case that UDF III should have recognized a specific loan allowance relating to the Austin Borrower's loan, in addition to its general reserve balance, and put the loan on non-accrual status with suspended income recognition as early as UDF III's 2013 Form 10-K. However Respondents will overcome these challenges to assure that UDF III joins UDF IV and UDF V in compliance with the periodic reporting requirements.

36. Respondents submit that suspension or deregistration would not be in the interest of investors. As noted above, the Division filed its settled non-scienter case as to UDF IV and the other named parties on 7/3/2018. After closing at \$3.25 on Tuesday 7/3/2018, and following the 7/4/2018 holiday, UDF IV jumped to close at \$4.90 on Thursday 7/5/2018, and at \$5.40 on Friday 7/6/2018. It has traded consistently above \$4 up to the present. With Respondents working hard alongside respected independent professionals to become current in their periodic reporting, and doing so at their first opportunity to obtain audits following resolution of the Division's non-scienter enforcement action, Respondents submit that a suspension or deregistration would be harmful to shareholders.

REQUEST FOR EVIDENTIARY HEARING

37. Respondents request that this matter be set for an evidentiary hearing, either before the Commission or an administrative law judge, to afford Respondents an opportunity to present testimony and exhibits to establish their defenses, and thus to show that it is neither necessary nor appropriate to suspend or revoke the registration of any securities issued by Respondents.

Dated: October 18, 2018

/s/ William E. Donnelly

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CERTIFICATE OF SERVICE AND FILING

Pursuant to Rule 150(c)(2), I certify that on October 18, 2018, I caused the foregoing to be sent: **(1) By US Mail (original and 3 copies)** directed to the Office of the Secretary, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-1090, with an electronic courtesy copy by **email** to apfilings@sec.gov. **(2) By email and US Mail** directed to Keefe M. Bernstein and David Whipple, Fort Worth Regional Office, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, TX 76102, and BernsteinK@sec.gov and WhippleDa@sec.gov.

/s/ William E. Donnelly