

Item 1. Cover Page



AVENUE CAPITAL MANAGEMENT II, L.P.

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FORM ADV PART 2

March 30, 2012

This brochure provides information about the qualifications and business practices of Avenue Capital Management II, L.P. If you have any questions about the contents of this brochure, please contact Eric L. Ross, Senior Managing Director and Chief Compliance Officer, at (212) 878-3520 or eross@avenuecapital.com. 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. Registration as an investment adviser with the SEC does not imply a certain level of skill or training.

Additional information about Avenue Capital Management II, L.P. is available on the SEC's website at www.adviserinfo.sec.gov.

Item 2. Material Changes

Since the last annual update of this brochure on March 30, 2011, Avenue Capital Management II, L.P. has updated this brochure to provide disclosure with respect to the fact that we now manage one or more managed accounts.

Because this Item 2 discusses only those changes to this brochure that have been made since March 30, 2011 that the firm believes to be material, this brochure should be reviewed in its entirety.

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Item 4. Advisory Business

Structure; History and Ownership

Avenue Capital Management II, L.P. (the “firm”) is an investment adviser with its principal place of business in New York City. The firm provides investment advisory services to investment funds, including private funds and registered investment companies, and separately managed accounts. In addition to our offices in New York, we have offices in London, Luxembourg, Munich and seven offices throughout Asia. This brochure provides information about the firm and its “relying advisers” listed in Section 1.B. of Schedule D in Part 1A of the firm’s Form ADV (in reliance on the position expressed in the letter of the SEC staff dated January 18, 2012 to the American Bar Association, Business Law Section).

As of June 30, 2005, Avenue Capital Management II, LLC, a Delaware limited liability company, completed a legal reorganization whereby the company was converted to a Delaware limited partnership now known as “Avenue Capital Management II, L.P.”. Avenue Capital Management II, LLC commenced business in 2000. The firm has been registered as an investment adviser with the Securities and Exchange Commission (“SEC”) since July 17, 2000.

Marc Lasry (Chairman, Chief Executive Officer and Co-Founder) and Sonia E. Gardner (President, Managing Partner and Co-Founder) are the Senior Principals of the firm and together control the general partner of the firm, Avenue Capital Management II GenPar, LLC. Robert Symington and Shawn Foley are Co-Senior Portfolio Managers and are responsible for the firm’s U.S. Distressed Debt strategy. Edward Gellert is a Senior Portfolio Manager and is responsible for the firm’s Real Estate strategy. Sriram Balakrishnan is a Senior Portfolio Manager and is responsible for the firm’s collateralized loan obligations (or “CLOs”), which are part of our High Yield strategy. Marc Lasry, Sonia Gardner and Robert Symington, together, are the Principals of the firm.

The firm and its relying advisers are part of Avenue Capital Group (“Avenue”, “Avenue Capital” or “we”), an established global alternative investment firm founded in 1995. Avenue Capital has approximately 250 employees worldwide, including 80 investment professionals. Avenue Capital maintains an institutional infrastructure with extensive accounting, operations, legal, investor relations, risk management, compliance and information technology teams.

Our primary investment advisory service is to provide discretionary investment advice to investment funds, including private funds and registered investment companies.

Avenue Capital’s primary focus is investing in distressed debt and other special situations investments in the United States, Europe and Asia. The Senior Principals and the portfolio managers of the investment funds managed by the firm have spent virtually their entire careers in this space.

The firm generally pursues a theme-driven, concentrated investment strategy that is analytically intensive and relies upon individual credit, industry and macro research and analysis. To execute this strategy, the firm has assembled an experienced team of investment professionals. The depth of experience of these professionals allows for thorough research and analysis of potential investment credits, including credits with complicated, multi-layered capital structures in complex and dynamic industries.

We advise a large number of funds using investment strategies that can be grouped into the following general categories:

- U.S. Distressed Debt;

- High Yield; and
- Real Estate.

In addition to our U.S. Distressed Debt strategy, a portion of the assets we manage may be invested using a High Yield strategy and/or Real Estate strategy. Our High Yield strategy includes both CLO funds that are private funds and a closed-end registered investment company, or RIC, that is a public fund (the “RIC”). Thus, we advise both public and private funds.

Prospective investors in any fund are advised to review the fund’s private placement memorandum, explanatory memorandum, or confidential offering circular or, in the case of a RIC, the prospectus that is included in the registration statement that has been filed with the SEC, for a more in-depth description of that fund’s investment strategy and objectives and related risk factors.

Many of the private funds we advise are feeder funds to or parallel funds of other funds. In some cases, such as certain of the U.S. Distressed Debt funds, we advise successor funds to earlier funds that have concluded their investment period.

In addition to the funds, we also advise one or more separately managed accounts on a discretionary basis. The objective and strategy of a managed account may, but is not required to be, similar to the investment objective and strategy of a fund managed by the firm.

A list of the funds we manage can be found below at Item 10.

Types of Advisory Services

As described above, we provide advisory services to investment funds, including private funds and registered investment companies, and separately managed accounts for institutional investors. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor’s decision to invest in the funds. The advisory services we provide to investment funds are provided on a discretionary basis. The advisory services we provide to managed accounts may be discretionary or non-discretionary.

The investment strategies we employ on behalf of the funds, including, as applicable, restrictions on permissible investments and/or investment guidelines, are described below at Item 8.

Assets Under Management

As of February 29, 2012, we managed approximately \$7,172,900,000 of client assets, all on a discretionary basis.¹

Item 5. Fees and Compensation

Fees

Detailed information regarding fees is included in each fund’s confidential offering memorandum or registration statement, as applicable. Because this brochure will only be delivered to qualified purchasers as defined in section 2(a)(51) of the Investment Company Act of 1940, a complete description of our compensation arrangements is not required to be included in this brochure. Fees paid for services

¹ The foregoing amount represents assets under management as historically calculated by Avenue Capital and does not represent “regulatory assets under management” as calculated in Item 5.F.(2) of the firm’s Part 1A of Form ADV.

provided to managed accounts are determined on a client-by-client basis and may, but are not required to, be substantially similar to those paid by funds.

The private funds we advise generally pay management fees and incentive allocations or carried interest, depending upon each fund's investment strategy. The registered investment companies we advise generally pay management fees. Management fees, calculated as a percentage of the net asset value or aggregate commitments of the fund attributable to each investor, are generally paid monthly, quarterly or semi-annually in advance. With respect to our funds that pay us a carried interest, management fees are *pro rated* for partial periods in the event that our investment management agreement with the fund is terminated or an investor makes a capital contribution or purchases shares at any time other than at the beginning of a fund's valuation period, but are payable in full for partial periods resulting from distribution of fund assets. With respect to our funds that pay us an incentive allocation, management fees are *pro rated* for partial periods. With respect to our funds that only pay us a management fee, management fees are *pro rated* for partial periods.

Incentive allocations or carried interest are calculated as a percentage of profits of the funds. Some funds pay incentive allocations, in whole or in part, on mark-to-market performance at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark. Other funds pay a carried interest on realized returns. Such carried interest payments are not paid to us until investors receive 100% of their capital back plus a preferred return.

Management fees, incentive allocations and carried interest rates may be negotiable.

Expenses

Funds

The funds are generally responsible for their own operating expenses, and certain of the funds bear all or a portion of their organizational expenses. The payment of these expenses by a fund will reduce the value of each investor's investment in the fund.

Detailed information regarding the expenses to which each fund is subject is set out in the offering documents with respect to the particular fund. Generally, each feeder fund bears its own expenses and its *pro rata* share of the expenses of any master fund or intermediate fund, including, without limitation, the following categories of expenses:

- formation expenses;
- expenses incurred in connection with the evaluation, acquisition or disposition of investments, including:
 - private placement fees,
 - sales commissions,
 - appraisal fees,
 - taxes,
 - brokerage fees,
 - underwriting commissions and discounts,
 - travel expenses;
 - legal, accounting, investment banking, consulting, information services and professional fees;

- research; and
- other transaction costs.
- expenses incurred in connection with the carrying or management of investments, including custodial, trustee, record keeping and other administration fees;
- expenses incurred in connection with the preparation and distribution of its financial statements, tax returns and K-1's;
- attorneys' and accountants' fees and disbursements;
- taxes and other governmental charges levied against it;
- insurance, regulatory or litigation expenses (and damages), including regulatory expenses of the fund's general partner and the firm;
- expenses incurred in connection with its dissolution, liquidation or winding-up;
- expenses relating to defaults by investors in the payment of any capital contributions;
- expenses for transactions not consummated;
- expenses incurred in connection with any restructuring or amendments to its constituent documents and related entities, including the fund's general partner and the firm;
- expenses incurred in connection with the formation of alternative investment vehicles to the extent permitted under the fund's constituent documents or in any side letter entered into with an investor;
- fees and expenses payable to any fund administrator;
- expenses incurred in connection with distributions to investors and in connection with any meetings with investors called by the fund's general partner;
- expenses incurred in connection with the fund's obligation to indemnify the firm;
- litigation expenses;
- any amounts paid by the fund for, or resulting from, hedging transactions; and
- such other expenses as are set forth in the fund's private placement memorandum and/or limited partnership agreement.

Fee income, including commitment fees, break-up fees, directors' fees and similar income realized with respect to investments or proposed investments by a fund, will first be applied to unreimbursed out-of-pocket expenses related to the applicable transaction; any excess amount will be used to reduce the applicable investment management fee otherwise payable by the fund's investors by an identical amount.

Public funds generally bear the same expenses as the private funds and bear certain additional expenses, to the extent incurred, because they are registered investment companies, including:

- listing fees;
- dues and expenses incurred in connection with membership in investment company organizations;
- fees and expenses of transfer agents and registrars;
- expenses for portfolio pricing services by a pricing agent;

- expenses in connection with the issuance, offering and underwriting of shares issued;
- expenses relating to investor and public relations;
- expenses of registering or qualifying securities for public sale;
- expenses of preparation and distribution of reports, notices and dividends to shareholders;
- expenses of a dividend reinvestment plan;
- costs of stationery; and
- costs of shareholders' and other meetings.

Separately Managed Accounts

The expenses borne by separately managed accounts are set forth in their agreements with us and generally include all custodial fees, brokerage commissions, clearing fees, interest and withholding or transfer taxes incurred in connection with trading for the client's account.

For more information regarding our brokerage practices and brokerage expenses that may be incurred, please see Item 12.

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

As discussed in Item 5 above, the private funds we advise generally pay incentive allocations or carried interest, depending upon the fund's investment strategy. Incentive allocations or carried interest are calculated as a percentage of profits of the funds. Some funds pay incentive allocations, in whole or in part, on mark-to-market performance at the end of a period (year-end or upon a partial or full withdrawal), subject to a high watermark. Other funds pay a carried interest on realized returns. Such carried interest payments are not paid to us until investors receive 100% of their capital back plus a preferred return. Incentive allocations and carried interest rates may be negotiable.

We also serve as the investment adviser to certain accounts that pay us an asset-based fee and not a performance-based fee. As a result we have a conflict of interest, because we can potentially receive greater fees from accounts having a performance fee structure than from those accounts we charge asset-based fees only. We have an incentive to:

- direct the best investment ideas to, or allocate or sequence trades in favor of, the accounts that pay performance-based fees;
- use trades by an account that does not pay performance-based fees to benefit accounts that do pay performance-based fees, such as where the performance-based fee paying account sells short before a sale by the account that does not pay performance-based fees, or the performance-based fee paying account sells a security only after an account that does not pay performance-based fees has made a large purchase of the security; and
- benefit an account that pays performance-based fees over an account that does not pay performance-based fees and which has a different and potentially conflicting investment strategy.

We have a fiduciary duty to our clients not to favor the account of one client over that of another, without regard to the types and amounts of fees paid by those accounts. In light of the conflicts of interest described above, we have allocation and other policies and procedures in place to ensure that accounts are

treated fairly. Generally allocations are made among accounts with a similar strategy that are managed by the same investment team on a *pro rata* basis, based on available cash. However, as described in Item 12, under the heading “Allocation Procedures”, there are a number of reasons for which a particular transaction may not be allocated on a *pro rata* basis. Explanations for variations from the applicable allocation procedure are required to be documented and are subject to the periodic review of our Chief Compliance Officer to ensure that all accounts are being treated fairly.

The public funds we advise are managed using our High Yield strategy and do not pay a performance fee. The public funds invest in securities that are similar to investments that may be held in our private funds in our U.S. Distressed Debt strategy (which do pay a performance fee). In allocating investments between our public funds and our U.S. Distressed Debt private funds, we employ an objective credit threshold test that takes into account the anticipated yield(s) of the relevant investment(s) as a basis for allocation. Although these funds are managed by the same team of investment professionals, the expected risk and return profile for the public funds is lower than for the private funds. Thus, we will allocate investments with a total yield at the time of investment below the credit thresholds to the public funds, and investments with a total yield above the credit thresholds to the private funds.

Item 7. Types of Clients

We serve as the investment manager of, and provide investment advisory services to, investment funds, including private funds and registered investment companies, and to one or more managed accounts. Neither the firm nor any of our affiliates is acting as an investment adviser or otherwise making any recommendation as to an investor’s decision to invest in the funds. With respect to the funds, investment advice is provided directly to the funds and not individually to each of the funds’ limited partners or shareholders, as applicable. With respect to the managed accounts, the investment objective and strategy of each client will not involve a recommendation or determination by us as to the appropriate investment program for such client nor due diligence by us as to such client’s financial condition or risk profile.

The funds’ investors may consist of one or more of the following: individuals, pension and profit sharing plans, financial institutions (including funds of funds), trusts, university endowments, charitable organizations and corporations or other business entities.

Each fund investor or managed account client is required:

- to be a “Qualified Client” as such term is defined in SEC Rule 205-3 under the Investment Advisers Act of 1940;
- to be a “Qualified Purchaser” as such term is defined in Section 2(a)(51) of the Investment Company Act of 1940; and
- to meet such other eligibility requirements as we determine on a case by case basis.

Managed account clients may consist of one or more of the following: individuals, pension and profit sharing plans, financial institutions (including funds of funds), trusts, university endowments, charitable organizations and corporations or other business entities.

There is no minimum size for the funds or managed accounts we advise. The funds have minimum investment amounts ranging from \$2,000 to \$250,000,000. These minimums may be reduced or waived by the general partners of the funds that are partnerships or the board of directors or trustees of the funds that are companies or trusts, subject in certain cases to applicable statutory minimums.

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

Methods of Analysis and Investment Strategies

We pursue a theme-driven, concentrated investment strategy that is analytically intensive and relies upon individual credit, industry and macro research and analysis. In addition to conducting extensive fundamental credit analysis, we may actively participate on creditors' committees and steering committees. For those companies that require a restructuring (in or out of court), we may seek to influence and/or actively drive the reorganization, bankruptcy or restructuring process. Our goal is to select industries that are undergoing periods of rapid change and/or deterioration, which may provide significant investment opportunities as these cycles run their course. Following a disciplined, theme-based strategy allows us to pursue a relatively concentrated portfolio with a limited number of core investments. This results in a portfolio that represents a careful selection of distressed investments within such industries rather than a broader, "indexed" approach. We employ a value investing strategy based on fundamental, proprietary research and comprehensive due diligence. Our due diligence process seeks to uncover hidden value and/or risk, thereby increasing potential returns and reducing the risk of investment loss.

Our investment strategies are grouped into the following categories:

- U.S. Distressed Debt;
- High Yield; and
- Real Estate.

Our U.S. Distressed Debt strategy includes the Control Distressed Investment sub-strategy. Our High Yield strategy includes both private CLO funds and the RIC. Our Real Estate strategy includes private funds.

Funds may use one or more special purpose vehicles to effect a fund investment or in such circumstances as the firm may deem appropriate, including in an effort to increase the tax efficiency of a fund investment or to enable compliance with local investment laws.

Our investment strategies and certain risks associated with our investment strategies are described in this Item 8. Prospective investors in any fund(s) are advised to review the respective funds' private placement memorandum, explanatory memorandum, or confidential offering circular or, in the case of a RIC, the prospectus that is included in the registration statement that has been filed with the SEC, for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

U.S. Distressed Debt Strategy

The firm's U.S. Distressed Debt strategy focuses on the distressed debt and undervalued securities of U.S. companies as well as trade claims of creditors against bankrupt debtors. As a general matter, the U.S. Distressed Debt strategy may invest in real estate debt or equity.

The strategy generally focuses on:

- companies in financial distress or undergoing a turnaround;
- companies in bankruptcy, reorganization or liquidation;
- companies in industries that are in turmoil;
- companies that are undervalued because of discrete extraordinary events; and

- companies whose securities the firm believes to be undervalued.

The U.S. Distressed Debt strategy generally targets:

- restructured and post-reorganization equities;
- event-driven situations;
- trade claims;
- distressed securities;
- high-yield debt; and
- bank debt.

In investing in the distressed debt and undervalued securities of companies, the firm's U.S. Distressed Debt investment professionals seek "good companies with bad balance sheets" - firms with sustainable businesses and positive cash flow but whose financial situation is distressed. Except as discussed below in respect of the firm's Control Distressed Investment sub-strategy, the firm typically does not seek to gain operational control of companies we invest in, but we may have operational control of such companies from time to time. The firm's U.S. Distressed Debt investment professionals generally focus on pre-investment research and analysis and post-investment monitoring, rather than post-investment operating, issues, except in respect of the firm's Control Distressed Investment sub-strategy.

In investing in trade claims, the firm's U.S. Distressed Debt investment professionals seek to make investments in the claims of creditors against bankrupt debtors arising out of the ordinary course of business, ranging from obligations owed to creditors by such debtors for goods and services delivered prior to the filing of a bankruptcy, to causes of action against debtors for failure to honor prospective contracts. Investments may include, among others:

- wage claims;
- tax claims;
- environmental claims;
- personal injury claims;
- contract rejection claims;
- government claims;
- claims for administrative expenses;
- lease claims;
- investments in other claims, including securitized lease receivables and equipment note payments; and
- participations in vendor financing, asset-based lending and factoring, including purchasing accounts receivable against companies at a discount and writing put contracts.

The firm's Control Distressed Investment sub-strategy seeks to make investments in a variety of securities and assets, including, but not limited to:

- bank debt;

- bonds;
- preferred stock;
- trade claims; and
- common equity.

Investments will generally be made in the financial instruments believed by the firm at the time of investment to be the fulcrum or controlling instrument of a company anticipated to file for bankruptcy protection and/or otherwise restructure. The firm may also target or structure new investment instruments that would afford the firm control or influence over a restructuring process. In general, this sub-strategy seeks to make investments in debt and equity instruments that the firm believes will provide for an opportunity to influence or control in a company's restructuring, reorganization or bankruptcy. The firm anticipates that the portfolio of the fund(s) pursuing a Control Distressed Investment sub-strategy will be highly concentrated.

As a general matter, we do not use fund-level leverage as part of our U.S. Distressed Debt strategy, although we may in the future, but we do invest in asset classes (derivatives and options) that include implicit leverage.

Prospective investors in any of our funds employing our U.S. Distressed Debt strategy are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

High Yield Strategy

The firm's High Yield strategy encompasses the RIC as well as our private funds investing in collateralized loan obligations, or CLOs. The RIC generally uses leverage as an integral part of that strategy, although there can be no assurance that it will do so, and the CLO funds will use inherent leverage appurtenant to derivative instruments. The RIC's primary investment objectives are to seek a high level of current income, with a secondary objective of capital appreciation. We seek to achieve these objectives by opportunistically investing primarily in credit obligations, including senior secured floating rate and fixed rate loans of issuers which operate in a variety of industries and geographic regions, and in companies that we believe have strong leadership, stable cash flow and improving credit performance. This strategy is actively managed.

During normal market conditions, the RIC seeks to invest at least 80% of its assets in:

- senior secured floating rate and fixed rate loans (*i.e.*, securities that are rated below investment grade by a nationally recognized credit rating organization, or unrated securities that are deemed to be of comparable quality, which are commonly known as "junk" securities and are regarded as predominantly speculative with respect to the issuer's capacity to pay interest and repay principal);
- second lien or other subordinated or unsecured floating rate and fixed rate loans or debt (including those that, at the time of investment, could be considered "junk" securities as described above);
- other debt obligations, including high-yield, high-risk obligations (*i.e.*, instruments that are commonly known as "junk" securities as described above);

- structured products, including collateralized debt and loan obligations that increase or decrease exposure to credit obligations;
- swaps and other derivative instruments (including credit default, total return, index and interest rate swaps, options, forward contracts, futures contracts and options on futures contracts) that increase or decrease exposure to credit obligations; and
- short-term debt securities such as U.S. government securities, commercial paper and other money market instruments and cash equivalents (including shares of money market funds).

During normal market conditions, the RIC may also invest up to 20% of its assets in:

- structured products that do not increase or decrease exposure to credit obligations;
- swaps and other derivative instruments (including total return, index and interest rate swaps, options, forward contracts, futures contracts and options on futures contracts) that do not increase or decrease exposure to credit obligations;
- foreign currencies and foreign currency derivatives (including foreign currency related swaps, futures contracts and forward contracts) acquired for the purpose of hedging currency risk; and
- equity securities obtained through the conversion or exchange of convertible or exchangeable instruments, debt restructurings or bankruptcy proceedings and hedges on such positions.

Through our CLO strategy, we seek to invest in companies we believe have strong leadership, stable cash flow and improving credit performance. The CLO strategy's investments consist primarily of:

- relatively liquid, large non-investment grade syndicated commercial loans, including participation and assignment interests in loans; or
- high yield corporate and other debt obligations, including synthetic securities, of corporations, partnerships, limited liability companies, trusts, the US government or other sovereign issuers.

The CLO strategy is actively managed and generally seeks to target companies with:

- dominant market share;
- appropriate capital structure;
- significant asset/franchise value;
- high industry barriers to entry; and
- strong strategic sponsorship.

Prospective investors in any of our funds employing our High Yield strategy are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular or, in the case of the RIC, the prospectus that is included in the registration statement that has been filed with the SEC, for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

Real Estate Strategy

The firm's Real Estate strategy seeks U.S.-focused opportunistic real estate investments. Investments may take the form of, or include, among others:

- direct or indirect interests in real property;
- joint ventures and other vehicles for the acquisition of real estate assets (including the acquisition of debt and equity interests in joint ventures);
- acquisition or origination of mezzanine debt, mortgage loans and other real estate-backed indebtedness and other indebtedness of entities that own interests in real estate or are otherwise engaged in real estate-related businesses; and
- investments in public or private real estate investment trusts, pooled investment funds or other real estate-related companies (including management, brokerage, development, financing or other operating companies).

The Real Estate strategy's investment focus includes, among others, residential, office, retail, industrial and hotel properties. Our private funds that pursue the Real Estate strategy may have primary management responsibility over certain of the real estate assets in which they invest. In some instances, we may invest with, or lend to, operating partners who will have primary responsibility for the day-to-day execution of the investment business plan for a particular real estate asset. We may also co-invest with other financial partners with whom the firm's principals have strong relationships.

The Real Estate strategy generally focuses on:

- situations, as opposed to trends, as well as complex "difficult to understand" transactions;
- residential, office, retail, hotel and industrial properties; and
- value-added, redevelopment, special situation or independently sourced opportunities.

The firm's Real Estate strategy investment professionals focus on real estate investments and institutional-quality underwriting. Investments may include activist and joint venture opportunities. The strategy may also purchase real estate-related non-performing and performing debt, partnership interests, or public securities. The strategy may also provide liquidity to recapitalizations and may invest in distressed situations that allow for turnaround opportunities.

As a general matter, we do not use leverage as part of our Real Estate strategy, although we may in the future.

Prospective investors in any of our funds employing our Real Estate strategy are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

Risks Associated with the Firm's Investment Strategies

The investment strategies described above that we use for the funds cover a wide range of investment types. Material risks involved in our investment strategies are described below. Prospective investors in any fund are advised to review the fund's private placement memorandum, explanatory memorandum, or confidential offering circular or, in the case of a RIC, the prospectus that is included in the registration

statement that has been filed with the SEC, for a more in-depth description of that fund's investment strategy and objectives and related risk factors.

Conflicts of Interest

An investment in a fund or managed account involves certain potential conflicts of interest, including those described below.

Other Clients. In addition to responsibilities with respect to the management and investment activities of any particular fund or managed account, the firm will have similar responsibilities with respect to various other existing and future pooled investment vehicles and client. The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

Investment Activities of Funds and Other Clients; Allocation of Investment Opportunities Among Funds and Other Clients. The firm conducts the various funds' investment programs in a manner that is similar to the investment programs of other clients, particularly where the investment objectives and policies of various clients overlap. As a result, there may be conflicts between clients with respect to the allocation of investment opportunities. See Item 12 ("Brokerage Practices") below for a description of how the firm addresses such potential or action conflicts.

Combined Orders; Nominee Arrangements. If the firm has determined to invest at the same time for one or more Other Clients, the firm will generally place combined orders for all such accounts simultaneously and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one vehicle or account cannot be fully executed under prevailing market conditions, the firm will allocate the investments among the different vehicles or accounts on a basis that it considers equitable. Situations may occur where a client could be disadvantaged because of the investment activities conducted by investment managers for other clients. A fund may also serve as a nominee or hold securities as a nominee for the other Avenue funds and any other client that is participating in an investment alongside the fund.

Time Commitment. The firm and its principals and their respective affiliates are not obligated to devote any specific amount of time to the affairs of any fund or managed account. The principals and their respective affiliates spend substantial time on other business activities, including those related to the other Avenue clients. The firm's senior principals and their affiliates currently engage in and will be free to continue to engage in investment activities for their own accounts.

Agreements with Certain Investors in Private Funds. The funds, the firm and their respective affiliates have and may from time to time in the future enter into agreements with one or more investors whereby in consideration for agreeing to invest certain amounts in a fund and other consideration deemed material to the fund, such investors may be granted rights not otherwise afforded to other investors, including, without limitation, the right to receive reports from the fund on a more frequent basis or to receive reports that include information not provided to other investors, the right to pay a reduced carried interest and/or investment management fee, the right to receive a share of the carried interest and/or investment management fee earned by the firm or its affiliate and such other rights as may be negotiated between the funds, the firm and their respective affiliates, on the one hand, and such investor, on the other hand. Such agreements will have the effect of establishing rights under, or altering or supplementing the terms of, the fund's constituent documents with respect to such investors.

Agreements with Certain Managed Account Clients. The firm and its respective affiliates provide advice to one or more managed accounts. These managed accounts invest side-by-side (*i.e.*, in parallel) with one or more of the funds managed by the firm and may invest alongside the funds managed by our affiliates. The agreements entered into with managed account clients grant rights not afforded to other

clients or to fund investors. Such rights may, and in certain cases do, include, without limitation, increased transparency (*e.g.*, the right to receive reports regarding the managed account on a more frequent basis or to receive reports that include information not provided to other clients or fund investors), the right to withdraw capital on a more frequent basis than other clients or fund investors, the right to terminate the managed account on short notice and such other rights as may be negotiated between the firm and its respective affiliates, on the one hand, and such client, on the other hand. In addition, the fees and expenses paid by managed account clients may be less, in some cases substantially less, than those paid by other clients or by the funds and the investors in the funds.

Transactions with Affiliates. A client may engage in transactions with the firm or its affiliates. The firm may cause a fund or managed account to engage in cross trades. The value of any affiliated transactions or any cross trades with any affiliated funds will be determined in a manner that is consistent with the fair valuation methodologies that are used by the firm.

Discounted Products and Services from Portfolio Companies. Certain portfolio companies may offer product and service discounts from time to time to employees of the firm and its affiliates. For example, in order to encourage greater knowledge and understanding of their products and services, or as a general matter for friends and family, certain hospitality-related portfolio companies of a fund and existing other clients from time to time provide discounted hotel room rates to employees of the firm and its affiliates.

Investments Involving Other Clients. A client may, from time to time, make an investment in a portfolio company in which one or more other clients invests in a different part of the capital structure. There may be instances where such a portfolio company may become insolvent or bankrupt and where a fund's and the firm's other clients' interests in such portfolio company may conflict. To the extent that a fund holds securities in a portfolio company with rights, preferences and privileges that are different than those held by other clients in the same portfolio company, the firm and its affiliates may be presented with decisions when the interests of a fund and the firm's other clients are in conflict. It is possible that in a bankruptcy proceeding, a fund's interest may be subordinated or otherwise adversely affected by virtue of the firm's other clients' involvement and actions relating to its investment. As a result, there may be conflicts between clients with respect to voting the securities of such issuers and other matters relating to various investments. See Item 11 ("Code of Ethics, Participation or Interest in Client Transactions and Personal Trading – Participation or Interest in Client Transactions") and Item 17 ("Voting Client Securities") for a description of how the firm addresses such potential or actual conflicts.

Diverse Investment Management Firm. The firm and the other investment managers that make up Avenue engage in a broad range of investment management activities, including sponsoring and managing other pooled investment vehicles, client accounts and other activities. Although the relationships and activities of the Avenue managers should enable these entities to offer attractive opportunities and services to their clients, such relationships and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the Avenue managers conflict with the interests of certain of Avenue's clients, including, without limitation, competition with other investment vehicles (proprietary or third-party managed) in which clients may have an interest, purchasing and selling investments in entities in which clients may have an interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of certain clients.

Other Activities. None of the firm or any of its principals are required to manage the investments of any particular client as their sole and exclusive function and each may engage in other business ventures and other activities unrelated to the affairs of any client, including directly or indirectly purchasing, selling, holding or otherwise dealing with any securities for the account of other investment funds, for their own accounts or for the accounts of their family or other clients. Without limiting the foregoing, the firm's

principals may invest in, participate on advisory boards of and/or provide other services to, funds that are unaffiliated with the firm and its family of funds. The firm and/or its principals may become aware of business opportunities in which clients will not be given an opportunity to participate.

Investment Management Fee; Incentive Allocation and/or Carried Interest. The investment management fees and the incentive allocations or carried interest borne by funds have generally not been established on the basis of an arm's-length negotiation between the fund, on the one hand, and the firm or its affiliates, on the other hand. However, the firm's principals believe that the investment management fees, and the terms of the incentive allocations or carried interest, generally reflect prevailing market terms. The existence of an incentive allocation or carried interest may create an incentive for the firm to cause a fund to make, more speculative investments than it would otherwise make in the absence of such performance-based compensation. In addition, the investment management fees will be charged on capital contributions that have not yet been drawn or redistributed. In the case of a fund that pays carried interest on drawn capital, which may create an incentive for a fund to draw down capital more quickly.

Although an incentive allocation, such as is paid to the general partners of certain of our private funds, has largely become a customary standard for private investment funds, this type of relative allocation of profits and losses can be characterized as creating an incentive to the general partner for speculative investment and thus a potential conflict with the interests of the limited partners. In addition, since the incentive allocation of certain of our private funds (our hedge funds) is based upon portfolio gains, both realized and unrealized (net of realized and unrealized losses), it is possible that the general partner may receive an incentive allocation based upon unrealized appreciation in particular positions that was not in fact achieved upon disposition of such positions. Further, while the general partner is entitled to receive an incentive allocation based upon the realized and unrealized net profits initially allocated to each limited partner, it is allocated net losses solely on the basis of its invested capital.

The firm believes that (i) a "waterfall" in which the investors in certain of our U.S. Distressed Debt funds (our funds that are structured like private equity funds) must receive a full return of cash contributions and a preferred return thereon prior to the fund's general partner's receipt of any carried interest and (ii) alignment of the general partner's interests with those of the limited partners by the general partner's investment of its own capital alongside the limited partners' capital, are important safeguards that help to mitigate potential and actual conflicts of interest. There can be no assurance, however, that certain investment decisions made with respect to a fund and one or more other clients will not adversely affect the fund or its limited partners, even if such investment decisions are made in good faith. In addition, it is often difficult to anticipate or predict all circumstances under which the interests of a fund's general partner and the firm may conflict with investors in the fund, the fund itself or other clients.

Diverse Investors. Each fund's investors may include taxable and tax-exempt entities and persons or entities resident of or organized in various jurisdictions. As a result, conflicts of interest may arise in connection with decisions made by the firm or an affiliate that may be more beneficial for one type of investor. In making such decisions, the firm and its affiliates intend to consider the investment objectives of the fund as a whole, not the investment objectives of any investor individually.

Minority Investor in Avenue Capital Group. In the ordinary course of a fund's investment activities, from time to time the fund may enter into transactions with parties related to Morgan Stanley, which is an affiliate of Avenue. Such transactions may include, among other things, the fund purchasing securities from, or settling trades with, a party related to Morgan Stanley.

Risks Related to Our Investment Strategies

Risks Associated With Market Conditions And Investment Opportunities

General Economic Conditions and Recent Events. Various sectors of the global financial markets have been experiencing an extended period of adverse conditions. Since 2007, market uncertainty in the United States has increased dramatically and adverse market conditions have expanded to other markets. These conditions have resulted in reduced liquidity, greater volatility, general widening of credit spreads and a lack of price transparency. These difficult global credit market conditions have adversely affected the market values of equity, fixed-income and other securities and these circumstances may continue or even deteriorate further. The short- and longer-term impact of these events is uncertain, but could have a material effect on general economic conditions, consumer and business confidence and market liquidity. Investments made by the funds are expected to be sensitive to the performance of the overall economy. A negative impact on economic fundamentals and consumer and business confidence would likely increase market volatility and reduce liquidity, both of which could have a material adverse effect on the performance of the funds and these or similar events may affect the ability of the funds to execute their investment strategies.

In recent periods the SEC, the Commodity Futures Trading Commission (“CFTC”) and Congress have devoted increased attention to the issue of whether hedge funds, fund of funds, and other private investment vehicles should be subject to increased or different modes of regulation. On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, among other things, imposes registration requirements on many investment advisers to hedge funds, private equity funds and other private investment funds that are presently exempt from registration with either the SEC or the states, imposes new recordkeeping and reporting requirements on many fund advisers, and makes certain other changes to the regulatory landscape affecting investment advisers and private investment funds. As a consequence of amendments to the CFTC rules, the firm, its affiliates and its funds may be required to register with the CFTC as a commodity pool operator or commodity trading advisor in the future. Future changes in applicable securities laws or regulations could impose additional compliance or financial burdens upon the firm or its clients, including funds managed by the firm, or affect their operations in other respects.

Market Disruptions. The funds may incur major losses in the event of market disruptions and other extraordinary events in which historical pricing relationships (on which we base a number of the funds’ trading positions) become materially distorted. The risk of loss from pricing distortions is compounded by the fact that in disrupted markets many positions become illiquid, making it difficult or impossible to close out positions against which the markets are moving. Certain of Avenue’s previous investments have benefited from favorable borrowing conditions in the debt markets, which historically have been cyclical. The financing available to the funds from their banks, dealers and other counterparties is typically reduced during market disruptions. Market disruptions caused by unexpected political, military and terrorist events may from time to time cause dramatic losses for the funds and such events can result in otherwise historically low-risk strategies performing with unprecedented volatility and risk.

Availability of Suitable Investments. While we believe that many attractive investments of the type in which the funds invest are currently available, there can be no assurance that such investments will continue to be available or that available investments will continue to meet the funds’ investment criteria. Furthermore, the funds may be unable to find a sufficient number of attractive investment opportunities to meet their investment objectives. Past performance is not necessarily indicative of future performance.

Competition. The markets for securities in the funds’ investment programs are highly competitive. The funds will be competing for investment opportunities with a significant number of financial institutions and other private funds as well as various institutional investors. Some of these competitors are larger

and have greater financial, human and other resources than the funds and may in certain circumstances have a competitive advantage over the funds. As a result of this competition, there may be fewer attractively priced investment opportunities than in the past, which could have an adverse impact on the ability of the funds to meet their investment goals or the length of time that is required for the funds to become fully invested. There can be no assurance that the returns on any fund's investments will be commensurate with the risk of investment in the fund.

No Assurance of Investment Return. The funds' task of identifying and evaluating investment opportunities, managing such investments and realizing a significant return for investors is difficult. Many organizations operated by persons of competence and integrity have been unable to make, manage and realize a profit on such investments successfully. Avenue believes that its investment strategy and investment approach moderate this risk through a careful selection of securities and other financial instruments. However, there is no assurance that the funds will be able to invest their capital on attractive terms or generate returns for their investors. Investors in the funds could experience losses on their investment.

Risks Associated with the Firm's Investments and Investment Activities

Nature of Investments. Our investment strategy involves investing in senior and subordinated, secured or unsecured, debt obligations, securities and assets that are inefficiently priced as a result of business, financial, market or legal uncertainties. The level of analytical sophistication, both financial and legal, necessary for successful returns on such investments is unusually high. There can be no assurance that we will evaluate correctly the nature and magnitude of the various factors that could affect the value of these investments.

In particular, the funds will purchase securities and other obligations of companies that are experiencing significant financial or business distress, including companies involved in bankruptcy or other reorganization and liquidation proceedings. Many of these securities typically remain unpaid unless and until the company reorganizes and/or emerges from bankruptcy proceedings. In addition, it frequently may be difficult to obtain information as to the conditions of these securities. The market prices of these securities are also subject to abrupt and erratic market movements and above average price volatility, and the spread between the bid and asked prices of such securities may be greater than normally expected. Although such investments may result in significant returns to the funds, they involve a substantial degree of risk and may not show any return for a considerable period of time, if at all.

Distressed investment opportunities can occur in companies that have filed for, or plan to file for, reorganization under Chapter 11 of the U.S. Bankruptcy Code. Sourcing, diligence, structuring and governance of private distressed investments require consideration of factors that are often not present in standard private equity investing or investments in the senior and secured debt of financially sound companies. If our evaluation of the anticipated outcome of an investment situation should prove incorrect, the funds could experience losses. Successful investing requires a specialized skill set that includes:

- the capacity to accurately value a company's assets and analyze its capital structure;
- a sophisticated knowledge of the complex legal environment in which such investing occurs, particularly bankruptcy, securities, corporate and indenture law;
- the experience necessary to determine accurately the financial interests and legal rights of the debtor and each of its creditor constituencies; and
- refined negotiating skills.

A wide variety of considerations makes any evaluation of the outcome of an investment in a financially distressed company uncertain. These considerations include the possibility of litigation between the participants in a reorganization or liquidation proceeding or a requirement to obtain consents from governmental authorities or others, as well as numerous other factors. In addition, we may not have access to reliable and timely information concerning material developments affecting a company. The uncertainties inherent in evaluating such investments may be increased by legal and practical considerations which limit our access to reliable and timely information concerning material developments affecting an investment, or which cause lengthy delays in the completion of a reorganization or liquidation proceeding. Competition from other investors may also render it unadvisable for us to pursue intended results or promptly effect transactions.

Troubled company and other asset-based investments require active monitoring and will, at times, require participation in business strategy or reorganization proceedings by Avenue. To the extent that Avenue becomes involved in such proceedings, the funds may have a more active participation in the affairs of the issuer. In addition, involvement by Avenue in a company's reorganization proceedings could result in the imposition of restrictions limiting a fund's ability to liquidate its position in the securities of the company.

A portion of the funds' investments may be in obligations or securities that are rated below investment grade by recognized rating services such as Moody's and Standard & Poor's. Securities rated below investment grade and unrated securities generally offer a higher current yield than that available from higher grade issues but typically involve greater risk. The value of securities rated below investment grade and unrated securities is typically sensitive to adverse changes in general economic conditions and changes in the financial condition of their issuers and subject to price fluctuation in response to changes in these conditions or in interest rates. During periods of economic downturn or rising interest rates, issuers of securities rated below investment grade and unrated instruments may experience financial stress that could adversely affect their ability to make payments of principal and interest and increase the possibility of default. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may also decrease the values and liquidity of securities rated below investment grade and unrated securities, especially in a market characterized by a low volume of trading. In addition, the secondary market for high yield securities, which is concentrated in relatively few market makers, may not be as liquid as the secondary market for more highly rated securities. As a result, the funds could find it more difficult to sell these securities or may be able to sell the securities only at prices lower than if such securities were widely traded. The prices quoted by different dealers may vary significantly, and the spread between the bid and asked price is generally much larger for high yield securities than for higher quality instruments. Under continuing adverse market or economic conditions, the secondary market for high-yield securities could contract further, independent of any specific adverse changes in the condition of a particular issuer, and these securities may become illiquid.

To the extent that a secondary market does exist for debt obligations, including senior secured floating rate and fixed rate loans and subordinated or unsecured loans, the market is more volatile than for liquid, listed securities and may be subject to irregular trading activity, wide bid/ask spreads and extended trade settlement periods. Markets for other investments of the funds, including derivative instruments, bonds, currencies and other instruments can also be highly volatile. Purchasers of leveraged loans are predominantly commercial banks, investment funds and investment banks. As secondary market trading volumes increase, arrangers and obligors of new leveraged loans are frequently adopting standardized documentation to facilitate trading that should improve market liquidity. There can be no assurance, however, that the current level of liquidity will continue or that future levels of supply and demand in leveraged loan trading will provide an adequate degree of liquidity. No assurance can be given that a fund that purchases a leveraged loan will be able to sell that loan if the obligor has deteriorated in credit quality. Even in the absence of a default with respect to any leveraged loan, due to potential market volatility, the market value of such loan at any time will vary, and may vary substantially, from the price

at which such loan was initially purchased and from the principal amount of such loan. The market value of leveraged loans will generally fluctuate with, among other things, the financial condition of the obligors of the loans, general economic conditions, the condition of certain financial markets, political events, developments or trends in any particular industry and changes in prevailing interest rates. No assurance can be given as to the amount of proceeds of any sale or disposition of any leveraged loan, or that the proceeds of any such sale or disposition would be sufficient to repay principal of and interest or other amounts due on the notes that may have been issued by a fund using such leveraged loan as collateral, and/or pay other amounts payable prior thereto.

The funds may invest in securities which are subject to legal or other restrictions on transfer or for which no liquid market exists, or acquire illiquid securities, *e.g.*, through bankruptcy reorganization proceedings. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the over-the-counter markets. Restricted securities may sell at a price lower than similar securities that are not subject to restrictions on resale. Because the markets for such securities are still evolving, liquidity in these securities is limited and liquidity with respect to lower-rated and unrated subordinated classes may be even more limited. The funds may be unable to liquidate all or a portion of their positions in such securities. In addition, the market prices, if any, for such securities tend to be more volatile and the funds may not be able to realize what it perceives to be their fair value in the event of a sale. The high yield securities markets have suffered periods of extreme illiquidity for certain types of instruments in the past. For these reasons, among others, calculating the fair market value of the funds' holdings may be difficult. The funds may, in their discretion, utilize the assistance of internal or external pricing services or valuation sources in calculating such fair market values when and if available.

Debt investments are subject to credit and interest rate risks. "Credit risk" refers to the likelihood that an issuer will default in the payment of principal and/or interest on an instrument. Financial strength and solvency of an issuer are the primary factors influencing credit risk. In addition, lack or inadequacy of collateral or credit enhancement for a debt instrument may affect its credit risk. Credit risk may change over the life of an instrument, and debt obligations, which are rated by rating agencies, are often reviewed and may be subject to downgrade. Senior loans, like most other debt obligations, are subject to credit risks of default. In addition, because second lien or other subordinated or unsecured loans or debt are subordinated in payment and/or lower in lien priority to senior loans, they are subject to additional risk that the cash flow of the borrower and property securing the loan or debt, if any, may be insufficient to meet scheduled payments after giving effect to the senior secured obligations of the borrower. This risk is generally higher for subordinated unsecured loans or debt, which are not backed by a security interest in any specific collateral.

"Interest rate risk" refers to the risks associated with market changes in interest rates. Interest rate changes may affect the value of a debt instrument indirectly (especially in the case of fixed rate debt securities) and directly (especially in the case of debt instruments whose rates are adjustable). In general, rising interest rates will negatively impact the price of a fixed rate debt instrument and falling interest rates will have a positive effect on price. Adjustable rate instruments also react to interest rate changes in a similar manner although generally to a lesser degree (depending, however, on the characteristics of the reset terms, including the index chosen, frequency of reset and reset caps or floors, among other factors). Interest rate sensitivity is generally more pronounced and less predictable in instruments with uncertain payment or prepayment schedules. In addition, interest rate increases generally will increase the interest carrying costs to the funds of borrowed securities and leveraged investments (*e.g.*, derivative transactions). If interest rates fall, it is possible that issuers of fixed income securities with high interest rates will prepay or "call" their securities before their maturity dates. In this event, the proceeds from the

prepaid or called securities would likely be reinvested in securities bearing the new, lower interest rates, resulting in a possible decline in the funds' income.

In addition, the funds may agree to buy or sell bank claims or other similar private paper, with an understanding that formal written contracts for the purchase or sale will be prepared at a later date. The terms of these contracts may be less favorable than the funds anticipated. In some circumstances, they may be so unfavorable that a fund decides to terminate a proposed transaction.

The funds may from time to time make investments in securities of private companies without an active trading market. Traditional exit opportunities for such investments have consisted primarily of initial public offerings and acquisitions of portfolio companies by publicly traded companies, often for stock. The ability of the funds to sell securities and realize investment gains will depend upon favorable market conditions. As recent history indicates, initial public offering and merger and acquisition opportunities may be limited or non-existent for extended periods of time, whether due to economic, regulatory, or other factors. In addition, general fluctuations in the market prices of securities may affect the value of the investments held by the funds. Therefore, there is no assurance that the funds will be able to realize liquidity for such investments in a timely manner, if at all.

The funds' investments may also be adversely affected by changes in economic conditions or political events that are beyond their or our control. For example, a market crash, a war, or the death of a major political figure may have significant adverse effects on the funds' investment results.

Nature of Bankruptcy Proceedings. There are a number of significant risks when investing in companies involved in Chapter 11 cases, including the following:

- Many events in a Chapter 11 case are the product of contested matters and adversary proceedings that are beyond the control of the creditors. While creditors are generally given an opportunity to object to significant actions, there can be no assurance that a bankruptcy court in the exercise of its broad powers would not approve actions that would be contrary to the interests of the funds.
- A Chapter 11 filing may have adverse and permanent effects on a company. For instance, the company may lose its market position and key employees and otherwise become incapable of restoring itself as a viable entity. Further, if the reorganization case becomes a liquidation, the liquidation value of the company may not equal the liquidation value that was believed to exist at the time of the investment.
- The duration of a Chapter 11 case is difficult to predict. A creditor's return on investments can be adversely impacted by delays while the plan of reorganization is being negotiated, voted on by the creditors and confirmed by the bankruptcy court, until it ultimately becomes effective.
- The administrative costs in connection with a Chapter 11 case are frequently high and may be paid out of the debtor's estate prior to any return to creditors. Reorganizations can be contentious and adversarial. It is by no means unusual for participants to use the threat of, as well as actual, litigation as a negotiating technique. We anticipate that Avenue and/or the funds may be named as defendants in civil proceedings. For example, if a proceeding involves protracted or difficult litigation, or turns into a liquidation, substantial assets may be devoted to administrative costs.
- Creditors can be subject to equitable subordination and lose their ranking and priority if they engage in certain inequitable conduct or they exercise "domination and control" over a debtor and other creditors can demonstrate that they have been harmed by such actions, especially in the case of investments made prior to the commencement of Chapter 11 cases.

- Bankruptcy law permits the classification of “substantially similar” claims in determining the classification of claims in a reorganization. Because the standard for classification is vague, there exists the risk that a fund’s influence with respect to the class of securities or other obligations it owns can be lost by increases in the number and amount of claims in that class or by different classification and treatment.
- In the early stages of the Chapter 11 case, it is often difficult to estimate the extent of, or even to identify, any contingent claims that may be made.
- Certain claims, such as claims for taxes, may have priority by law over the claims of certain creditors.

Concentration. Because a significant portion of a fund’s aggregate capital commitments may be invested in a single company, any single loss may have a significant adverse impact on the fund’s capital. Accordingly, the fund’s assets may be subject to greater risk of loss than if they were more widely diversified since the failure of one or a limited number of investments could have a material adverse effect on the fund. The funds generally are not subject to any requirement to diversify by industry. Moreover, given the research intensive nature of the firm’s U.S. Distressed Debt strategy, the exposure of certain of the funds will be highly concentrated in financially troubled or distressed companies and the aggregate return of the funds may be substantially adversely affected by the unfavorable performance of the overall relative performance of the distressed sector. Concentration in financially troubled or distressed companies may subject the funds to greater volatility than a more diversified portfolio of investments. In addition, because any fund may invest a higher percentage of its assets in a relatively small number of issuers, each fund is more susceptible to any single economic, market, political or regulatory event affecting those issuers than is a more broadly diversified fund.

Limited Number of Investments. Because a fund may only make a limited number of investments and such investments generally will involve a high degree of risk, poor performance by even a single portfolio company could severely affect the total returns to investors. Other than as set forth in the funds’ private placement memoranda or a RIC’s prospectus, investors have no assurance as to the degree of diversification of the funds’ investments, either by geographic region, asset type or sector. To the extent the funds concentrate portfolio investments in a particular issuer, security or geographic region, their portfolio investments will become more susceptible to fluctuations in value resulting from adverse economic or business conditions with respect thereto. As a consequence, the aggregate return of a fund may be adversely affected by the unfavorable performance of one or a small number of portfolio investments. Moreover, because it is not reasonable to expect all of a fund’s investments to perform well or even return capital, for a fund to achieve above-average returns one or a few of its investments must perform very well. There are no assurances that this will be the case.

Control Investments and Provision of Managerial Assistance. The funds may make control investments in issuers, obtain rights to participate substantially in and to influence substantially the conduct of the management of issuers or obtain rights to designate directors (and non-executive chairmen) to serve on the boards of directors of issuers. Control investments, or the obtaining of these rights, could expose the funds to risk of claims by issuers and their security holders and creditors, risk of liability for environmental damage, product defect, failure to supervise management, violation of governmental regulations and other types of liability, in which the limited liability characteristic of business operations may be ignored.

The funds may also be exposed to risk in connection with the disposition of control investments. Disposition of these investments may be more difficult than if the firm did not have a close relationship with the issuer. The funds may be required to make representations and warranties about the business and financial affairs of the investments typical of those made in connection with the sale of any business, or may be responsible for the contents of disclosure documents under applicable securities law. The funds

may also be required to indemnify the purchasers of such investment or underwriters to the extent that any such representations and warranties or disclosure documents turn out to be incorrect, inaccurate or misleading. These arrangements may result in contingent liabilities, which will be borne by the funds and such liabilities may exceed the value of the funds' investments.

In addition, the funds may not be able to dispose of these investments when they desire to do so. Some of these investments may be subject to legal or contractual restrictions on resale by the funds. In some instances, the disposition of these investments may require lengthy negotiations and/or take extended periods of time to complete.

Risk of Minority Positions. The funds may hold minority positions in issuers. Accordingly, the funds may not be able to exercise control over such issuers. In addition, in certain situations, including where the issuer is in bankruptcy or undergoing a reorganization, minority investors may be subject to the decisions taken by majority investors and the outcome of the funds' investments may depend on such majority controlled decisions, which decisions may not be consistent with the funds' objectives.

Investments in Pooled Investment Vehicles. A fund may acquire interests in other pooled investment vehicles that pursue various investment strategies, and invest in various asset classes. The fund may not participate in the management and control of such pooled investment vehicles or their underlying investments and may not have the opportunity to evaluate the specific investments made by them. In addition, both the fund and such pooled investment vehicles are likely to impose performance-based allocations or fees, management fees and other expenses, which would result in greater expense than if the fund invested directly in the investments of such pooled investment vehicles.

Non-U.S. Investments. Non-U.S. investments may involve certain special risks, including the following:

- political, social or economic instability;
- the unpredictability of international trade patterns;
- the possibility of non-U.S. governmental actions such as expropriation, nationalization or confiscatory taxation;
- the imposition or modification of exchange controls; price volatility;
- the imposition of withholding taxes on dividends, interest and gains;
- fluctuations in currency exchange rates;
- different bankruptcy laws and customs; and
- different legal systems and laws relating to creditors' rights.

As compared to U.S. entities, non-U.S. entities generally:

- disclose less financial and other information publicly,
- may be subject to less stringent and less uniform accounting, auditing and financial reporting standards and
- may be subject to less stringent regulatory oversight.

Also, it may be more difficult to obtain and enforce legal judgments against non-U.S. entities than against domestic entities. Non-U.S. markets also have different clearance and settlement procedures which in some markets have at times failed to keep pace with the volume of transactions, thereby creating substantial delays and settlement failures that could adversely affect the funds' performance. Greater tax risks and complexities also may be associated with these investments. The foreign securities in which the

funds may invest may be issued by companies or governments located in emerging market countries. Compared to the United States and other developed countries, emerging market countries may have relatively unstable governments, economies based on only a few industries and securities markets that trade a small number of securities. Securities issued by companies or governments located in emerging market countries tend to be especially volatile and may be less liquid than securities traded in developed countries. The funds are not obligated to engage in any currency hedging operations and there can be no assurance as to the success of any hedging operations that the funds may implement.

Exchange Risk Exposure. Interests in the funds are generally denominated in U.S. dollars and issued in U.S. dollars. Certain of the assets of the funds may, however, be invested in securities and other investments which are denominated in currencies other than U S dollars. Accordingly, the value of such assets may be affected favorably or unfavorably by fluctuations in currency rates. To the extent unhedged, the value of the funds' assets will fluctuate with the U.S. dollar exchange rates as well as the price changes of the funds' investments in the various local markets and currencies. Thus, an increase in the value of the U.S. dollar compared to the other currencies in which the funds make investments will reduce the effect of increases and magnify the U.S. dollar equivalent of the effect of decreases in the prices of the funds' securities in their local markets. Conversely, a decrease in the value of the U.S. dollar will have the opposite effect on the funds' non-U.S. dollar securities. The firm generally intends to hedge the foreign currency exposure of the funds; however, the funds will necessarily be subject to foreign exchange risks. In addition, prospective investors whose assets and liabilities are predominantly in other currencies should take into account the potential risk of loss arising from fluctuations in value between U.S. dollars and such other currencies. The funds may enter into forward contracts to hedge exchange risk exposure.

Counterparty Risk. Some of the markets in which the funds may effect transactions are "over-the-counter" or "interdealer" markets. The participants in such markets are typically not subject to credit evaluation and regulatory oversight as are members of "exchange-based" markets. This exposes the funds to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not bona fide) or because of a credit or liquidity problem, thus causing the relevant fund to suffer a loss. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where a fund has concentrated its transactions with a single or small group of counterparties. The funds are generally not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Moreover, the funds' internal counterparty review process, which evaluates the creditworthiness of their counterparties, may prove insufficient. The lack of a complete and "foolproof" evaluation of the financial capabilities of the funds' counterparties and the absence of a regulated market to facilitate settlement may increase the potential for losses by the funds. Changes in the credit quality of the companies that serve as the funds' counterparties with respect to derivatives, swaps or other transactions supported by the counterparty's credit will affect the value of those instruments. Certain entities that have served as counterparties in the markets for these transactions have recently incurred significant financial hardships including bankruptcy and losses as a result of exposure to subprime mortgages or other lower quality credit investments that have experienced recent defaults or otherwise suffered extreme credit deterioration. As a result, such hardships have reduced such entities' capital and called into question their continued ability to perform their obligations under such transactions. By using derivatives, swaps or other transactions, a fund assumes the risk that its counterparties could experience similar financial hardships. In the event of default by, or the insolvency of, a counterparty, such fund may sustain losses or be unable to liquidate a derivative or swap position.

Systemic Risk. Credit risk may also arise through a default by one of several large institutions that are dependent on one another to meet their liquidity or operational needs, so that a default by one institution causes a series of defaults by the other institutions. This is sometimes referred to as a "systemic risk" and

may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the funds interact on a daily basis.

Current Economic Conditions in European Countries. Certain European countries, including Greece, Ireland, Italy, Portugal and Spain, are currently experiencing varying degrees of financial distress. Risks from the debt crisis in Europe could result in a disruption of the financial markets which could have a detrimental impact on global economic conditions. Recently, contagion fears have expanded to Spain and Italy, and credit spreads widened further in European peripheral countries and European banks. There remains considerable uncertainty as to future developments in the European debt crisis and the impact on global financial markets. A significant deterioration of the European debt crisis could result in material reductions in the value of sovereign debt and other asset classes, disruptions in capital markets, widening of credit spreads, loss of investor confidence in the financial services industry, a slowdown in global economic activity, and other adverse developments that could negatively impact the performance of the funds.

Projections. The funds may make investments relying upon projections developed by the firm, a prospective portfolio company or other third-party source concerning such company's future performance and cash flow. Projections are inherently subject to uncertainty and factors beyond the control of the firm, the portfolio company or such other sources. The inaccuracy of certain assumptions, the failure to satisfy certain financial requirements and the occurrence of other unforeseen events could impair the ability of a portfolio company to realize projected values.

Fraud. Instances of fraud and other deceptive practices committed by senior management of certain companies in which the funds invest may undermine our due diligence efforts with respect to such companies, and if such fraud is discovered, negatively affect the valuation of the funds' investments. In addition, when discovered, financial fraud may contribute to overall market volatility, which can negatively impact the funds' investment programs.

Risks Associated with the Firm's Investments

Bank Loans, Participations and Assignments. The firm's investment program may include investments in significant amounts of bank loans purchased by assignment or by participation. These obligations are subject to unique risks, including:

- the possible invalidation of an investment transaction as a fraudulent conveyance under relevant creditors' rights laws;
- so-called lender-liability claims by the issuer or creditors of the obligations;
- environmental liabilities that may arise with respect to collateral securing the obligations; and
- limitations on the ability of the funds to directly enforce their rights with respect to participations.

Assignments and participations are sold strictly without recourse to the selling institutions and the selling institutions will generally make no representations or warranties about the underlying loan, the borrowers, the documentation of the loans or any collateral securing the loans. In addition, the funds will be bound by provisions of the underlying loan agreements, if any, that require the preservation of the confidentiality of information provided by the borrower. Because of certain factors including confidentiality provisions, the unique and customized nature of the loan agreement and the private syndication of the loan, loans are not purchased or sold as easily as are publicly traded securities.

Participations

In analyzing each bank loan participation, we compare the relative significance of the risks against the expected benefits of the investment. Successful claims by third parties arising from these and other risks will be borne by the funds.

In the event of the insolvency of the selling institution, a fund, by owning a participation interest, may be treated as a general unsecured creditor of the selling institution and may not benefit from any set off between the selling institution and the borrower. In addition, a fund may purchase a participation interest from a selling institution that does not itself retain any portion of the applicable loan and, therefore, may have limited interest in monitoring the terms of the loan agreement and the continuing creditworthiness of the borrower. When a fund holds a participation interest in a loan it will not have the right to vote under the applicable loan agreement with respect to every matter that arises thereunder and it is expected that each selling institution will reserve the right to administer the loan sold by it as it sees fit and to amend the documentation evidencing such loan in all respects. Selling institutions voting in connection with such matters may have interests different from those of the funds and may fail to consider the interests of the funds in connection with their votes.

Assignments

The purchaser of an assignment of an interest in a loan typically succeeds to all the rights and obligations of the assigning selling institution and becomes a lender under the loan agreement with respect to that loan. As a purchaser of an assignment, a fund generally will have the same voting rights as other lenders under the applicable loan agreement, including the right to vote to waive enforcement of breaches of covenants or to enforce compliance by the borrower with the terms of the loan agreement and the right to set off claims against the borrower and to have recourse to collateral supporting the loan. Assignments are, however, arranged through private negotiations between assignees and assignors and in certain cases the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning selling institution.

Bankruptcy Claims. The funds may invest in bankruptcy claims, including trade claims, which are amounts owed to creditors of companies in financial difficulty. Bankruptcy claims are illiquid, generally do not pay interest and there can be no guarantee that the debtor will ever be able to satisfy the obligation on the claim. The markets in bankruptcy claims are not generally regulated by U.S. federal securities laws or the SEC. Because bankruptcy claims are frequently unsecured, holders of such claims may have a lower priority in terms of payment than certain other creditors in a bankruptcy proceeding. In addition, under certain circumstances, such investments may be adversely affected by laws relating to, among other things, fraudulent conveyances, voidable preferences, lender liability and the bankruptcy court's discretionary power to disallow, subordinate and disenfranchise certain claims.

The trade claims market, in particular, is highly specialized and consists of purchasing the unsecured debt, or the priority and administrative debt, owed to trade vendors by companies in financial distress. Such claims often involve non-economic sellers who lack the expertise to assess the value of their claims in the context of bankruptcy or financial distress and choose to divest them for liquidity purposes. This may allow for the purchase of trade claims at substantial discounts to where *pari passu* unsecured bonds are trading. In addition to the risks otherwise associated with low-quality obligations and inherent in investments in entities experiencing financial distress, the risks associated with trade claims include:

- the possibility that the amount of the claim may be disputed by the obligor,
- difficulties in obtaining information regarding the obligor's true financial condition,

- fraud on the part of the assignor of the claim and
- logistical and mechanical issues that may affect the ability of the fund or its agents to collect on the claim in whole or in part.

DIP Loans. Debtor-in-possession (“DIP”) loans involve a fundamental credit risk based on the borrower’s ability to make principal and interest payments and the inherent risks in the bankruptcy process. DIP loans are subject to a court approval process in which parties-in-interest may be heard but there can be no assurance that the funds would be successful in obtaining favorable results. If our calculations as to the outcome or timing of a reorganization are inaccurate, a company that has filed for bankruptcy may not be able to make payments on a DIP loan on time or at all. In addition, DIP loans may be privately negotiated transactions, each of which has individualized terms. These positions may be illiquid and difficult to value. DIP loans may be subject to price volatility due to various factors including, but not limited to, changes in interest rates, market perception of the creditworthiness of the borrower and general market liquidity.

High Yield Debt Obligations. High yield debt obligations are generally unsecured and may be subordinated to certain other obligations of the obligor thereof. The lower rating of securities in the high yield sector reflects a greater possibility that adverse changes in the financial condition of an obligor or in general economic conditions or both may impair the ability of the obligor to make payments of principal and interest. In addition, the market for high yield debt securities is not liquid at all times and for all obligors. Particular issues may be held by only a few investors, many of such obligations are not registered under the Securities Act, most are not listed on a securities exchange and market-making activity, if any, may cease at any time during the life of such obligations. Due to potential market volatility, the market value of such high yield debt obligations at any time will vary, and may vary substantially, from the price at which such high yield debt obligations were initially purchased and from the principal amount of such high yield debt obligations. No assurance can be given as to the amount of proceeds of any sale or disposition of any high yield debt obligations (whether upon default or otherwise), or that the proceeds of any such sale or disposition would be sufficient to repay principal of and interest or other amounts due on the notes that may have been issued by a fund using such high yield debt obligations as collateral and pay other amounts payable prior thereto in an amount equal to the outstanding principal and accrued and unpaid interest of such high yield debt obligations.

Loan Origination. The funds may seek to originate loans, including, but not limited to, senior, second lien and mezzanine loans and other similar investments. The funds may subsequently offer such investments for sale to third parties; *provided, however*, that, there is no assurance that a fund will complete the sale of such an investment. In determining the target amount to allocate to an originated investment, we may take into consideration the fact that a fund may sell, assign or offer participations in such investment to third parties. Accordingly, if the fund is not successful in offering such participations, this could result in the fund being “overweighted” with respect to a particular borrower.

Investments in Equity Securities. The funds may invest their assets in equity securities, including preferred or common stocks. Investments in equity securities of small or medium-sized market capitalization companies will have more limited marketability than the securities of larger companies. In addition, securities of smaller companies may have greater price volatility. All of the funds’ investments in stocks will be subject to normal market risks. While diversification among issuers may mitigate these risks, investors must expect fluctuations in value of equity securities held by the funds based on market conditions.

Options. The funds may purchase and sell (“write”) options on equities on national and international securities exchanges and in the domestic and international over-the-counter market. The seller (“writer”)

of a put option which is covered (*e.g.*, the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security, plus the premium received and gives up the opportunity for gain on the underlying security below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the option. The buyer of a put option assumes the risk of losing its entire investment in the put option. If the buyer of the put holds the underlying security, the loss on the put will be offset in whole or in part by any gain on the underlying security.

The writer of a call option which is covered (*e.g.*, the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the value of the underlying security less the premium received and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The buyer of a call option assumes the risk of losing its entire investment in the call option. If the buyer of the call sells short the underlying security, the loss on the call will be offset, in whole or in part, by any gain on the short sale of the underlying security.

Options may be cash settled, settled by physical delivery or by entering into a closing purchase or closing sale transaction. In entering into a closing purchase transaction, the funds will be subject to the risk of loss to the extent that the premium paid for entering into such closing purchase transaction exceeds the premium received when the option was written.

Stock Index and Market Options. The funds may also purchase and sell call and put options on stock indices and exchange traded funds (“ETFs”) listed on national securities exchanges or traded in the over-the-counter market for the purpose of realizing their investment objectives or for the purpose of hedging their portfolios. A stock index or ETF fluctuates with changes in the market values of the stocks included in the index or ETF. The effectiveness of purchasing or writing stock index or ETF options for hedging purposes will depend upon the extent to which price movements in the funds’ portfolios correlate with price movements of the stock indices or ETFs selected. Because the value of an index or ETF option depends upon movements in the level of the index or ETF rather than the price of a particular stock, whether the funds will realize gains or losses from the purchase or writing of options on indices or ETFs depends upon movements in the level of stock prices in the stock market generally or, in the case of certain indices or ETFs, in an industry or market segment, rather than movements in the price of particular stocks. Accordingly, successful use by the funds of options on stock indices or ETFs will be subject to our ability to correctly predict movements in the direction of the stock market generally or of particular industries or market segments. This requires different skills and techniques than predicting changes in the price of individual stocks.

Repurchase Agreements and Reverse Repurchase Agreements. A fund may invest in repurchase agreements and reverse repurchase agreements. In its purchase of repurchase agreements, such fund does not bear the risk of a decline in the value of the underlying security unless the seller defaults under its repurchase obligation. In the event of the bankruptcy or other default of a seller of a repurchase agreement, the fund could experience both delays in liquidating the underlying securities and losses, including possible decline in the value of the underlying security during the period while the fund seeks to enforce its rights thereto, possible lack of access to income on the underlying security during this period, and expenses of enforcing its rights.

Credit Derivative Transactions. As part of its investment strategy, a fund may enter into credit derivative transactions. Credit derivatives are transactions between two parties which are designed to isolate and transfer the credit risk associated with a third-party (the “reference entity”). Credit derivative

transactions in their most common form consist of credit default swap transactions under which one party (the “credit protection buyer”) agrees to make one or more fixed payments in exchange for the other party’s (the “credit protection seller”) obligation to assume the risk of loss if an agreed-upon “credit event” occurs with respect to the reference entity. Credit events are specified in the contract and are intended to identify the occurrence of a significant deterioration in the creditworthiness of the reference entity (mainly a default on a material portion of its outstanding obligations, a bankruptcy or a restructuring of its debt). Upon the occurrence of a credit event, credit default swaps may be cash settled (either directly or by way of an auction) or physically settled. If the transaction is cash settled, the amount payable by the credit protection seller following a credit event will usually be determined by reference to the difference between the nominal value of a specified obligation of the reference entity and its market value after the occurrence of the credit event (which sometimes may be established in an industry-wide auction process). If the transaction is physically settled, the credit protection buyer will deliver an obligation of the reference entity that is either specified in the contract or the general characteristics are described therein to the credit protection seller in return for the payment of its nominal value.

Credit derivatives may be used to create an exposure to the underlying asset or reference entity, to reduce existing exposure or to create a profit through trading differences in their buying and selling prices. The funds may enter into credit derivatives transactions as protection buyers or sellers.

There are a number of uncertainties in the tax laws relating to credit default swaps. There can be no assurance that the characterization adopted by the funds with respect to a particular credit default swap will be respected by the Internal Revenue Service or a court, and any recharacterization by the Internal Revenue Service, if successful, could adversely affect the investors’ investments in the funds.

Credit derivative transactions are an established feature of the financial markets and both the number of participants and range of products available have significantly increased over the years. Credit derivative transactions dependent upon credit events are priced incorporating many variables including the pricing and volatility of the common stock of the reference entity, potential loss upon default by the reference entity on any of its obligations, and the shape of the curve of the applicable risk-free rate, among other factors. As such, there are many factors upon which market participants may have divergent views. Additionally, credit derivatives may require the posting of collateral. A bankruptcy of the collateral holder may result in losses to the extent posted collateral exceeds the obligations of the pledging party under the credit derivative transaction.

As with short selling, securities regulators have implemented, and/or are implementing, certain prohibitions and disclosure requirements with respect to derivatives transactions which may negatively impact the funds and, therefore, adversely affect the performance of the funds.

Other Derivatives. The funds may take advantage of opportunities in the area of swaps, options on various underlying instruments and certain other customized derivative instruments. The funds may enter into swap transactions, including credit default, total return, index and interest rate swap agreements, as well as options thereon, and may purchase or sell interest rate caps, floors and collars. In addition, the funds may take advantage of opportunities with respect to certain other derivative instruments which are not presently contemplated for use by the funds or which are currently not available. Derivative instruments contain much greater leverage than do non-margined purchases of the underlying instrument in as much as only a very small portion of the value of the underlying instrument is required to be paid in order to effect such investments. Other risks may include market risk, liquidity risk, counterparty credit risk, legal risk and operations risk. Swaps generally do not involve delivery of securities, other underlying assets or principal. Accordingly, the risk of loss with respect to swaps generally is limited to the net amount of payments that the fund is contractually obligated to make, or in the case of the other

party to a swap defaulting, the net amount of payments that the fund is contractually entitled to receive. If the firm is incorrect in its forecast of market values, interest rates or currency exchange rates, the investment performance of the funds would be less favorable than it would have been if these investment techniques were not used.

Transactions in certain derivatives are subject to clearance on a U.S. national exchange and to regulatory oversight. In addition, recent market developments related to swaps have prompted increased scrutiny with respect to these instruments. As a result of the Dodd–Frank Wall Street Reform and Consumer Protection Act (which was passed into law in July 2010), swaps are subject to increased regulation. Such regulation may limit the funds’ ability to use swaps and increase the cost of using swaps.

Recent financial reform legislation may require the funds to comply with margin requirements and with certain clearing and trade-execution requirements in connection with its derivative activities, although the application of those provisions is uncertain at this time. The financial reform legislation may also require the counterparties to the funds’ derivative instruments to spin off some of their derivatives activities to a separate entity, which may not be as creditworthy a fund’s current counterparty. The new legislation and any new regulations could significantly increase the cost of derivative contracts (including through requirements to post collateral which could adversely affect the funds’ available liquidity), materially alter the terms of derivative contracts, reduce the availability or desirability of derivatives, reduce the ability to monetize or restructure existing derivative contracts, and increase the funds’ exposure to less creditworthy counterparties.

Special risks may apply to instruments which are invested in by the funds in the future which cannot be determined at this time or until such instruments are developed or invested in by the funds. For example, such derivative instruments are expected to be highly illiquid and it is possible that the funds will not be able to terminate such derivative instruments prior to their expiration date or that the penalties associated with such a termination might impact the funds’ performance in a material adverse manner. If the funds seek to participate through the use of such derivative instruments, the funds will not acquire any voting interests or other shareholder rights that would be acquired with a direct investment in the underlying securities or financial instruments. Accordingly, the funds will not participate in matters submitted to a vote of the shareholders. In addition, the funds may not receive all of the information and reports to shareholders that the funds would receive with a direct investment. Further, the funds will pay the counterparty to any such derivative instrument structuring fees and ongoing transaction fees, which will reduce the investment performance of the funds. Finally, certain aspects of the appropriate U.S. federal income tax treatment of such derivative instruments are uncertain and, if the funds’ U.S. federal income tax treatment of such instruments proves to be inappropriate, an investor’s after tax return from its investment in a fund may be adversely affected.

Risks of Clearing Houses, Counterparties or Exchange Insolvency. The liquidity of a secondary market in derivatives is subject to the risk of trading halts, suspensions, exchange or clearing house equipment failures, government intervention, insolvency of a brokerage firm, clearing house or exchange or other disruptions of normal trading activity, including prime brokers refusing to clear or settle any trade.

Synthetic Obligations. Synthetic obligations, *i.e.*, swap transactions, structured investments or other investments purchased from, or entered into by a fund, with respect to a reference debt security or other obligation, present risks in addition to those resulting from direct purchases of the reference obligations underlying such synthetic obligations. With respect to each synthetic obligation, the relevant fund will usually have a contractual relationship only with the counterparty of such synthetic obligation, and not the reference obligor on the reference obligation. The fund generally will have no right directly to enforce compliance by the reference obligor with the terms of the reference obligation nor any rights of set-off

against the reference obligor (and may be subject to setoff rights exercised by the reference obligor against the counterparty or another person or entity), nor have any voting or other consensual rights of ownership with respect to the reference obligation. The fund will not directly benefit from any collateral supporting the reference obligation and will not have the benefit of the remedies that would normally be available to a holder of such reference obligation. In addition, in the event of the insolvency of the counterparty, the fund will be treated as a general creditor of such counterparty, and will not have any claim with respect to the reference obligation. Consequently, the fund will be subject to the credit risk of the counterparty as well as that of the reference obligor.

Structured Products. Structured products, including collateralized debt obligations, or CDOs, collateralized bond obligations, or CBOs, collateralized loan obligations, or CLOs, structured notes, credit-linked notes and other types of structured products, representing a non-recourse or limited-recourse obligation issued by a special purpose vehicle, may present risks that are greater than those presented by other types of collateralized loan obligations. Holders of structured products bear risks of the underlying investments, index or reference obligation and are subject to counterparty risk. The holder of a structured product may have the right to receive payments to which it is entitled only from the issuer of the structured product, and generally does not have direct rights against the issuer of, or the entity that sold, assets underlying the structured product. Certain structured products may be thinly traded or have a limited trading market and may have the effect of increasing a fund's illiquidity to the extent that the fund, at a particular point in time, may be unable to find qualified buyers for, and may have difficulty valuing, these securities. CBOs, CLOs and other CDOs are typically privately offered and sold, and thus, are not registered under the securities laws. Structured products may also be subject to prepayment risk, credit risk, structural risk, legal risk and interest rate risk (which may be exacerbated if the interest rate payable on a structured finance obligation changes based on multiples of changes in interest rates or inversely to changes in interest rates). In addition, the performance of a structured product will be affected by a variety of factors, including its priority in the capital structure of the obligor thereof, the availability of any credit enhancement, the level and timing of payments and recoveries on and the characteristics of the underlying loans or other assets that are being securitized, remoteness of those assets from the originator or transferor, the adequacy of and ability to realize upon any related collateral and the capability of the servicer of the securitized assets.

Forward Trading. The funds may invest in forward contracts and options thereon, which, unlike futures contracts, are not traded on exchanges and are not standardized; rather banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward contracts may be entered into, for among other reasons, to hedge exchange risk exposure. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade 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 currencies or commodities or have quoted prices with an unusually wide spread between the price at which they are prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by the funds due to unusually high trading volume, political intervention or other factors. The imposition of controls by government authorities might also limit such forward (and futures) trading to less than that which we would otherwise recommend, to the possible detriment of the funds. Market illiquidity or disruption could result in major losses to the funds.

Futures Transactions. Futures transactions involve the execution and clearing of trades on an exchange, the laws and regulations of which will vary depending on the country in which the transaction occurs. The funds may not be afforded certain protections, including the right to use domestic alternative-dispute-resolution procedures depending on the exchange on which it participates in futures transactions. Also,

funds received to margin foreign futures transactions may not be provided the same protections in all jurisdictions. In addition, the price of any futures or option contract and, therefore, the potential profit and loss resulting therefrom, may be affected by any fluctuation in the exchange rate between the time the order is placed and the futures contract is liquidated or the option contract is liquidated or exercised.

Liquidity of Futures Contracts. The funds may at some future time use futures as part of their investment program. Avenue will determine and pursue all steps that are necessary and advisable to ensure compliance with the U.S. Commodity Exchange Act, as amended, and the rules and regulations promulgated thereunder. Futures positions may be illiquid because certain commodity exchanges limit fluctuations in certain futures contract prices during a single day by regulations referred to as “daily price fluctuation limits” or “daily limits.” Under such daily limits, during a single trading day no trades may be executed at prices beyond the daily limits. Once the price of a particular futures contract has increased or decreased by an amount equal to the daily limit, positions in that contract can neither be entered into nor liquidated unless traders are willing to effect trades at or within the limit. Futures prices have occasionally moved beyond the daily limits for several consecutive days with little or no trading. Over-the-counter instruments generally are not as liquid as instruments traded on recognized exchanges. These constraints could prevent the funds from promptly liquidating unfavorable positions and subject the funds to substantial losses. In addition, the Commodity Futures Trading Commission and various exchanges impose speculative position limits on the number of positions that may be indirectly held or controlled in particular commodities.

Hedging Transactions. The distressed market in which the funds may invest is subject to fluctuations and the market value of any particular investment may be subject to substantial variation. The entire market or, particular securities traded on a market may decline even if earnings or other factors improve since the prices of debt securities and equity securities are subject to numerous economic, political, procedural and other factors that have little or no correlation to the performance of a particular company. The funds may utilize a variety of financial instruments, such as derivatives, options, interest rate swaps, caps and floors, futures and forward contracts, both for investment purposes and for risk management purposes. When used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent the funds from achieving the intended hedging effect or expose the funds to risk of loss. While the funds may enter into hedging transactions to seek to reduce risk, such transactions may result in a poorer overall performance for the funds than if they had not engaged in any such hedging transaction. We may determine not to hedge a position and may not identify appropriate risks to hedge. Moreover, it should be noted that the funds’ portfolios will always be exposed to certain risks that cannot be hedged.

In connection with a hedging transaction, the funds’ may be required to allocate funds or provide a credit line to be used as collateral for the margin capital of the hedge. Such a requirement would tie up a portion of the funds’ capital that could otherwise have been available for investment. This could cause a fund to be less invested in its core investment strategy than it would have been absent such hedging transaction, and could possibly result in an adverse effect on the overall returns of the funds.

General Risks of Real Estate Ownership. The funds may acquire, indirectly, debt interests in real estate. The real estate investments of the funds will be subject to the risks generally incident to the ownership and the development and/or redevelopment of real property, including:

- uncertainty of cash flow to meet fixed and other obligations;
- adverse changes in local market conditions, population trends, neighborhood values, community conditions, general economic conditions, local employment conditions, interest rates, and real estate tax rates;

- changes in fiscal policies;
- competition from other properties; and
- uninsured losses and other risks that are beyond the control of the funds such as the threat of terrorism and their consequences.

There can be no assurance of profitable operations because the cost of owning the funds' investments may exceed the income produced, particularly since certain expenses related to real estate and its development and ownership, such as property taxes, utility costs, maintenance costs and insurance, tend to increase over time and are largely beyond the control of the owner.

Risks Associated with Property Acquisitions. Certain of the funds will acquire real property. These acquisitions are subject to many risks. The funds may acquire properties that are subject to liabilities or that have problems relating to environmental condition, state of title, physical condition or compliance with zoning laws, building codes or other legal requirements. In each case, the funds' acquisition of a real estate property may be without any recourse, or with only limited recourse, with respect to unknown liabilities or conditions. As a result, if any liability were asserted against the funds relating to those properties, or if any adverse condition existed with respect to the properties, the funds might have to pay substantial sums to settle or cure it, which could adversely affect the cash flow and operating results of the funds.

Construction Risks. Certain of the funds may acquire properties that require development or redevelopment. Real estate development involves the risk that construction may not be completed within budget or on schedule because of cost overruns, work stoppages, shortages of building materials, the inability of contractors to perform their obligations under construction contracts, defects in plans and specifications or in construction or other factors. Any delay in completing a project may result in increased interest and construction costs, the potential loss of purchasers or tenants and the possibility of defaults under project financings. Newly developed real estate projects may be disproportionately affected by fluctuations in demand and supply as they have no existing tenancies and need to be leased in their entirety.

Special Risks Relating to Hospitality Properties. Certain of the funds may invest in hotel properties. Because hotels are not used by individuals as their primary residence and are not subject to long-term lease arrangements, their performance is more sensitive to changes in economic conditions, overbuilding, competition and fluctuations in demand (including those resulting from actual or potential acts of terrorism or hostilities) than many other forms of real estate. In addition, the performance of hotel properties, as compared to that of other classes of real estate assets, is subject to greater risk from fluctuations in labor and other operating costs and from labor disturbances and shortages of labor. Hotel properties may also be adversely affected by reduced travel resulting from acts or threats of war or terrorism, international conflicts, natural disasters or outbreaks of illnesses.

Special Risks Relating to Investments in Multifamily Real Estate Properties. Certain of the funds may invest in multifamily real estate properties. Investment in apartments involves certain special risks. Apartment complexes have individual residential tenants with limited net worth and with lease terms that are typically shorter than those of a commercial lease. As a result, apartments are particularly vulnerable to competition from new development, and to changes in economic conditions or employment conditions in the surrounding geographic area. In addition, tenant turnover at apartment complexes causes the property owner to incur significant fix-up costs in order to prepare units for new tenants.

Risks Associated with Investment in Single-Family Residential Homes. Certain of the funds may invest in single-family residential real estate properties. Many residential markets have experienced low

demand for single-family homes and an oversupply of new and existing homes available for sale. As a result, sellers have generally experienced fewer home sales, higher inventories of unsold homes and the increased use of discounts, incentives, price concessions and other marketing efforts by sellers of new and existing homes to close sales, putting downward pressure on home selling prices, revenues and profitability. Unsold homes in the vicinity of homes purchased by a fund, or foreclosures of other homes in that vicinity, may also place additional downward pressure on the value of a fund's investments in the single-family residential real estate market.

Risks Associated with Investment in Real Estate Acquired from Distressed or Bankrupt Entities. Certain investment opportunities may originate from owners which are insolvent or in serious financial difficulty. As a result, the recourse to the sellers and/or the standards by which such properties are being serviced or operated may be adversely affected.

Losses Not Covered by Insurance. The funds' real estate investments are expected to be covered by comprehensive liability, fire, extended coverage and rental loss insurance, with policy specifications and insured limits that the firm believes are adequate and appropriate under the circumstances. Some types of losses, such as from terrorism, may be uninsurable or not economically insurable. In addition, many insurance carriers are excluding asbestos-related claims and most mold-related claims from standard policies. The firm will evaluate the availability and cost of additional insurance coverage for such claims. If the firm decides to purchase insurance for terrorism, asbestos or mold, the cost could have an adverse effect on the relevant fund's results of operations. If an uninsured loss or a loss in excess of insured limits occurs on a fund investment, the fund could lose its capital invested in an investment, as well as the anticipated future revenues from an investment and, in the case of debt that is recourse to the fund, the fund would remain obligated for such debt. Any loss of this nature would adversely affect the fund.

Regulatory Considerations. The real estate development projects in which certain funds invest will likely require the approval of governmental authorities and, in some cases, consents of third parties. There can be no assurance that any such approvals and consents will be obtained on a timely basis, if at all. The need to obtain such approvals and consents and otherwise to comply with regulatory requirements may cause significant delays in the development process, exacerbating the risk that changes in the local market will render a project economically unattractive.

Real Estate Investments Are Illiquid. Investments in real estate or interests in real estate are highly illiquid and subject to industry cyclicality, downturns in demand, market disruptions and the lack of available capital for potential purchasers. Accordingly, there can be no assurance that the funds will be able to realize on investments in a timely manner or that there will be purchasers of commercial space or residential units that meet the funds' investment objectives. In some cases, the ability to dispose of projects may be hampered by the need to obtain governmental approvals or authorizations.

New Developments and Acquisitions May Fail to Perform as Expected. In deciding whether to acquire or develop a particular property, the firm will make certain assumptions regarding the expected future performance of such assets. If anticipated acquisitions do not occur as expected, or anticipated partners in such projects do not ultimately co-invest, the financial performance of the relevant fund may be adversely affected.

Joint Venture Partners; Joint Venture Risks. Certain funds expect to co-invest with third parties through partnerships, joint ventures or other entities in many investment opportunities. These funds also may make investments in operating companies controlled by others. The funds may share control or have limited control over these entities and, therefore, may have only a limited ability to protect their interests in such investments. Such investments may involve risks not present in investments where a third party is not involved, including the possibility that a third-party partner or co-venturer may have financial difficulties resulting in a negative impact on such investment, may have economic or business interests or

goals which are inconsistent with those of the fund, or may be in a position to take action contrary to the fund's interests. In addition, the fund may under certain circumstances be liable for the actions of its third-party partners or co-venturers.

Investing in Real Estate Has Risks of Environmental Liabilities. Under various laws, ordinances and regulations, an owner or operator of real property may become liable for the costs of removal or remediation of certain hazardous substances released on, about, under or in its property. Environmental laws often impose this liability without regard to whether the owner or operator knew of, or was responsible for, the release of hazardous substances. The presence of hazardous substances, or the failure to remediate hazardous substances properly, may adversely affect a fund's ability to sell, use or finance real estate. In addition to clean-up actions brought by governmental agencies and private parties, the presence of hazardous substances on a property may lead to claims of personal injury, property damage or other claims by private plaintiffs.

Residential Mortgages and Consumer Loans. The funds may invest in residential mortgages and consumer loans. Such loans may be at the time of acquisition, or may become after acquisition, nonperforming for various reasons. With respect to collateralized loans, the underlying property may be too highly leveraged, poorly managed or substantially in need of rehabilitation. Such nonperforming and subperforming loans may require a substantial amount of workout negotiations or restructuring, which may entail, among other things, a substantial reduction in the interest rate and a substantial write-down of the principal of the loan. Moreover, Avenue may find it necessary or desirable to foreclose on some if not many of the loans acquired. This foreclosure process may be lengthy and expensive. The value of the loan will be adversely impacted by a decline in the value of the underlying collateral, which is likely to be beyond the control of the funds. Finally, there is unlikely to be a liquid secondary market for these types of investments. Consequently, the funds will not be able to dispose of these investments at prices that reflect their value or the amount paid by them.

Risks of Acquiring Real Estate Loans and Participations. Real estate loans acquired by the funds may be at the time of their acquisition, or may become after acquisition, nonperforming for a wide variety of reasons. Such nonperforming real estate loans may require a substantial amount of workout negotiations and/or restructuring, which may entail, among other things, a substantial reduction in the interest rate and a substantial write down of the principal of such loans. However, even if a restructuring were successfully accomplished, a risk exists that upon maturity of such real estate loan, replacement "takeout" financing will not be available. Purchases of participations in real estate loans raise many of the same risks as investments in real estate loans and also carry risks of illiquidity and lack of control. It is possible that we may find it necessary or desirable to foreclose on collateral securing one or more real estate loans purchased by the funds. The foreclosure process can be lengthy and expensive. Borrowers often resist foreclosure actions by asserting numerous claims, counterclaims and defenses against the holder of a real estate loan including, without limitation, lender liability claims and defenses, even when such assertions may have no basis in fact, in an effort to prolong the foreclosure action. In some jurisdictions, foreclosure actions can take up to several years or more to conclude. At any time during the foreclosure proceedings, the borrower may file for bankruptcy, staying the foreclosure action and further delaying the foreclosure process. Foreclosure litigation tends to create a negative public image of the collateral property and may result in disrupting ongoing leasing and management of the property.

Risks Arising from Investments in Real Estate Acquired from Distressed or Bankrupt Organizations. Certain real estate investment opportunities may originate from owners which are insolvent or in serious financial difficulty. As a result, the recourse to the sellers and/or the standards by which such properties are being serviced or operated may be adversely affected.

Real Estate Equity Investments. Equity interests in real estate are generally incident to the ownership of real property. In addition, the funds' ownership of equity interests in real estate may have tax consequences for certain investors in the funds that do not apply in the case of the funds' ownership of debt interests in real estate.

Follow-On Investments. The funds may be called upon to make investments to increase their investments in certain portfolio companies or to make investments that help preserve, protect or enhance the value of an existing investment in a portfolio company. There can be no assurance that the funds will want to make such investments or that the funds will have sufficient funds to do so. Any decision not to make such investment or the inability to make such investment could potentially have a substantial negative impact on an investment in a portfolio company. Moreover, to the extent that a fund does not make such investment in a company, such company may seek capital from other investors. Any such arrangements with other investors could rank senior to, and/or cause the dilution of, or otherwise negatively impact, the investment of the fund.

Other Investments. As we consider appropriate, and to the extent consistent with the funds' investment strategies, we may invest a portion of the funds' assets in one or more money market funds, collective investment trusts, mutual funds and/or exchange-traded funds. When any such investments are made, a fund investor will effectively be paying, in addition to the compensation payable to Avenue, such fund investor's proportionate share of any management fees, or other compensation, charged by the manager of such money market fund, collective investment trust, mutual fund or exchange fund, as well as a *pro rata* portion of the expenses incurred by such entity.

Use of Leverage. Certain of the funds, particularly those employing our High Yield strategy, may obtain leverage using any form or combination of financial leverage instruments, including reverse repurchase agreements, credit facilities such as bank loans or commercial paper, and the issuance of preferred shares or notes. These fund may use leverage opportunistically and may choose to increase or decrease leverage, or use different types or combinations of leveraging instruments, at any time based on the firm's assessment of market conditions and the investment environment. There can be no assurance that any fund will use leverage as part of its investment program, or that it will do so successfully.

Leverage creates risks, including the likelihood of greater volatility of net asset value and the risk that fluctuations in the costs to borrow may affect the return to holders of interests in the funds. To the extent the income derived from investments purchased with proceeds received from leverage exceeds the cost of leverage, the funds' distributions will be greater than if leverage had not been used. Conversely, if the income from the investments purchased with such proceeds is not sufficient to cover the cost of the financial leverage, the amount available for distribution to investors will be less than if leverage had not been used. In the latter case, the funds may nevertheless maintain leveraged position if such action is deemed to be appropriate based on market conditions.

The costs of a financial leverage program will be borne by the relevant funds and consequently will result in a reduction of the net asset value of the funds. Leverage increases the size of a fund's portfolio. Because the firm gets paid fees on the basis of the size of the funds' portfolios, without deduction for potential exposure, whether created by leverage or otherwise, during periods in which a fund is using leverage, the fees paid by the fund for investment advisory services will be higher than if the fund did not use leverage. This may create a conflict of interest between the firm, on the one hand, and holders of interests in the funds, on the other hand.

Any lender in connection with a credit facility may impose specific restrictions as condition to borrowing. The credit facility fees may include, among other things, up front structuring fees and on-going commitment fees (including fees on amounts undrawn on the facility) in addition to the traditional interest expense on amounts borrowed. The credit facility may involve a lien on the relevant fund's assets.

Similarly, to the extent a fund issues preferred shares or notes for which it seeks a credit rating from one or more rating agencies, the fund may be subject to fees, covenants and investment restrictions required by the rating agency as a result. Such covenants and restrictions imposed by a rating agency or lender may include asset coverage or portfolio composition requirements that are more stringent than those imposed by applicable law.

The funds also expect to enter into other transactions that may give rise to a form of leverage including, among others, swaps, futures and forward contracts, options and other derivative transactions.

Short Selling. The funds' investment program may include short selling. Short selling involves selling securities which may or may not be owned by the seller and borrowing the same securities for delivery to the purchaser, with an obligation to return the borrowed securities to the lender at a later date. Short selling allows the seller to profit from declines in market prices to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. The extent to which a fund engages in short sales will depend upon its investment strategy and perception of market direction. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to the funds of buying those securities to cover the short position. There can be no assurance that the securities necessary to cover a short position will be available for purchase at the time a fund desires to close out such short position. Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

In response to dislocations in the financial services industry during the financial crisis of 2008 and other market events, securities regulators of many jurisdictions have implemented, and/or are considering implementing, certain temporary and longer term restrictions and disclosure requirements with respect to short selling of securities, which may negatively impact the funds, including amendments to Regulation SHO (Rule 201 or the "alternative uptick rule"), which impose restrictions on short selling when an equity security that is listed on a national securities exchange (whether traded on an exchange or in the over-the-counter market) experiences a 10% or greater decline in price from the prior day's closing price, at which point short selling with respect to such security will only be permitted if the price of the security is above the current national best price for the remainder of the day and the following day. Limitations on the short selling of securities could interfere with the ability of the funds to execute certain aspects of their investment strategies, including its ability to hedge certain exposures and execute transactions to implement its risk management guidelines and any such limitations may adversely affect the performance of the funds.

Securities Lending. The risks in lending portfolio securities, as with other extensions of credit, consist of the failure of another party, in this case the approved intermediary, to comply with the terms of agreement entered into between the lender of the securities (*i.e.*, a fund) and the approved intermediary (*i.e.*, the prime broker). Such failure to comply can result in the possible loss of rights in the collateral put up by the borrower of the securities, the inability of the approved intermediary to return the securities deposited by the fund and the possible loss of any corporate benefits (including, without limitation, certain voting rights) accruing to the fund from the securities deposited with the approved intermediary.

Item 9. Disciplinary Information

This Item is not applicable to us.

Item 10. Other Financial Industry Activities and Affiliations

Material Financial Industry Affiliations of the Firm

The firm currently has direct relationships with the following private funds:

- Avenue Special Situations Fund IV, L.P.
- Avenue Special Situations Fund IV (Parallel), L.P.
- Avenue Special Situations Fund V, L.P.
- Avenue Special Situations Fund VI (A), L.P.
- Avenue Special Situations Fund VI (B-Feeder), L.P.
- Avenue Special Situations Fund VI (B), L.P.
- Avenue Special Situations Fund VI (C-Feeder), L.P.
- Avenue Special Situations Fund VI (C), L.P.
- Avenue Special Situations Fund VI (Master), L.P.
- Avenue Investments, L.P.
- Avenue International, Ltd.
- Avenue International Master, L.P.
- Avenue CLO Fund, Ltd.
- Avenue CLO II, Ltd.
- Avenue CLO III, Ltd.
- Avenue Real Estate Fund LP
- Avenue Real Estate Fund Parallel LP
- Avenue-CDP Global Opportunities Fund, L.P.
- Avenue-SC Global Opportunities Fund, L.P.
- Avenue TC Fund, L.P.
- Avenue Blue TC Fund, L.P.
- Avenue Special Opportunities Fund I, L.P.
- Avenue Special Opportunities Co-Investment Fund I, L.P.
- Avenue Employee Participation Plan, LLC
- Avenue Real Estate Employee Participation Plan, LLC
- MAGS Capital, LLC
- MAGS Capital II, LLC
- MAGS Capital III, LLC
- MAGS Capital VI, LLC

- MAGS Capital VIII, LLC

Through affiliated entities, the firm currently has indirect relationships with the following additional private funds:

- Avenue Strategic Partners Feeder, L.P.
- Avenue Strategic Partners, L.P.
- Avenue Strategic Partners Feeder, Ltd.
- Avenue Strategic Partners, Ltd.
- 12th Avenue Employee Participation Plan, LLC
- Avenue Asia Special Situations Fund II, L.P.
- Avenue Asia Capital Partners, L.P.
- Avenue Asia Special Situations Fund III, L.P.
- Avenue Asia Special Situations Fund III (Parallel), L.P.
- Avenue Asia Special Situations Fund IV, L.P.
- Avenue Asia Investments, L.P.
- Avenue Asia International, Ltd.
- Avenue Asia International Master, L.P.
- Avenue Asia Employee Participation Plan, LLC
- Avenue Europe International, Ltd.
- Avenue Europe International Master, L.P.
- Avenue Europe Investments, L.P.
- Avenue Europe Special Situations Fund II (Euro), L.P.
- Avenue Europe Special Situations Fund II (U.S.), L.P.
- Avenue Europe Special Situations Fund, L.P.
- Avenue Europe Special Situation Fund (Parallel), L.P.
- Avenue Europe Special Situations Fund (Parallel II), L.P.
- Avenue-SLP European Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, L.P.
- Avenue Europe Opportunities Fund, Ltd.
- Avenue Europe Opportunities Intermediate Fund, L.P.
- Avenue Europe Opportunities Master Fund, L.P.
- Avenue Europe Employee Participation Plan, LLC

The firm serves as adviser to the RIC, which is a registered investment company (*i.e.*, a public fund). An affiliate of the firm, Avenue Europe International Management, L.P., serves as sub-adviser to the RIC.

An affiliate of the firm, Avenue Asia Capital Management, L.P., manages the assets of one or more liquidating trusts established to manage the liquidation of certain assets formerly held by Avenue Asia Investments, L.P., Avenue Asia International, Ltd., and Avenue Asia International Master, L.P.

The firm has relationships with the following entities that act as investment advisers:

- Avenue Asia Capital Management, L.P. (registered as an investment adviser with the SEC since 2001 and registered with the Securities Exchange Board of India as a Foreign Institutional Investor since 2008)
- Avenue Europe International Management, L.P. (registered as an investment adviser with the SEC since 2004)
- 12th Avenue Management, L.P. (registered as an investment adviser with the SEC since 2007)

The firm has relationships with the following entities (general partners of private funds that are advised by us) that are its “relying advisers”:

- Avenue Capital Partners IV, LLC
- Avenue Capital Partners V, LLC
- Avenue Capital Partners VI, LLC
- Avenue International Master GenPar, LLC
- Avenue Partners, LLC
- Avenue Real Estate GenPar, LLC
- Avenue Global Opportunities Fund GenPar, LLC
- Avenue TC GenPar, LLC
- Avenue Blue TC GenPar, LLC
- Avenue SO Capital Partners I, LLC
- Avenue-SC Global Opportunities Fund GenPar, LLC
- GL Avenue Employee Management, LLC

The firm has relationships with the following entities (general partners of private funds that are advised by our investment adviser affiliates and certain entities used to carry on the these affiliates’ businesses) that are “relying advisers” of certain of its investment adviser affiliates:

- Avenue Asia Capital Partners II, LLC
- Avenue Asia Capital Partners III, LLC
- Avenue Asia Capital Partners IV, Ltd.
- Avenue Asia International Master GenPar, Ltd.
- Avenue Asia Investments GenPar, LLC
- Avenue Asia Services, LLC
- Avenue Asia Advisors Private Limited

- Avenue Asia Singapore Pte Ltd.
- GCF Services, Ltd.
- Ai Hua Consulting (Beijing) Co., Ltd.
- Bo Yuan Jun He Consulting (Beijing) Co., Ltd.
- IH Services HK Limited
- PT LGR Indonesia
- Avenue Europe Capital Partners II, LLC
- Avenue Europe Capital Partners, LLC
- Avenue Europe International Master GenPar, Ltd.
- Avenue Europe Investments GenPar, LLC
- Avenue Europe Opportunities Fund GenPar, LLC
- Avenue-SLP European Opportunities Fund GenPar, LLC
- Avenue Europe Management, LLP (authorized by the U.K. Financial Services Authority since 2004)
- Avenue Germany Management GMBH
- Avenue Strategic Partners Feeder GenPar, LLC
- Avenue Strategic Partners GenPar, LLC

In October 2006, Morgan Stanley became an indirect minority owner of Avenue. From time to time, certain funds may utilize Morgan Stanley for prime brokerage, consulting and other services.

Avenue is affiliated with Amroc Investments, LLC. Marc Lasry and Sonia Gardner, the Senior Principals of Avenue, own Amroc. As of January 1, 2008, all of Amroc's employees became employees of Avenue entities and there are no commissions or other fees paid to Amroc for sourcing investments. We do not believe that the firm's relationship with Amroc is material to our ongoing business activities.

FCB Firmen-Credit Bank GmbH (f/k/a Yapi Kredi Bank (Deutschland) AG), a bank located in Frankfurt, Germany, is owned by Avenue Europe Investments, L.P., a Delaware limited partnership, and Avenue Europe Opportunities Fund, L.P., a Delaware limited partnership, each of which is managed by Avenue Europe International Management L.P., an investment adviser that is affiliated with the firm. See disclosure under the heading "Participation or Interest in Client Transactions" in Item 11.

In connection with the management and sales of certain real estate investments, the firm may retain the services of EDGE Management LLC, a real estate management company, and Shares of NY Marketing LLC, a real estate brokerage firm. EDGE Management LLC is beneficially owned by Edward Gellert, a Senior Portfolio Manager of the firm, and Shares of NY Marketing LLC is beneficially owned by Edward Gellert and his brother Bob Gellert, a Portfolio Manager of the firm. See disclosure under the heading "Participation or Interest in Client Transactions" in Item 11.

A number of entities with which the firm is affiliated serve as the general partners of private funds whose investment programs are managed by the firm and/or by affiliates of the firm.

Other Activities

None of Avenue, its principals, nor any of their affiliates (including the firm), or their respective affiliates, employees, officers, directors, principals, shareholders and members, or affiliates of any such persons or entities is required to manage any of the funds or managed accounts as its sole and exclusive function and each may engage in other business ventures and other activities unrelated to the affairs of the funds or managed accounts. Any Avenue person may become aware of business opportunities in which any fund or managed account is not expected to be given an opportunity to participate.

Except as otherwise set forth in a fund's offering documents, no Avenue person is obligated to devote any specific amount of time to the affairs of the funds or managed accounts. Avenue persons spend substantial time on other business activities, including those related to various existing and future pooled investment vehicles and other client accounts sponsored, formed, offered and managed by Avenue and its affiliates.

Furthermore, the Senior Principals of Avenue, and other officers and employees of Avenue and its affiliates, may, from time to time, serve on the boards of directors, credit committees, or other committees, of one or more entities in which one or more of the Avenue funds or managed accounts has invested. In addition, certain Avenue persons may, from time to time, provide certain services to the firm, the funds, one or more of the firm's other affiliates, and/or one or more of the investments or companies in which the funds invest. As a result, there may be a number of conflicts of interest which may arise, which could adversely affect the funds and/or managed accounts of the firm. Please see the disclosure provided elsewhere in this brochure under Item 8 as well as in the offering documents of the applicable fund.

Avenue persons engage in a broad range of investment management activities, including sponsoring and managing other private funds and other activities. Certain Avenue persons also expect to sponsor and operate future pooled investment vehicles and other client accounts that pursue similar investment objectives or other lines of investment activity. Although the relationships and activities of Avenue persons should enable these entities to offer attractive opportunities and services to the funds and investors, such relationships and activities, in the ordinary course of business, may also give rise to circumstances in which the interests of these entities and other affiliates of the Avenue persons conflict with the interests of the funds and investors, including, by way of example but not limitation, competition with other investment vehicles (proprietary or third-party managed) in which investors may also have an interest, purchasing and investments in entities in which investors may have an interest, or taking or advocating positions in certain transactions that may be considered adverse to the interests of investors.

The Avenue persons, the funds, the general partners of such funds (if applicable) or their respective members, officers, directors, employees, principals or affiliates may come into possession of material, non-public information. The possession of such information may limit the ability of the funds to buy or sell a security or otherwise to participate in an investment opportunity.

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

Code of Ethics; Personal Trading

We have adopted a written code of ethics that applies to the firm, our employees and certain related persons. Our code of ethics is administered by our chief compliance officer or his designees. Employees are given training with respect to our code of ethics when they are hired and annually thereafter. Each

client may obtain a copy of our code of ethics by submitting a written request to Eric L. Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at (212) 878-3520.

The following general principles and standards of conduct are established by our code of ethics:

- We must operate at the highest level of ethical standards in keeping with our fiduciary duties to clients, and in compliance with all applicable laws.
- We have a duty to place the interests of clients first and to avoid conflicts of interest.
- Information about our operations and investment strategies, as well as information about investors in our funds or our managed account clients (other than, possibly, their name), unless otherwise consented to by the investor, is strictly confidential and will not be disclosed to anyone outside the firm and its consultants and agents, unless required by law or a government agency and upon prior notice to the chief compliance officer.
- Our employees may not use any confidential information or otherwise take inappropriate advantage of their position for the purpose of furthering any private interest or as a means of making any personal gain.
- Our employees and their immediate families may not accept any benefit from a client, an investor in one or more of our funds or person who does business with us, except for normal business courtesies and non-cash gifts of nominal value, except as otherwise provided for by our code of ethics.
- Insider trading is prohibited and may expose an employee to stringent penalties.

Our code of ethics deals with a range of topics including, without limitation, the following:

- Categories of persons related to the firm who are covered by the code of ethics.
- Opening of personal securities accounts by covered persons.
- Pre-approval requirement for most personal securities transactions.
- Submission to the firm of information concerning personal securities holdings and transactions.
- Restrictions on trading in securities of particular issuers.
- Gifts, entertainment and investee company promotions (*i.e.*, any discounted or complimentary goods or services provided by an investee company to a firm employee, such as hotel rooms).
- Charitable contributions.
- Political contributions and payments.
- Reporting of violations and our whistle-blower policy.
- How the code of ethics is administered.
- How exceptions to the code of ethics may be granted by our chief compliance officer.

Each covered person is required to acknowledge that he or she has received and reviewed, and understands the Code of Ethics.

Participation or Interest in Client Transactions

A principal transaction occurs when an investment adviser, acting for its own account (or the account of an affiliate) buys a security from, or sells a security to, a client's account. An agency cross trade occurs when a person acts as an investment adviser in relation to a transaction in which such investment adviser, or any person controlling, controlled by, or under common control with such investment adviser, acts as broker for both such advisory client and for another person on the other side of the transaction. The funds have different procedures with respect to completing principal and agency cross transactions that are set forth in each fund's operative documents. Accordingly, the portfolio managers are required to identify any potential principal transaction, and any potential agency cross trade between two or more funds, prior to effecting the transaction and to contact the firm's chief compliance officer. The chief compliance officer, in consultation with outside counsel (if necessary), will determine whether or not the trade would constitute a principal transaction or an agency cross trade, and if so, whether such transaction is permissible and what procedures must be followed to complete the transaction. The firm has the right to cause the funds to engage in agency cross trades, including the purchase or acquisition of participations in originated investments for purposes of rebalancing the portfolios of the funds or for other reasons consistent with the investment and operating guidelines of the funds. These rebalancing transactions, if effected, may or may not be subject to commissions. It is our more customary policy to rebalance funds and accounts by trading in the market rather than by effecting agency cross trades.

We do not presently intend to engage in principal transactions, but we do have the right to engage in such transactions and may do so in the future. During the most recent fiscal year, the firm did not engage in principal transactions.

The funds may, from time to time, make an investment in a portfolio company in which one or more of Avenue's other clients invests in a different part of the capital structure. There may be instances where such a portfolio company may seek to take an action where the funds' and the other clients' interests in such portfolio company may conflict. To the extent that the funds hold securities in a portfolio company with rights, preferences and privileges that are different than those held by other clients in the same portfolio company, Avenue's principals and their representative affiliates may be presented with decisions when the interests of the funds and the other clients are in conflict. It is possible that a fund's interests may be subordinated or otherwise adversely affected by virtue of the other clients' involvement and actions relating to their investment. Avenue has adopted procedures to address and, in some cases, mitigate the actual conflicts of interest that may arise. Any deviation from these procedures must be approved in advance by the chief compliance officer.

The funds may engage in certain transactions with, and pay fees in connection with sourcing investments to, FCB Firmen-Credit Bank GmbH (f/k/a Yapi Kredi Bank (Deutschland) AG) ("FCB"), a bank located in Frankfurt, Germany. FCB was originally acquired by a fund that is managed by an affiliate of the firm. FCB was acquired because it is believed to be an appropriate investment opportunity and its acquisition will enable the acquiring fund, through FCB, to originate loans across the entire European Union as direct assignments. In connection with the funds' pursuing investments sourced by FCB, the funds will pay certain fees to FCB (and thus indirectly to the funds that own FCB). The fees to be charged by FCB for providing services to the funds and their affiliated entities depend partly on the quality of the underlying assets, as more distressed assets will require greater involvement and resources from FCB. The fees to be paid by the funds are required to be reasonable and no less advantageous to the funds than are available from unaffiliated persons.

As described in Item 10, in connection with the management and sale of investments made by certain of the funds that primarily invest in real estate assets and real estate related businesses, the firm may retain the services of EDGE Management LLC, a real estate management company, and Shares of NY

Marketing LLC, a real estate brokerage firm. EDGE Management LLC is beneficially owned by Edward Gellert, a Senior Portfolio Manager of the Advisor, and Shares of NY Marketing LLC is beneficially owned by Edward Gellert, a Senior Portfolio Manager of the Advisor, and his brother Bob Gellert, a Portfolio Manager of the Advisor. The firm believes that these arrangements will enable the firm to exercise a degree of control over the management and sales of certain portfolio real estate investments, and that this control will serve to optimize the potential returns of the funds with respect thereto. The firm will endeavor to ensure that fees paid to these entities by funds will be at or below market rates. The firm will periodically determine the market rates for management and real estate broker services through independent third parties.

In some circumstances, where a fund owns a real estate asset outright or acts as the “operating partner” in a joint venture arrangement, employees of the firm or an affiliate may perform asset-level management functions of a type normally performed by an owner of real estate, including, among others:

- asset and business plan level financial reporting functions;
- supervision of service providers;
- administration/negotiation of relationships with tenants;
- negotiation with purchasers of for-sale residential units;
- interaction with government agencies and civic bodies; and
- design, planning and execution of tenant improvements and capital improvement projects.

When the firm provides these services, the fund on behalf of which they are provided may compensate the firm or affiliates for the cost of performing them.

In certain circumstances, the firm and its employees may receive discounted or complimentary goods or services provided from an investee company in which one or more funds invests. The firm’s compliance manual addresses such practices in its policy regarding gifts, entertainment and investee company promotions.

The firm may, from time to time, recommend a security in which the firm, directly or indirectly, has an interest. For instance, it may be expected that one or more of the funds may invest capital in another of the funds or in securities of issuers in which one or more of the other funds hold positions. In addition, the general partners of certain of the funds have invested their own capital in their funds. Given the likely frequency of these occurrences, clients and investors in the funds will not be provided with notification of them. This may represent a conflict of interest for the firm.

We will not be engaged as an investment adviser to advise investors as to the appropriateness of investing in the funds or managed accounts we manage. Although we will not receive any compensation for selling interests in the funds, we will receive compensation in our capacity as manager of these funds based in part upon the amount invested in the funds.

Accounts that are beneficially owned by the firm’s employees, principals and affiliates may from time to time transact in trade claims of distressed companies. These transactions will be subject to our personal account trading policy.

Item 12. Brokerage Practices

Selection of Brokers

In effecting securities transactions, the firm generally seeks to negotiate with brokers a combination of the most favorable commission and the best price obtainable on each transaction. Consequently, brokers are selected primarily on the basis of their execution capability and trading expertise consistent with the effective execution of the transaction.

In determining the broker or dealer to be used and the commission rates to be paid, the firm considers the utility and reliability of brokerage services, including:

- execution capability and performance,
- financial responsibility and investment information,
- market insights, and
- other research provided by the brokers.

Accordingly, the commissions charged by brokers may be greater than the amount another broker might charge if the firm determines in good faith that the amount of these commissions is reasonable in relation to the value of the brokerage services and research information provided by the brokers. The firm's authority to select the broker or dealer to be used may be limited by legal restrictions such as those imposed under the U.S. Employee Retirement Income Security Act of 1974, as amended (ERISA).

Consistent with the requirements of best execution, brokerage commissions may be directed to brokers in recognition of investment research and information furnished as well as for services rendered in the execution of orders by such brokers. By allocating transactions in this manner, the firm is able to supplement its research and analysis with the views and information of brokerage firms. The funds may also allocate a portion of their brokerage business to brokerage firms whose employees participate as brokers in the introduction of investors to the funds or who agree to bear the expense of capital introduction, marketing or related services by third parties.

The firm may effect securities transactions, to the extent permitted by law, with brokerage firms affiliated with the firm or with investment companies registered under the Investment Company Act of 1940, if it reasonably believes that the quality of execution and the commission are comparable to that available from other qualified firms. Certain broker-dealers, through which the RIC may effect securities transactions, may be affiliated persons (as defined in the Investment Company Act) of the firm or the applicable registered fund. Avenue has adopted certain policies incorporating the standards of Rule 17e-1 issued by the SEC under the Investment Company Act which require that the commissions paid to affiliates of the RIC be reasonable and fair compared to the commissions, fees or other remuneration received or to be received by other brokers in connection with comparable transactions involving similar securities during a comparable period of time. The rule and procedures also contain review requirements and require the firm and Avenue Europe International Management, L.P. (an affiliate of the firm that acts as sub-adviser to the RIC) to furnish reports to the trustees of the RIC and to maintain records in connection with these reviews.

Soft Dollar and Directed Brokerage Arrangements

Research or brokerage services provided by brokers through which portfolio transactions for the funds and managed accounts are executed may include:

- research reports on particular industries and companies,

- economic surveys and analyses,
- recommendations as to specific securities,
- online quotations,
- news and research services,
- financial publications, and
- other products and services (*e.g.*, software based applications for market quotes and news and database programs providing portfolio company and industry data)

that prove lawful and appropriate assistance to the firm in the performance of its investment decision-making responsibilities on behalf of the funds, managed accounts and other accounts which its affiliates manage (these are all referred to collectively as “soft dollar items”). Avenue generally uses soft dollar items for the benefit of all of its clients. Whether an individual managed account client authorizes the firm to engage in soft dollar arrangements will be set forth in that client’s investment management agreement.

Soft dollar items may be provided directly by brokers, by third parties at the direction of brokers or purchased by or on behalf of the funds and managed accounts with credits or rebates provided by brokers. Soft dollar items obtained in connection with portfolio transactions for the funds and for managed accounts are intended to fall within the “safe harbor” of Section 28(e) of the U.S. Securities Exchange Act of 1934, as amended. The commissions to be paid to the brokers providing soft dollar items may be greater than the amount another broker might charge if the firm determines in good faith that the amount of these commissions is reasonable in relation to the value of the brokerage services and research products and services provided by the brokers.

We do not presently intend to receive soft dollar items, but we do have the right to receive such items and may do so in the future. During the most recent fiscal year, the firm did not use any soft dollar items or engage in directed brokerage transactions.

Aggregation of Orders

If the firm has determined to purchase (or sell) an investment at the same time for more than one investment vehicle or account, the firm will generally place combined orders for all such accounts simultaneously, and if all such orders are not filled at the same price, it will generally average the prices paid. Similarly, if an order on behalf of more than one vehicle or account cannot be fully executed under prevailing market conditions, the firm will allocate (or sell, as applicable) the investments among the different vehicles or accounts on a basis that it considers equitable. Situations may occur where the funds and or managed accounts could be disadvantaged because of the investment activities conducted by the firm for other investment vehicles or accounts.

Allocation Procedures

In addition to our responsibilities with respect to the management and investment activities of the funds and the managed accounts, we and our affiliates will have similar responsibilities with respect to various other existing pooled investment vehicles and managed accounts (such clients, together with clients of the firm, are referred to as “Avenue clients”). The existence of such multiple vehicles and accounts necessarily creates a number of potential conflicts of interest.

We expect that investments will be allocated between and among Avenue clients, particularly where the investment objectives and policies of the Avenue clients overlap (in whole or in part). There are, or are

expected to be, differences between and among the Avenue clients, which may affect how a transaction is allocated with respect to, among other considerations:

- investment objectives,
- investment strategies,
- investment parameters and restrictions,
- portfolio management personnel,
- tax considerations,
- liquidity considerations,
- hedging considerations,
- legal and/or regulatory considerations,
- asset levels,
- timing and size of investor capital contributions and redemptions,
- cash flow considerations,
- market conditions,
- existing exposures to an investee company or security, and
- other criteria we deem relevant (the nature and extent of the differences will vary from client to client).

In addition, certain investments may be purchased in odd lots, or there may exist stub amounts, either of which are not readily allocable to multiple clients. Notwithstanding the differences between and among Avenue clients, and the possible existence of hard to allocate investments, there may be circumstances where some or all of the Avenue clients participate in parallel investment transactions. If we deem it appropriate, taking into account the investment objectives and policies of the various clients, this participation will generally be on a *pro rata* basis (based on available cash as determined by us), at the same time and on the same terms; this will be the case most commonly with respect to Avenue clients that have similar investment objectives and investment strategies.

However this will not always be the case. There will be circumstances where:

- only some of the Avenue clients participate in parallel investment transactions;
- the level of participation between and among the Avenue clients in parallel investment transactions is not on a *pro rata* basis;
- the terms of parallel investment transactions vary between and among one or more of the Avenue clients;
- one or more of the Avenue clients effectively engage in opposite transactions with respect to a particular investment (*e.g.*, an Avenue client acquires a long position in a security while one or more of the other Avenue clients sells or shorts the security); and/or
- investment transactions between and among the Avenue clients vary in other respects.

Such non-parallel and/or non-*pro rata* investment transactions between and among the Avenue clients will be made in the discretion of Avenue when deemed:

- appropriate given the differences between the clients involved,
- appropriate because the target holdings of the particular investment that Avenue has established with respect to the clients involved differ from client to client, and/or
- otherwise to be in the best interests of the clients involved.

From time to time, we may review Avenue clients' exposure to certain investments and determine exposure targets for clients on a net asset value basis. Where the exposure targets with respect to a particular investment differ from client to client, Avenue, prior to entering a transaction, may prepare a report that sets forth (i) the target exposures, on a net asset value basis, for certain clients with respect to specific investments and (ii) a consistent methodology for the allocation of transactions in these investments among these clients. After that, until the net asset value exposure targets are achieved or modified, purchases or sales, as applicable, in the relevant investments (which will generally be made on an aggregated basis) will be allocated to clients in the amounts (expressed as a percentage of the aggregate amount purchased or sold) determined pursuant to the report rather than on a *pro rata* basis.

It is our general policy that no Avenue client will receive inappropriate preferential treatment or otherwise be treated unfairly; and we will seek to uphold this policy when making decisions regarding investment allocations.

In certain cases, such as with respect to trade claims for our trade claims fund, opportunities during a particular period and up to a certain size may be offered only to one or more funds and not to other Avenue clients.

The firm may from time to time provide advisory or sub-advisory services to one or more public funds, including, without limitation, the RIC. The public funds we advise are managed using our High Yield strategy and do not pay a performance fee. The public funds invest in securities that are similar to investments that may be held in those of our private funds that are managed using our U.S. Distressed Debt strategy (which do pay a performance fee). In allocating investments between our public funds and our U.S. Distressed Debt private funds, we employ an objective credit threshold test that takes into account the anticipated yield(s) of the relevant investment(s) as a basis for allocation. Although these funds are managed by the same team of investment professionals, the expected risk and return profile for the public funds is lower than for the private funds. Thus, we will allocate investments with a total yield at the time of investment below the credit thresholds to the public funds, and investments with a total yield above the credit thresholds to the private funds. Notwithstanding this, the firm may, with the prior approval of the chief compliance officer, sell short or otherwise take short positions (including entering into a credit default swap) in investments at or below the applicable credit thresholds. Also, the firm, in making an investment (including an investment that comprises multiple component transactions) for its other accounts that is focused on an obligation above the applicable credit threshold (or on an instrument that is not subject to the applicable credit thresholds), may purchase or sell obligations at or below the applicable credit threshold in order to hedge or otherwise limit the investment in the obligation or other instrument that is the focus of such investment. In addition, for purposes of covering or closing a short position, the private funds are able to borrow or buy investments at or below the applicable credit thresholds. The firm may also invest in cash and other liquid investments that do not meet the credit thresholds.

Trade Errors

We have adopted a policy for the purpose of addressing trade errors that may arise, from time to time, with respect to the securities transactions of the funds and the managed accounts. An example of a trade error is the sale of a security when it should have been purchased. Pursuant to the policy, we will seek to identify and correct any trade errors in an expeditious manner. Trade errors that result in losses for a private fund or managed account that are the result of our gross negligence or willful misconduct, as

determined by us, will be reversed, and we will be responsible to make the affected funds and managed accounts whole. Trade errors that result in losses for a fund, other than a fund that is a registered investment company, or managed account that are not the result of our gross negligence or willful misconduct, as determined by us, will be reversed and we may, but are not required to, bear such losses in whole or in part. Any such losses we do not bear will be borne by the affected funds and/or managed accounts. Trade errors that result in losses for a fund that is a registered investment company, whether or not they are the result of our gross negligence or willful misconduct, will be reversed, and we will be responsible to make the affected registered investment company whole. Gains from trade errors will be credited to the affected funds or managed accounts. Gains from trade errors may not be used to offset losses from trade errors. “Soft dollars” or “client commissions” will not be used, either directly or indirectly, to correct trade errors. We document each trade error and maintain a trade error file. The determination of whether or not a trade error has occurred will be in our sole discretion.

Item 13. Review of Accounts

Each fund and managed account is maintained, supervised and reviewed on a regular basis by its respective investment principals. Matters reviewed include specific investments held, the percentage of assets in various types of asset classes and the relative and absolute performance of each account. The investment principals for each fund are listed in that fund’s confidential offering memorandum.

With respect to the private funds and registered investment companies for which the firm serves as the investment manager, each investor receives annual audited financial statements of each such fund. In addition, investors in the registered investment companies the firm advises receive semi-annual unaudited reports, and investors in the various private funds receive additional financial statements and reports as described in the confidential offering memorandum for each private fund.

With respect to other clients for whom we serve as the investment manager on a managed account or sub-advisory basis, we will provide such clients with reports and statements, the content and frequency of which will be as agreed.

Item 14. Client Referrals and Other Compensation

Compensation for Client Referrals; Placement Agents for Funds

The firm is one of four registered investment advisers that are part of Avenue Capital Group. Any one of our four registered advisers, or another member of Avenue Capital Group, may retain the services of one or more placement agents in connection with the solicitation of prospective investors. Avenue has retained Hightower Securities, LLC, Spoonhill Asset Management, Inc., J.P. Morgan Securities Inc., Morgan Stanley & Co., Jefferies & Co., Inc., Credit Suisse Securities (SA) LLC, Aspen Capital Partners (Europe), Ltd., Barclays, Meridian Capital, Probitas Funds Group, LLC, Lazard Freres & Co., Inc and ABAX Brokerage Services LLC as placement agents. Typically, placement agents retained by Avenue are paid a fee based upon a percentage of the investor's investment or of the applicable Avenue adviser's management fee. These fees are borne by Avenue. If an investor that is placed with Avenue by one of the placement agents we have retained has a brokerage or other relationship with that placement agent, that investor may pay additional fees to the placement agent if the terms of its relationship with the placement agent so provide. To the extent applicable, solicitations of prospective managed clients are made in accordance with SEC Rule 206(4)-3 adopted under the Investment Advisers Act of 1940.

Item 15. Custody

We have custody, as defined in Rule 206(4)-2 under the Investment Advisers Act of 1940, of the assets of certain of the private funds as a result of the service of certain of our affiliates as general partners of some of the private funds we manage and our ability to remove the independent directors of some of the private funds we manage. The private funds are audited annually and deliver audited financial statements to their investors within 120 days' of the applicable fiscal year-end. We do not have custody of our CLO funds' or RICs' assets.

Item 16. Investment Discretion

Item 4 includes a description of the investment discretion that we exercise.

Item 17. Voting Client Securities

We have policies and procedures in place for the voting of proxies and processing of corporate actions on behalf of the funds and managed accounts we advise that are designed to ensure compliance with the proxy voting, disclosure and record keeping requirements under SEC Rules 206(4)-6 and 204-2 adopted under the Investment Advisers Act. Our policies and procedures are also designed to ensure that all corporate actions are voted in the best interest of each fund, provide disclosure to fund investors and ensure that certain documentation is retained. As a general matter, clients may not direct our vote in a particular solicitation.

The Firm's objective is to ensure that its proxy voting and corporate action activities on behalf of the funds are conducted in a manner consistent, under all circumstances, with the best interest of the funds.

Proxy Voting

With respect to certain proxy proposal issues, we vote in accordance with predetermined "for" or "against" designations, except when we determine the best interests of the client require a contrary vote. We vote other proxy proposals on a "case by case" analysis in the best interests of the client.

In the event that the firm votes contrary to the proxy voting guidelines, we will document the basis for our contrary voting decision.

In addition, the firm may choose not to vote proxies in certain situations or for certain funds, such as (i) where a fund has informed the firm that it wishes to retain the right to vote the proxy, (ii) where the firm deems the cost of voting would exceed any anticipated benefit to the fund, (iii) where the proxy is received for a fund that has been terminated, or (iv) where a proxy is received by the firm for a security it no longer manages on behalf of a fund. The firm will document the basis for the decision not to vote.

We may occasionally be subject to conflicts of interest in the voting of proxies. If at any time the firm becomes aware of an actual conflict of interest relating to a particular proxy proposal, the firm will handle the proposal as follows:

- If the proposal is designated in the proxy voting policies as "For" or "Against," the proposal will be voted by the firm in accordance with the proxy voting policies; or

- If the proposal is designated in the proxy voting policies above as “Case by Case” (or not addressed in the proxy voting policies), the firm will notify the fund of such conflict and will vote the fund’s shares in accordance with the fund’s instructions.

Each investor in a private fund and each managed account client may obtain information on how we voted with respect to the securities of such fund or managed account, as applicable, and obtain a copy of proxy voting policies and procedures by submitting a written request to Eric L. Ross at 399 Park Avenue, 6th Floor, New York, New York 10022 or by contacting Mr. Ross at 212-878-3520. With respect to any registered investment company, the firm shall promptly provide information to the registered investment company regarding how the registered investment company’s proxies and corporate actions were voted to enable the registered investment company to make the required disclosures regarding the proxy voting.

Corporate Actions

Conflicts of interest may arise where multiple funds simultaneously hold securities representing different parts of the capital structure of a financially troubled or distressed issuer. Conflicts of interest may also arise where multiple funds simultaneously hold different investment positions with respect to the same issuer. Avenue has adopted procedures to address and, in some cases, mitigate the actual conflicts of interest that may arise. Any deviation from these procedures must be approved in advance by the firm’s Chief Compliance Officer.

Where multiple funds hold different securities of the same issuer and either a specific right, such as a vote with respect to a security or the grant of a waiver, or an ongoing right, such as an opportunity to serve on a creditor’s committee or otherwise engage in discussions with an issuer, arises, and Avenue does not identify a conflict of interest, the following procedures will apply:

- Avenue will exercise the right or ongoing right in the best interest of the relevant fund(s).
- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant fund is clear.
- The Chief Compliance Officer must be notified prior to the exercise of the right.

If Avenue does identify an unresolved conflict of interest, the following procedures will apply:

- If the course of action that is in the best interest of each fund is not clear, or if the course of action involves an ongoing right, then Avenue will designate an independent representative to make a recommendation with respect to, or assume responsibility for, the exercise of the right or undertaking the ongoing right for one or more of the funds.
- Avenue will be responsible for determining whether the course of action that is in the best interest of the relevant fund(s) is clear.
- The Chief Compliance Officer must be notified prior to the designation of an independent representative.
- In the case of a RIC, the independent representative may be the manager, if Avenue is acting as sub-adviser, or Board of Directors (or Trustees) of the RIC.
- In the case of a private fund, the independent representative may be an advisory committee established by the fund to handle such matters or, if permitted under the fund’s organizational documents, a third-party advisor.
- If an independent representative is designated, Avenue employees who communicate with the independent representative must be careful not to disclose material non-public information to

the independent representative unless the prior approval of the Chief Compliance Officer is obtained and such party has a duty of confidentiality with regard to such material non-public information (such as through the execution of a confidentiality agreement or service as a manager or board member of a RIC).

Item 18. Financial Information

We have included herewith a balance sheet for our most recent fiscal year.

AVENUE CAPITAL MANAGEMENT II, L.P.

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

DECEMBER 31, 2011

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

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Report of Independent Auditors

To the General and Limited Partners of Avenue Capital Management II, L.P.:

In our opinion, the accompanying consolidated statement of financial condition presents fairly, in all material respects, the financial position of Avenue Capital Management II, L.P. and its subsidiaries at December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. This consolidated financial statement is the responsibility of the General Partner; our responsibility is to express an opinion on this consolidated financial statement based on our audit. We conducted our audit of this statement in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated statement of financial condition is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated statement of financial condition, assessing the accounting principles used and significant estimates made by management, and evaluating the overall statement of financial condition presentation. We believe that our audit of the consolidated statement of financial condition provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

March 30, 2012

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

December 31, 2011

ASSETS

Investments, at fair value (cost \$1,006,100,000)	\$ 926,269,091
Cash and cash equivalents	57,242,927
Due from affiliates	9,304,292
Debt issuance costs, net	8,840,853
Interest receivable	2,742,913
Property and equipment, net	17,834,674
Deferred tax asset, net	7,291,381
Management fees receivable	114,738
Prepaid expenses and other assets	1,784,779
Total Assets	\$ 1,031,425,648

LIABILITIES AND PARTNERS' DEFICIENCY

Current maturities of notes payable - bank	\$ 450,000
Long-term portion of notes payable - bank	11,330,458
Senior and subordinated notes payable	990,634,941
Payable for investments purchased	4,600,000
Compensation payable to employees	98,151,901
Interest payable	5,145,012
Payable to third party marketers	4,085,589
Accounts payable, accrued expenses and other liabilities	11,780,421
Total Liabilities	1,126,178,322
Commitments and contingencies	
Partners' Deficiency	(94,752,674)
Total Liabilities and Partners' Deficiency	\$ 1,031,425,648

AVENUE CAPITAL MANAGEMENT II, L.P. and Subsidiaries

NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION DECEMBER 31, 2011

1. ORGANIZATION

Avenue Capital Management II, L.P. (the "Partnership") is a Delaware limited partnership formed on June 30, 2005 to provide investment advisory services to the investment funds and other pooled investment vehicles (the "Funds"). The general partner of the Partnership is Avenue Capital Management II GenPar, LLC (the "General Partner"), a Delaware limited liability company. The Partnership is a registered investment adviser with the U.S. Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940.

The Partnership follows the guidance in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810-10, *Consolidation*, under which an entity should consolidate a variable interest entity ("VIE") if (i) the entity has the power to direct the VIE's activities that most significantly impact the VIE's economic performance, and (ii) the entity's economic interest could potentially be significant to the VIE. In February 2010, the FASB issued a deferral of this guidance for certain investment entities. Under the deferral, an asset manager that has no obligation to fund potentially significant losses of an investment entity and has no obligation to absorb a disproportionate share of that investment entity's losses can continue to apply the current accounting guidance to investment entities that have the attributes of entities subject to ASC 946, Financial Services – Investment Companies. The deferral is applicable to all Funds except for Avenue CLO Fund, Ltd. ("CLO I"), Avenue CLO II, Ltd. ("CLO II"), and Avenue CLO III, Ltd. ("CLO III") (collectively, the "Subsidiaries"). Accordingly, the Partnership consolidates the assets and liabilities of the Subsidiaries. The Subsidiaries are incorporated under the laws of the Cayman Islands. The Subsidiaries together with the Partnership are referred to as the "Group". All intercompany balances have been eliminated in consolidation.

The Funds' (excluding the Subsidiaries) activities consist predominantly of investing and trading in U.S. and foreign, public and private, equities, debt obligations, and other indebtedness of companies undergoing financial distress, a turnaround in business operations or companies which management believes are undervalued because of a discrete extraordinary event.

The Subsidiaries' activities consist predominantly of investing and trading in senior secured loans of below investment grade companies. The reinvestment periods of CLO I and CLO II ended on February 15, 2010 and October 30, 2011, respectively. The reinvestment period of CLO III will end on July 20, 2012. As of December 31, 2011, the balances attributable to the controlling interest (the Partnership) and the non-controlling interest (the holders of the outstanding voting preferred shares in the Subsidiaries) from the Subsidiaries amount to \$(414,846,186) and \$391,329,588, respectively, and are included in partners' deficiency.

At December 31, 2011 the Group has a partners' deficiency of \$94,752,674 in the consolidated statement of financial condition. The Partnership has a deficiency of \$71,236,076 (excluding the Subsidiaries' deficiency) which is primarily due to compensation payable to employees of the Partnership that are tied to incentives earned by the general partners of certain Funds. Such incentives are accrued annually but until paid are subject to reversal in subsequent years as more fully described in Note 6. Under terms of the employment agreements, such compensation accruals are only paid to the employees once the general partners of the Funds have received distributions representing incentive allocations. After receipt of such incentive payments, the general partners will contribute to the Partnership amounts necessary to meet obligations under the employment agreements.

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

**NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 2011**

2. SIGNIFICANT ACCOUNTING POLICIES

This consolidated statement of financial condition has been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"), which require the use of estimates and assumptions by management that affect the reported amounts of assets and liabilities, including the fair value of investments, and disclosure of contingent assets and liabilities at the date of the consolidated statement of financial condition. Actual amounts and results could differ from such estimates and such differences could be material.

Cash and Cash Equivalents – Cash and cash equivalents include cash at banks and short-term investments with an original maturity of three months or less when purchased. At December 31, 2011 the majority of the cash and cash equivalents balances were held at affiliates of The Bank of New York Mellon, Inc. and Citigroup Inc. (69% and 31%, respectively).

Investments - Investments in securities are held at fair value which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (See Note 12 which further discusses the Group's valuation policies).

Debt Issuance Costs - Costs incurred in conjunction with the issuance of senior and subordinated notes payable by the Subsidiaries are amortized on a straight line basis over the life of these notes.

Property and Equipment - Property and equipment are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated using the methods described in Note 3.

Payable to Third Party Marketers - The Partnership recognizes amounts owed to third party marketers for helping to identify investors in certain funds it manages. Such amounts are generally computed as a percentage of the investors' capital committed to such funds, and are generally payable in quarterly installments over a three year period and are included in payable to third party marketers in the accompanying consolidated statement of financial condition.

Management Fees - Management fees are recorded on an accrual basis in accordance with the various investment management agreements.

Income and Expense - All items of income and expense are recorded when earned and incurred, respectively. Interest income is recognized only if amounts are reasonably estimable and collectable. Interest income may be received in cash or in-kind in accordance with the terms of the debt. Discounts on debt securities are amortized subject to collectability and other criteria determined by the Partnership. Interest income on cash held at banks is recognized on an accrual basis.

Interest expense on senior and subordinated notes payable by the Subsidiaries is expensed as incurred.

Operating Lease Expense, Deferred Rent and Lease Incentive - Rental expense on an operating lease is charged to income on a straight-line basis over the term of the lease.

During 2009, the Partnership entered into a ten-year operating lease for office space with ten months of free rent. The lease is subject to a rent escalation after five years from commencement of the lease. The free rent and rent escalation is included in the straight-line calculation of annual lease expense. In addition, the lease entitles the Partnership to receive a work allowance from the landlord as a lease incentive. The majority of such incentive was received during 2011. This incentive is being amortized over the term of the lease and is netted in minimum lease payments. The resulting deferred rent payable of \$4,403,927 is included in other liabilities in the consolidated statement of financial condition.

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

**NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 2011**

Income Taxes - No provision is made in the consolidated statement of financial condition for liabilities for federal, state, local income taxes or foreign taxes, other than New York City unincorporated business taxes, since such liabilities are the responsibility of the individual partners of the Partnership or the investors in the Subsidiaries.

The Partnership uses the liability method to account for New York City unincorporated business taxes in accordance with ASC 740, *Income Taxes*. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using currently enacted tax rates for the years in which the temporary differences are expected to reverse. As of December 31, 2011, the Partnership recorded deferred tax assets relating to temporary differences in accrued compensation, accrued expenses and a net operating loss for New York City unincorporated business tax purposes. The Partnership also recorded a deferred tax liability related to a temporary difference between the carrying amount of an airplane and its tax basis at December 31, 2011. The deferred tax assets and the deferred tax liability have been offset resulting in a net deferred tax asset in the consolidated statement of financial condition.

Interest and penalties, if any, assessed under the relevant tax law are recognized as incurred and are included in other liabilities in the consolidated statement of financial condition.

The Group follows the authoritative guidance for uncertainty in income taxes included in ASC 740, which requires the Group to determine whether a tax position is more likely than not to be sustained upon examination, including resolution of any related appeals or litigation process, based on the technical merits of the position. For tax positions meeting the more likely than not threshold, the tax position recognized in the consolidated statement of financial condition is measured as the largest benefit that is greater than fifty percent likely of being realized upon ultimate settlement with the relevant taxing authority. At December 31, 2011, there were no tax positions required to be accrued in accordance with the criteria set forth above.

The Partnership files tax returns in the US federal jurisdiction, various state jurisdictions and New York City jurisdiction. As of December 31, 2011, the tax years that remain subject to examination by such jurisdictions under the statute of limitations are 2008 and thereafter.

Representations and Warranties - In the normal course of business, the Group enters into arrangements with third parties that may contain a variety of representations and warranties, and may include indemnifications. The Group's maximum exposure under these arrangements is unknown. However, the Group expects the risk of material loss to be remote and no amounts have been recorded as liabilities relating to such arrangements at December 31, 2011.

AVENUE CAPITAL MANAGEMENT II, L.P. and Subsidiaries

NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION DECEMBER 31, 2011

3. PROPERTY AND EQUIPMENT

Property and equipment are carried at cost and consist of:

		Depreciation/ Amortization Period/Method
Airplane	\$ 16,378,353	20 years/Straight-line
Automobile	86,376	5 years/Accelerated
Computer network and equipment	1,124,675	5 years/Accelerated
Computer software	2,219,730	3 years/Accelerated
Furniture and fixtures	684,822	5 years/Accelerated
Leasehold improvements	4,919,650	Lease Term/Straight-line
Less accumulated depreciation and amortization	(7,578,932)	
Net	\$ 17,834,674	

Capitalized computer software consists of various licenses, implementation and other software costs. Internal use software costs are recorded in accordance with ASC 350-40, *Intangibles – Internal-Use Software*.

4. PAYABLE FOR INVESTMENTS PURCHASED

The amounts related to unsettled purchases of investments at December 31, 2011, relate to the Subsidiaries' activities and are presented in payable for investments purchased in the consolidated statement of financial condition.

5. RELATED PARTY TRANSACTIONS

During 2011, the Partnership provided investment advisory services to various Funds pursuant to various investment management agreements.

The Partnership and several affiliated investment managers share office space, employees and other overhead expenses. Direct expenses attributable to the Partnership performing its duties for the entities it manages are charged directly to the Partnership. All other allocable overhead expenses are shared pro-rata with the affiliated investment managers primarily based on management fees of the respective underlying funds being managed. Included in due from affiliates is \$7,806,094 resulting from the allocation of these expenses. Additionally, direct expenses paid by the Partnership on behalf of these affiliated investment managers of \$868,547 are included in due from affiliates in the consolidated statement of financial condition. Most of these amounts were repaid subsequent to year end.

The Partnership also pays certain costs directly on behalf of the Funds and is reimbursed by the Funds. Included in due from affiliates is \$654,992 due from the Funds at December 31, 2011.

ASC 810-10, provides guidance on the consolidation of certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In the normal course of business, the Partnership enters into a variety of transactions with VIEs. At December 31, 2011, the Partnership has determined that certain Funds and the Subsidiaries are VIEs. The exposure of the Partnership to these VIEs (other than the Subsidiaries) is limited to its receivable for management fees, if any, in the consolidated statement of financial condition.

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

**NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 2011**

The Partnership determines if it is the primary beneficiary of a VIE by performing a qualitative analysis of each VIE that includes a review of, among other factors, its capital structure, contractual terms, related party relationships, the Partnership's fee arrangements and the design of the VIE. As of December 31, 2011, the Partnership has concluded that the Partnership was the primary beneficiary of the Subsidiaries, as it has the power to direct the Subsidiaries' activities that most significantly impact their economic performance, and the Partnership's economic interest could potentially be significant to the Subsidiaries. As such, the Partnership consolidated the assets and liabilities of the Subsidiaries as described in Note 1.

The Partnership also concluded that based on the above mentioned analysis the Partnership was not the primary beneficiary of the remaining VIEs, and as such, did not consolidate them.

The creditors, including the note holders, and the preferred shareholders of the Subsidiaries have no recourse to the general credit of the Partnership.

The carrying amount of the assets and liabilities of the Subsidiaries at December 31, 2011 are as follows:

Assets:

Cash	\$ 39,761,235
Investments, at fair value	926,269,091
Other assets	11,711,682
Total assets	<u>\$ 977,742,008</u>

Liabilities:

Senior and subordinated notes payable	\$ 990,634,941
Other liabilities	10,623,665
Total liabilities	<u>\$ 1,001,258,606</u>

6. EMPLOYMENT AGREEMENTS

Pursuant to various employment agreements, the Partnership is obligated to pay certain senior employees their share of the incentive allocations, if any, earned by certain of the Partnerships' affiliated Funds. These amounts are included in compensation payable to employees in the consolidated statement of financial condition totaling \$94,857,392 as of December 31, 2011. Amounts payable under employee agreements for the these funds are accrued based on the respective employees' percentage of cumulative incentive allocations earned in these funds and are paid pursuant to the terms of the funds' partnership agreements and respective employment agreements. Amounts are accrued annually, and until paid are subject to reversal in subsequent years based on the performance of these funds.

Pursuant to separation agreements with two senior employees, the Partnership owes severance compensation to the employees in the amount of \$2,232,694 which is included in compensation payable to employees in the consolidated statement of financial condition.

**AVENUE CAPITAL MANAGEMENT II, L.P.
and Subsidiaries**

**NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 2011**

7. LINE OF CREDIT

The Partnership and two affiliates share a \$10,000,000 line of credit with a bank that expires on March 30, 2012. Pursuant to terms of the agreement, the Partnership cannot have more than \$5,000,000 of the line of credit outstanding at any time. Interest is payable monthly on outstanding borrowings at a rate of LIBOR plus 2.25% per annum, or the Alternate Base Rate, as defined in the agreement, plus 0.25% per annum. At December 31, 2011, the Partnership did not have any borrowings outstanding.

The Partnership is contingently liable for \$2,898,688 on a standby letter of credit in connection with one of its office space leases as of December 31, 2011.

8. NOTES PAYABLE - BANK

The Partnership and two affiliates obtained a loan to purchase an airplane through a trust during 2007. As part of a refinancing entered into by the Partnership and two of its affiliates in December 2011, the original note was fully repaid and replaced by a secured note ("Note (i)") and an unsecured note ("Note (ii)"), and together with Note (i), the "Notes"). The principal terms of the Notes are summarized below:

	Total principal amount outstanding at December 31, 2011	Partnership's share of principal amount outstanding at December 31, 2011	Interest rate	Maturity
Note (i)	\$ 13,400,000	\$ 6,700,000	LIBOR + 1.15%	December 15, 2016
Note (ii)	10,160,916	5,080,458	LIBOR + 2%	December 15, 2014
Total	<u>\$ 23,560,916</u>	<u>\$ 11,780,458</u>		

The Partnership and two affiliates are jointly and severally liable to repay their respective borrowings plus accrued interest. In addition, Note (i) is secured by the airplane. The carrying amounts of the notes payable approximate fair value at December 31, 2011.

The applicable LIBOR for the notes payable - bank at December 31, 2011 is 0.28%.

Current and long-term maturities of the Partnership's share of the Notes are as follows:

Year Ending December 31,	
2012	\$ 450,000
2013	600,000
2014	5,680,458
2015	600,000
2016	4,450,000
Total	<u>\$ 11,780,458</u>

9. SENIOR AND SUBORDINATED NOTES PAYABLE

The following senior and subordinated notes payable were issued under the various indenture agreements (the "Indentures") entered into by the Subsidiaries:

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CLO I - On December 20, 2004, CLO I entered into an Indenture to issue various notes payable. The terms of the notes payable outstanding at December 31, 2011 are summarized as follows:

Note	Maturity	Interest Rate (per annum)	Outstanding Principal Amount
Class A-1L	February 2017	LIBOR + 0.35%	\$ 100,891,003
Class A-2L	February 2017	LIBOR + 0.60%	34,000,000
Class A-3L	February 2017	LIBOR + 1.10%	19,000,000
Class B-1L	February 2017	LIBOR + 2.15%	9,000,000
Class B-2L	February 2017	LIBOR + 6.25%	8,761,257
Class B-1F	February 2017	6.59%	10,000,000
			<u>\$ 181,652,260</u>

CLO II - On August 11, 2005, CLO II entered into an Indenture to issue various notes payable. The terms of the notes payable outstanding at December 31, 2011 are summarized below:

Note	Maturity	Interest Rate (per annum)	Outstanding Principal Amount
Class A-1L	October 2017	LIBOR + 0.26%	\$ 298,326,009
Class A-2L	October 2017	LIBOR + 0.42%	35,500,000
Class A-3L	October 2017	LIBOR + 0.72%	22,500,000
Class B-1L	October 2017	LIBOR + 1.80%	19,250,000
Class B-2L	October 2017	LIBOR + 4.75%	18,032,863
			<u>\$ 393,608,872</u>

CLO III - On May 10, 2006, CLO III entered into an Indenture to issue various notes payable. The terms of the notes payable outstanding at December 31, 2011 are summarized below:

Note	Maturity	Interest Rate (per annum)	Outstanding Principal Amount
Class A-1L	July 2018	LIBOR + 0.26%	\$ 307,598,809
Class A-2L	July 2018	LIBOR + 0.45%	39,000,000
Class A-3L	July 2018	LIBOR + 0.75%	24,000,000
Class B-1L	July 2018	LIBOR + 1.65%	21,500,000
Class B-2L	July 2018	LIBOR + 4.00%	22,000,000
Class X	July 2012	5.64%	1,275,000
			<u>\$ 415,373,809</u>
Total for CLO I, CLO II and CLO III			<u>\$ 990,634,941</u>

The applicable LIBOR for the notes payable for CLO I, CLO II and CLO III at December 31, 2011 is 0.46%, 0.43% and 0.41%, respectively.

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The interest payments on the notes payable are made based on the availability of funds and subject to the priority of payments as described in their respective Indentures. The notes payable are secured by the Subsidiaries' portfolio of investments which primarily comprises bank debt and corporate debt securities. Certain notes payable are senior to other notes payable, and all notes payable are senior to the preferred shares of the Subsidiaries. Generally, the seniority of the notes payable is indicated by their alphabetical and numerical order, except for Class X notes which are senior to all other notes payable by the Subsidiaries.

At December 31, 2011, the combined fair value of the senior and subordinated notes payable is estimated at approximately \$899,659,000.

Covenants - Under the Indentures, the Subsidiaries are subject to certain covenants including minimum collateralization and interest coverage levels, and portfolio collateral quality tests. At December 31, 2011, the Subsidiaries are in compliance with these covenants, except for certain tests for which noncompliance requires modifications to the portfolio to maintain or improve these tests, and does not trigger an event of default under the Indentures.

10. PREFERRED SHARES

At December 31, 2011, CLO I, CLO II and CLO III had 32,200,000, 34,625,000 and 38,700,000, respectively, authorized, issued, and outstanding voting preferred shares which were issued at \$1 per share (par value: \$0.001).

11. COMMITMENTS

The Partnership has operating leases for office spaces. Approximate aggregate minimum future payments under these leases are as follows:

Year Ending December 31,	
2012	\$ 3,433,722
2013	3,379,487
2014	3,374,556
2015	3,490,924
2016	3,723,648
Thereafter	<u>13,676,096</u>
Total	<u>\$31,078,433</u>

12. FAIR VALUE MEASUREMENT

The Group follows ASC 820, *Fair Value Measurement*, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Investments held by the Subsidiaries include common stocks, corporate debt securities and bank debt that are valued after consideration of relevant information, including a representative selection of transactions with or indications of fair value from dealers in these financial instruments, a number of independent

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pricing sources, and the liquidity of the relevant market on the valuation date. A valuation is determined by the Partnership, in good faith, within the range of bid and ask quotes and independent prices considered best to represent the estimated fair value in the circumstances. However, because of the inherent uncertainty of valuation, including assumptions made by the Partnership due to the lack of observable inputs, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

ASC 820 established a three-tier hierarchal framework for measuring fair value which prioritizes and ranks the level of market price observability used in measuring investments at fair value. Observable inputs reflect the assumptions market participants would use in pricing an asset or liability. The Partnership considers observable data to be that market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the Partnership's perceived risk of that instrument. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Unobservable inputs are based on the best information available in the circumstances. Investments and cash equivalents, if any, measured and reported at fair value are classified and disclosed in one of the following categories:

Level I - Quoted prices are available in active markets for identical investments as of the reporting date. Investments which are included in this category are cash equivalents.

Level II - Pricing inputs are other than quoted prices for identical securities in active markets, which are either directly or indirectly observable as of the reporting date. Investments which are generally included in this category include corporate debt securities and bank debt with multiple observable inputs from market participants.

Level III - Pricing inputs are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management judgment or estimation. Investments that are generally included in this category include corporate debt securities and bank debt with unobservable inputs from market participants.

The following is a summary of the categories of investments used as of December 31, 2011 in valuing the Group's investments at fair value:

	Level I		Level II		Level III		Total
Cash Equivalents	\$	1,607,557	\$	-	\$	-	\$ 1,607,557
Bank Debt		-		598,746,009		281,847,719	880,593,728
Common Stocks		-		-		1,971,710	1,971,710
Corporate Debt Securities		-		43,703,653		-	43,703,653
	\$	1,607,557	\$	642,449,662	\$	283,819,429	\$ 927,876,648

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13. RISKS

The following summary of certain risk factors is not intended to be a comprehensive summary of all risks inherent in the Group.

The Subsidiaries' investment activities expose them to various types of risk which are associated with the financial instruments and markets in which they invest. These risks include, but are not limited to: market, credit, interest rate, counterparty and settlement risks, illiquidity, exchange or cash tender offers, litigation, bankruptcy and other laws, lender liability, default of transaction co-parties, political and economic events, and financial fraud by underlying investments.

The Subsidiaries' investment activities subject them to market risk. Market risk is the risk of potential adverse changes to the value of financial instruments because of changes in market conditions such as interest and currency rate movements and volatility in security prices.

The Subsidiaries typically purchase bank debt via direct assignment from the seller. The Subsidiaries may also purchase bank debt via participation. When purchasing an assignment, the Subsidiaries typically succeed all loan rights and obligations and become a lender under the credit agreement with respect to the debt obligation purchased. Accordingly, the Subsidiaries have direct rights against the borrower; provided, however, that the Subsidiaries' rights may be more limited than the lender from which it acquired the assignment and the Subsidiaries may be able to enforce its rights only through an administrative agent. In contrast, when purchasing via participation, the Subsidiaries typically enter into a contractual relationship with the lender or third party selling such participations ("Selling Participant"), but not the borrower. As a result, the Subsidiaries assume the credit risk of the borrower and the Selling Participant and any other intermediate person between the Subsidiaries and the borrower. Although certain assignments or participations are secured by collateral, the Subsidiaries could experience delays or limitations in realizing such collateral or have its interest subordinate to other indebtedness of the borrower. The Subsidiaries may be contractually obligated to receive approval from the agent bank and/or borrower prior to the sale of these investments.

Bank debt in which the Subsidiaries invest generally pays interest at rates which are fixed or periodically re-determined by reference to a base lending rate plus a spread. Accordingly, the Subsidiaries are subject to interest rate risk. The Subsidiaries are also subject to interest rate risk on its other fixed income investments. The sensitivity to changes in interest rate risk is greater for long-term investments than for short-term investments.

The liquidity of the market for debt securities has fluctuated over time and may at times be illiquid, thereby impairing the ability of the Subsidiaries to sell an investment in a timely manner at the fair value as established by the Partnership. The market for less liquid investments may be more volatile than the market for highly liquid investments. If the Subsidiaries were forced to dispose of a less liquid investment at an inopportune time, the Subsidiaries may be forced to do so at a substantial discount to fair value, potentially resulting in a loss to the Subsidiaries.

The Subsidiaries' investment activities subject them to credit risk. Credit risk is the potential loss the Subsidiaries may incur as a result of the failure of an issuer or counterparty to make payments according to the terms of a contract. Credit risk arises from investment activities in which the Subsidiaries are exposed to the potential default or bankruptcy of debtors in the repayment of principal and interest. The Subsidiaries' exposure to credit risk is limited to amounts recorded as assets in the consolidated statement of financial condition.

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The Subsidiaries are also subject to credit risk to the extent that the agent banks, the trustee or other counterparties may be unable to fulfill their obligations either to return the Group's cash and investments or repay amounts owed. Although the Group monitors its agent banks, trustee and other counterparties, there is no guarantee that one or more of these parties will not become insolvent. While both the U.S. Bankruptcy Code and the Securities Investor Protection Act of 1970 seek to protect customer property in the event of a failure, insolvency or liquidation of a bank, there is no certainty that, in the event of a failure of a bank that has custody of the Group's assets, the Group would not incur losses due to its assets being unavailable for a period of time, less than full recovery of its assets ultimately, or both.

The Subsidiaries' investments are comprised primarily of U.S. bank debt and corporate debt securities spread across a large variety of industries with no industry category being dominant. The Subsidiaries do not have any significant exposure to any one issuer.

The Group maintains cash in bank deposit accounts which may exceed federally insured limits. The Group has not experienced any losses on such accounts and does not believe it is exposed to any significant risk on cash.

Legal, tax, and regulatory developments that may adversely affect the Group could occur. Capital markets are subject to comprehensive statutes, regulations, and margin requirements enforced by the SEC, other regulators and self-regulatory organizations and exchanges, which are authorized to take extraordinary actions in the event of market emergencies. The regulation of entities that engage in capital market transactions is an evolving area of law and is subject to modification by government, judicial and regulatory actions. It is impossible to know what, if any, changes in regulations may occur, but any regulations that restrict the ability of the Group to carry out its operations or achieve its investment objectives or the ability of the counterparties to extend credit in its trading (as well as other regulatory changes) could have a material adverse impact on the Group.

14. RECENT ACCOUNTING DEVELOPMENTS

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). The guidance in ASU 2011-04 is intended to result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the guidance changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Certain disclosures required under ASU 2011-04 are not applicable to non-public entities. ASU 2011-04 is effective for annual periods beginning after December 15, 2011.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities* ("ASU 2011-11"). The guidance in ASU 2011-11 requires an entity to enhance disclosures about offsetting and related arrangements to enable users of its financial statements to understand the effect or potential effect of those arrangements on its financial position. The required disclosures are applicable to financial instruments and derivatives that are either (1) offset in accordance with certain U.S. GAAP or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset or not. ASU 2011-11 is effective for annual periods beginning on or after January 1, 2013.

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15. SUBSEQUENT EVENTS

The Group has evaluated subsequent events through March 30, 2012, the date the consolidated statement of financial condition was authorized for issue and has concluded that no events occurred from the date of the consolidated statement of financial condition through the date the consolidated statement of financial condition was authorized for issue that would require disclosure in the consolidated statement of financial condition.