

Hudson Americas L.P.  
Hudson Advisors L.P.

Part 2A of Form ADV  
The Brochure

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This brochure provides information about the qualifications and business practices of Hudson Americas L.P. (“HAM”), the filing adviser, and Hudson Advisors L.P. (“HAL”), the relying adviser. Together, HAM and HAL are referred to herein as the “Registered Advisers.” If you have any questions about the contents of this brochure, please contact us at 214-754-8400. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

Additional information about the Registered Advisers is also available on the SEC’s website at: [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The Registered Advisers are registered investment advisers. Registration as an investment adviser does not imply a certain level of skill or training.

## **Item 2: Material Changes**

This amendment contains material changes from the Registered Advisers' amendment dated December 21, 2015. This amendment reflects a change of general partner for Hudson Americas L.P. in Item 4. This amendment provides additional information in Item 5 regarding the fees and expenses of the Registered Advisors, in Item 9 regarding the arbitration against the Republic of Korea with the International Center for Settlement of Investment Disputes, and in Item 10 regarding the regulatory registrations of certain affiliates of the Registered Advisors.

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## **Item 4: Advisory Business**

### **Background of the Registered Advisers and their Clients**

HAL is a Delaware limited partnership. HAL was formed in 1995 as a Texas limited liability company and converted to a Delaware limited partnership in August 2015. HAL is owned 99.9% by its sole limited partner The Hudson LP Holdings Trust, and 0.10% by its general partner Hudson Advisors GenPar, Inc. Hudson Advisors GenPar, Inc. is owned by The Hudson GP Holdings Trust. Codan Trust Company Limited serves as Trustee for both The Hudson LP Holdings Trust and The Hudson GP Holdings Trust. In addition to HAM, HAL has several subsidiaries domiciled in non-U.S. jurisdictions, including Asia and the European Union.

HAM is a Delaware limited partnership. HAM was formed in 2008 as a subsidiary of HAL. In 2015, HAM converted from a Delaware limited liability company to a Delaware limited partnership. HAM is owned 100% by HAL, its sole limited partner. Hudson Americas GenPar, LLC serves as the general partner of HAM. Hudson Americas GenPar, LLC is solely owned by HAL.

HAM and HAL are SEC-registered investment advisors. HAM and HAL have filed a single Form ADV with the SEC. This brochure includes information regarding both HAM (the filing adviser) and HAL (the relying adviser).

HAL, HAM and their affiliates provide investment advisory and related services to a family of closed-end, privately-offered funds (the “Funds”). Each Fund structure consists of a limited partnership organized in the United States under state law and one or two corresponding exempted limited partnerships formed in Bermuda (such fund structure organization, the “U.S./Bermuda Funds”). When a Fund is investing, its U.S./Bermuda Funds will invest on a side-by-side basis in proportion to the respective capital commitments of each Fund. The Funds are not registered under the Investment Company Act of 1940, as amended (“1940 Act”), and the offer and sale of interests in the Funds is not registered under the Securities Act of 1933, as amended (“1933 Act”). For purposes of this Form ADV, the Funds include (1) Lone Star Real Estate Fund IV (U.S.), L.P. and Lone Star Real Estate Fund IV (Bermuda), L.P. (together, “LSREF IV”), (2) Lone Star Residential Mortgage Fund I (U.S.), L.P. and Lone Star Residential Mortgage Fund I Holdings (Bermuda), L.P. (together, “LSRMF I”), (3) Lone Star Fund IX (U.S.), L.P., Lone Star Fund IX (Bermuda), L.P., and Lone Star Fund IX Parallel (Bermuda), L.P. (together “LSF IX”), (4) Lone Star Real Estate Fund III (U.S.), L.P. and Lone Star Real Estate Fund III (Bermuda), L.P. (together, “LSREF III”), (5) Lone Star Fund VIII (U.S.), L.P. and Lone Star Fund VIII (Bermuda), L.P. (together, “LSF VIII”), (6) Lone Star Real Estate Fund II (Bermuda), L.P. and Lone Star Real Estate Fund II (U.S.), L.P. (together, “LSREF II”), (7) Lone Star Fund VII (U.S.), L.P. and Lone Star Fund VII (Bermuda), L.P. (together, “LSF VII”), (8) Lone Star Real Estate Fund (Bermuda), L.P. and Lone Star Real Estate Fund (U.S.), L.P. (together, “LSREF”), (9) Lone Star Fund VI (Bermuda), L.P., and Lone Star Fund VI (U.S.), L.P. (together, “LSF VI”), (10) Lone Star Fund V (Bermuda), L.P. and Lone Star Fund V (U.S.), L.P. (together, “LSF V”), (11) Lone Star Fund IV (Bermuda), L.P. and Lone Star Fund IV (U.S.), L.P. (together, “LSF IV”), and (12) Lone Star Fund III (Bermuda), and Lone Star Fund III (U.S.), L.P. (together, “LSF III”).

The general partners of the Funds (the “General Partners”), each of which is a related person of Hudson (defined below), have broad discretion under the Funds’ respective limited partnership agreements to manage the affairs of the Funds. Each Fund has entered into an agreement with HAL to provide the services described below. In providing services to the Funds, HAL relies on the resources of HAM as well as its direct and indirect non-U.S. subsidiaries that supply services on a regional basis pursuant to participating affiliate arrangements (“Participating Affiliates”). HAL’s Participating Affiliates are further discussed in Item 10. HAL, HAM, and the Participating Affiliates are referred to collectively in this brochure as “Hudson.”

Lone Star Global Acquisitions, Ltd. (“LSGA”), a related person of Hudson and an SEC-registered investment adviser, provides investment advisory and related services to the Funds. LSGA has a subsidiary domiciled in the United States, Lone Star Americas Acquisitions, LLC (“LSAA”), which is also an SEC-registered investment adviser that provides advisory services to the Funds. In addition to the services that LSGA and LSAA provide to

the Funds, LSGA relies on the resources of certain of its direct and indirect subsidiaries that provide advisory services from outside the U.S. (also through participating affiliate arrangements). LSGA's participating affiliates are further discussed in Item 10. LSGA, LSAA and LSGA's participating affiliates are referred to collectively in this brochure as "Lone Star."

Certain employees, officers, directors, executives, members and contractors of Hudson, Lone Star, and their affiliates ("Key Employees") are given the opportunity to invest on a side-by-side basis with the Funds through employee investment vehicles that are structured to facilitate those Key Employees' investments (each, an "Employee Investment Vehicle"). The Employee Investment Vehicles co-invest with the Funds in each investment that the Funds acquire; the Employee Investment Vehicles do not make any differing or separate investments from the Funds. The structure and operations of the Employee Investment Vehicles are discussed in Item 11.

### **Description of Services**

HAL, either directly or through HAM or its Participating Affiliates, provides three categories of advisory services to the Funds.

- Due diligence and analysis services
- Asset management services
- Hedging services

HAL, either directly or through HAM or its Participating Affiliates, also provides ancillary services to the Funds. Hudson provides its due diligence and analysis, asset management, and ancillary services with respect to newly or recently originated corporate debt and commercial real estate-secured debt under the name LStar Capital ([www.lstarcap.com](http://www.lstarcap.com)).

### ***Due Diligence and Analysis Services***

HAL provides due diligence and analysis services to each of the Funds. HAM and the Participating Affiliates assist HAL in providing due diligence and analysis services on a regional basis. HAM provides due diligence and analysis services with respect to the Funds' investment activities in the Americas region.

Lone Star is responsible for investigating and evaluating potential investment opportunities that fall within a respective Fund's investment strategy and objectives, as set forth in its Offering Documents (defined below). After Lone Star has identified a potential investment opportunity, Lone Star provides information on the opportunity to Hudson. Hudson will then assist Lone Star in completing a full financial review and valuation of the investment opportunity, including a complete bottom-up, asset based due diligence evaluation of the transaction. Lone Star uses the documentation generated by Hudson's due diligence and analysis to evaluate the potential investment, and (often assisted in specific aspects by Hudson) to prepare an Investment Committee Memorandum with detailed information regarding the potential investment. Lone Star then presents the investment opportunity to the Investment Committee at LSGA responsible for the relevant Fund that is currently in its investment period (the "Investment Committee"). With respect to each of those Funds except for LSRMF I, the Investment Committee will include (i) the Chairman of LSGA; (ii) the President of LSGA, (iii) the three principals of Lone Star who direct certain regional operations of Lone Star for that Fund (each a "Region Head"), and (iv) the General Counsel of Lone Star (as a non-voting member). With respect to LSRMF I, the Investment Committee will include (i) the Chairman of LSGA, (ii) the President of LSGA, (iii) the President of LSAA (i.e., the Region Head for the North America region), (iv) two other senior officers of LSAA, and (v) the General Counsel of Lone Star (as a non-voting member). If approved by the Investment Committee with an affirmative vote of a majority of the members required to approve an investment, such investment will be presented to the General Partner of the Fund for final approval. Once approved by the General Partner, the investment may be committed and ultimately completed.

Hudson tailors its services to the investment strategy and objectives described in the relevant Fund's offering documents, including the Fund's private placement memorandum, limited partnership agreement and other governing documents (collectively, the "Offering Documents").

The Funds invest in a broad range of financial and other investment assets, subject to the terms of each Fund's Offering Documents. These assets include, but are not limited to:

- Commercial and single family residential real estate-secured debt, corporate debt and consumer debt;
- Direct and indirect equity investments in real estate and real estate-related assets;
- Control investments in financially oriented and other operating companies; and
- Securitized products such as residential mortgage-backed securities ("RMBS"), collateralized debt obligations ("CDOs") (the underlying assets of which generally consist of RMBS), commercial mortgage-backed securities ("CMBS"), and other asset-backed securities ("ABS").

Investment opportunities in each of these categories may be located in the U.S. or outside of the U.S., subject to certain geographical limitations of the respective Fund set forth in the Fund's Offering Documents. Such opportunities may include newly or recently issued loans or securities as well as more seasoned assets, subject to the terms of the Fund's Offering Documents. The Fund may invest in assets directly or indirectly through special purpose entities formed to hold the Fund's investments (each such entity is referred to as a special purpose vehicle or "SPV").

### ***Asset Management Services***

HAL provides general asset management services with respect to most of the investments of the Funds. HAM and the Participating Affiliates assist HAL in providing these services on a regional basis. HAM provides asset management services with respect to the Funds' assets in North America. Hudson contracts directly with the Funds' SPVs to provide asset management services with respect to investments held by the SPVs.

Once an investment has been approved by the Investment Committee and the Fund's General Partner and implemented for a Fund, Hudson typically develops an initial business plan for the ongoing management of the new investment, consistent with the Investment Committee Memorandum ("Business Plan"). After an investment has been closed and integrated into Hudson's asset management program, Hudson performs ongoing day-to-day asset management of the investment, consistent with the Business Plan. This includes making recommendations and providing advice regarding the investments of the Funds, including management, financing and disposition strategy recommendations. The Region Heads periodically review the implementation and ongoing validity of the Business Plan; this review process is discussed in Item 13. Hudson and Lone Star work closely together throughout the life of an investment. Lone Star also provides strategic and other related advice regarding investments held by the Funds. Senior management of Hudson, with input from Lone Star, will advise on the appropriate exit for an investment, based on an ongoing analysis of buy versus hold scenarios, with a goal of maximizing overall risk-adjusted investor returns.

### ***Hedging Services***

Because the Funds are U.S. dollar-based funds that invest on a global basis, Hudson provides foreign-currency hedging services, employing currency strategies that aim to reduce the foreign currency exposure of the Funds' investments (the goal, in principle, is to maintain a "currency neutral" position). Similarly, where the Funds invest in assets that have identified interest rate exposures or other risks, Hudson may provide

interest rate hedging services or other hedging services related to those investments where such hedging services are deemed appropriate and cost effective, in an effort to reduce their exposure to interest- rate volatility of such other risks. Lone Star provides regular advice and guidance to Hudson regarding the appropriate hedging strategy to follow with respect to a particular Fund or investment.

Hudson may hedge less than the full amount of an investment's currency, interest rate, or other risk exposure. Hudson's foreign exchange and interest rate hedging services encompass the hedging review, selection of hedging counterparties, trading and related accounting functions. HAL implements the Funds' hedging activities through a variety of derivatives. In connection with non-U.S. dollar denominated investments by the Funds, HAL typically uses forward foreign exchange contracts and foreign currency options to manage foreign currency exposure. Additionally, if Hudson hedges the interest rate exposure of an investment, it typically uses interest rate swaps and interest rate options.

### ***Ancillary Services***

Hudson provides to the Funds certain ancillary back office services that work in tandem with asset management, including legal, compliance, audit, accounting and periodic reporting, cash management, tax, risk management advice, operating company oversight, and information technology development and other similar and related services. Hudson also provides certain ancillary services to other related parties. HAM and the Participating Affiliates provide certain ancillary services (aside from the purchase of insurance) to the Funds on a regional basis, with HAM providing certain ancillary services with respect to the Funds' assets in the Americas region. Hudson also contracts directly with the Funds' SPVs to provide certain ancillary services with respect to investments held by the SPVs.

Hudson obtains insurance for Hudson, Lone Star and the Funds. HAL purchases insurance policies through third-party insurance brokers, including: (a) property and casualty policies for the assets owned by Hudson, Lone Star, the Funds, their SPVs and other entities within the Funds' investment structures; and (b) directors and officers liability and professional liability policies covering Hudson and Lone Star (including but not limited to their directors, officers and employees) the Funds, their SPVs, and other entities within the Funds' investment structures. Generally, HAL purchases these insurance policies on a group basis to cover Hudson, Lone Star, the Funds, the SPVs, and other entities within the Funds' investment structures, and the Funds reimburse HAL for their respective shares of the policy premiums as calculated by the insurance broker. HAL selects insurance based on factors including premium price and the insurance broker's ability to service and provide resources with respect to the insurance policy.

As part of Hudson's ancillary services, it determines the fair value of the Funds' investments, as discussed further in Item 8, and also provides periodic financial reports on the Funds' investments, as discussed in Item 13.

### **Wrap Fee Programs**

The Registered Advisers do not participate in wrap fee programs.

### **Assets under Management**

As of December 31, 2015, the Registered Advisers provided investment supervisory services, including due diligence and analysis services, asset management services, and hedging services, with respect to approximately \$39,803,900,000 in assets and unfunded commitments of the Funds.

## **Item 5: Fees and Compensation**

The limited partners of the Funds, other than LSF III and LSF IV, include only “qualified purchasers,” as that term is defined in Section 2(a)(51) of the 1940 Act. Accordingly, the fees that Hudson charges to those Funds are set out in the Funds’ Offering Documents but are not specifically described herein.

HAL provides, either directly or indirectly through HAM or one of HAL’s Participating Affiliates, asset management services to the Funds and to the SPVs for a fee capped, for each type of asset, at a specific percentage of assets under management over the life of the Fund. For LSF III and LSF IV, these fees are capped at 2.75% of assets under management. The Advisory Committee (defined below in Item 6) of each of LSF III and LSF IV approved the fee cap, and the fee cap may only be increased with the respective Fund’s Advisory Committee’s approval.

Hudson also provides due diligence and analysis services, hedging services, and ancillary services for a fee typically charged using actual time incurred and hourly billing rates based on the cost of providing these services, plus a specified margin. For LSF III and LSF IV, the fees for these services typically include a 10% margin. These fee arrangements were also approved by the Advisory Committee of each of these Funds.

In determining applicable billing rates, Hudson incorporates the overhead cost of the resources deployed, including, but not limited to, the costs of employee compensation and benefits, office leases, information technology, Hudson regulatory compliance, human resources, and other Hudson operations supporting the services provided. Hudson billing rates do not include costs of the General Partners, Lone Star, or the Funds.

Typically, Hudson’s fees are billed to the applicable Fund and/or SPV. For certain services provided by Hudson, HAL receives fees from the Funds and pays all or a portion of such fees to the applicable Hudson entity as compensation for the services provided by such entity. Certain assets held by the SPVs may be jointly owned by a Fund and an unaffiliated third party pursuant to a joint venture arrangement. The distributions received by such third party with respect to those assets will be net of the fees paid by the SPV to Hudson. The Employee Investment Vehicles do not pay any fees directly to the Registered Advisers, but receive distributions net of fees paid to Hudson.

Hudson typically receives fees for its services on a monthly basis in arrears and does not bill in advance. In limited circumstances, Hudson’s asset management fees (as set forth in the applicable agreement governing the asset management services) are paid on a quarterly basis, all or a portion of which is payable in advance. If Hudson did not perform asset management services for the entire quarter, Hudson would return to the applicable Fund and/or SPV any prepaid but unearned fees. Hudson does not require or solicit prepayment of fees six months or more in advance.

Caliber Home Loans, Inc. (“CHL”), a full service mortgage company and special servicer jointly owned by LSF V and LSF VI, provides a full complement of services including managing collection, modification and reporting activities for U.S. residential whole loan portfolios and mortgage servicing rights owned by certain of the Funds. Certain key employees of Lone Star and Hudson comprise a majority of the board of directors of CHL. The parameters of fee arrangements between CHL and the Funds other than LSF V or LSF VI are either specified in the limited partnership agreement of the applicable Fund or approved by the Advisory Committees (defined below) of the applicable Funds. CHL’s fees for servicing are generally based on a percentage of the unpaid principal balance of the loans serviced. CHL may also receive the types of incentive fees customarily retained by residential loan servicers for loss mitigation activities, based on a percentage of the loan balance. For any ancillary services performed by CHL (such as accounting and transaction management services), CHL’s fees are based on the actual cost incurred plus a specified margin. Neither Lone Star nor Hudson has ownership in CHL or shares in the fees it receives.

Each Fund will typically bear the cost of legal, travel, and other out-of-pocket organizational and syndication expenses incurred in the formation and closing of the Fund. Such organizational and syndication expenses are shared on a pro rata basis by commitments between the U.S./Bermuda Funds. The obligation of the Fund for such organizational and syndication expenses will be limited to a dollar amount as set forth in the Fund's limited partnership agreement; any costs in excess of this amount will be payable by the Fund and such amounts in excess will offset Management Fees (as defined below) payable to LSGA. The Funds generally bear all expenses related to their investment operations, including broker's commissions, clearance charges, due diligence expenses, loan servicing fees, travel expenses, taxes, other expenses incident to the purchase, maintenance and sale of investments by such Fund, charges incurred in connection with the custody of investments, outside legal and accounting fees, insurance and litigation expenses, and any taxes, fees, or other governmental charges levied against the Funds. To the extent not paid by the Funds or the SPVs directly, the Funds will reimburse Hudson for out-of-pocket third party expenses and charges incurred and paid on behalf of the Funds and/or the SPVs. Item 12 discusses Hudson's practices for choosing brokers and certain other counterparties.

Certain expenses incurred by one or more Funds may be paid by a single Fund, which is reimbursed by other Funds for their appropriate share of the relevant expenses. In such cases, HAL has implemented procedures designed to ensure that such allocations are based on a method whereby these expenses are reimbursed to the Fund that paid them in the proper amount.

LSGA is paid a fee for its services, which is the management fee described in the Fund's limited partnership agreement (the "Management Fee"). The Management Fees are payable out of funds of the Funds or pursuant to capital calls on the limited partners' unfunded commitments and are payable monthly in arrears during the commitment period of a Fund (i.e., the period during which the General Partner may call capital for new investments from limited partners), and quarterly in arrears thereafter.

Neither the Registered Advisers nor any of their supervised persons receive compensation for sales of Fund or Employee Investment Vehicle interests, or any other securities or investment products.

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

Hudson does not receive any performance-based fees for the services that it performs for the Funds. The General Partner of each Fund, which is a related person of Lone Star, receives a "carried interest," which is a certain percentage of the actual returns in excess of certain performance hurdles of each investment made by the relevant Fund. The amount of carried interest may change over time based on the performance of the Fund's investments and is similar to a performance-based fee. The General Partner will be entitled to receive its "carried interest" at the appropriate payment level within such Fund's distribution hierarchy (i.e., waterfall), which is set forth in the Fund's Offering Documents. Payment of the General Partner's carried interest will generally occur on an investment-by-investment basis after all capital contributed for such investment is returned and a specific preferred return on such investment is realized and paid to the relevant Fund's limited partners.

Certain supervised persons of Hudson are limited partners of one or more of the General Partners, and may, therefore, receive a portion of the "carried interest." This fee arrangement could create an incentive for these supervised persons when allocating investment opportunities to favor a Fund that pays higher carried interest over a Fund that pays lower carried interest. The Registered Advisers believe, however, that there are safeguards in place that protect against this circumstance. The Funds have typically been structured such that only one Fund is investing in a particular asset class at any given time. When two Funds are investing at the same time, the limited partnership agreement of each of the Funds specifies the types of eligible investments that each of these Funds may make, generally without significant overlap between such Funds. Such safeguards are further discussed in Item 11.

The Employee Investment Vehicles are not subject to carried interest allocations. In addition to the safeguards discussed in Item 11, the conflict of interest represented by managing the Employee Investment Vehicles side-by-



side with the Funds is mitigated by the structure of the Employee Investment Vehicles. The Employee Investment Vehicle(s) corresponding to a particular Fund participate in the same investments purchased by the Fund and represent a relatively small percentage of each investment. These structural elements are designed to align the interests of participants in the Employee Investment Vehicles with the interests of the Funds.

## **Item 7: Types of Clients**

### **Private Funds**

The Registered Advisers provide investment advisory services exclusively to private funds. Each Fund sets its own minimum investment requirements for investors, which was twenty-five million U.S. dollars for LSREF IV and LSF IX and ten million U.S. dollars for LSRMF I. The General Partner of a Fund may, in its sole discretion, waive the investment minimum.

Each investor participating in the Funds is required to meet certain minimum qualifications applicable to the respective Fund, i.e., the investor must be an “accredited investor” within the meaning of Rule 501 of Regulation D promulgated under the 1933 Act, and, with respect to the Funds other than LSF III and LSF IV, also must be a “qualified purchaser” as defined in Section 2(a)(51) of the 1940 Act.

### **Employee Investment Vehicles**

As noted in Item 4, and further described in Item 11, the Employee Investment Vehicles invest on a side-by- side basis with the Funds.

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

HAL provides, directly and through HAM and the Participating Affiliates, due diligence and analysis services, asset management services, ancillary services and hedging services to the Funds. The due diligence and analysis services provided by Hudson inform and support the origination and investment management services provided by Lone Star. Hudson has day-to-day responsibility for the management of most assets held by the Funds. Hudson also provides ancillary services and hedging services to the Funds. Lone Star conducts ongoing strategic and other related advice regarding the Funds’ investments.

### **Investment Strategies and Methods of Analysis**

#### ***Investment Strategies***

Hudson provides due diligence and analysis services, asset management services, and hedging services with respect to the investment strategies described in the relevant Fund’s Offering Documents, which include, but are not limited to, investing in: (1) commercial and single family residential real estate-secured debt, corporate debt and consumer debt; (2) direct and indirect equity investments in real estate and real estate- related assets; (3) control investments in financially oriented and other operating companies; and (4) securitized products such as RMBS, CDOs (the underlying assets of which generally consist of RMBS), CMBS and other ABS. Each Fund may use a substantial amount of direct or indirect leverage in connection with its investments. In performing services with respect to a Fund’s investment strategies, Hudson assists Lone Star by conducting due diligence and analysis services on certain potential investments identified by Lone Star that are consistent with the Fund’s Offering Documents. These services are conducted on an investment-by- investment basis, in conjunction with Lone Star’s origination and investment management services provided with respect to each investment.

### ***Methods of Analysis – Identification and Initial Due Diligence***

To identify potential investment opportunities for the Funds, Lone Star monitors the U.S. and non-U.S. markets for potential sales of the various types of assets that the Funds purchase. Lone Star's initial due diligence and analysis on potential investments generally includes assessment of current and future market conditions for specific assets, assessment of asset sellers and other counterparties, and identification of available financing opportunities from counterparties and third parties.

When evaluating a potential investment opportunity, Lone Star works with Hudson to complete a full financial review and valuation, which includes a complete bottom-up, asset-based due diligence evaluation of the transaction. Typically, Hudson will review information provided by Lone Star regarding the potential investment and will conduct extensive due diligence and analysis, including: (1) conducting and/or overseeing financial, physical and legal evaluations of a potential investment, based in part on information provided by Lone Star, and using various methods to analyze the investment's viability and value; (2) preparing written evaluation documentation with respect to the potential investment, which may include an initial acquisition plan that includes preparations to onboard the investment into Hudson's day-to-day asset management services; and (3) analysis and advice regarding the closing of the potential investment. In providing these services, Hudson uses various methods of analysis, which utilize proprietary and third-party data, and are tailored to the type and location of the potential investment being evaluated.

If Lone Star decides, based on the due diligence and analysis described above, that a Fund currently in its investment period should pursue the relevant investment, Lone Star recommends the investment to the Fund's Investment Committee in the form of an Investment Committee Memorandum, which incorporates certain of the due diligence and analysis performed by Hudson as reflected in its evaluation documentation. The Investment Committee and, subsequently, the Fund's General Partner must approve the potential investment before the respective Fund makes the investment.

### ***Methods of Analysis – Single-Family Residential Mortgage-Backed Securities***

In evaluating investments related to RMBS and CDOs, the underlying assets of which generally consist of RMBS, Hudson uses a proprietary model that assigns the probability of future defaults, prepayments and loss severities to the underlying loan collateral. The model considers, among other factors, borrower characteristics and the particular attributes of the loans underlying the securities, as well as projected future prices of residential real estate and interest rates. The resulting projections of future loan performance derived from the model are then applied to the RMBS's payment hierarchy (i.e., waterfall), and the projected cash flow of the security being valued is extracted. In the case of a CDO, Hudson then assigns the cash flow from each security backing the CDO to the CDO's waterfall and extracts the projected cash flow of the CDO. Hudson also evaluates the resulting prepayment, default and severity assumptions under more stressful scenarios to account for macroeconomic uncertainty and various residential real estate price depreciation paths.

When evaluating RMBS and CDOs, Hudson uses market information such as residential real estate prices, market rents, new and existing property sales and data from loan servicers regarding modifications. Additionally, Hudson evaluates data from vendors as well as public data from trustees of the securities and servicers of the loans.

### ***Methods of Analysis – Corporate Equity and Debt***

In evaluating investments related to corporate equity and debt, Hudson uses a combination of the discounted cash flow method and the company's multiple methods (i.e., price-to-earnings, price-to-book, EBITDA, etc.). Hudson also projects the future performance of the company under evaluation (including liquidation value as necessary), which Hudson calculates using the company's financial statements, credit, business plans, material agreements and other information. In the analysis conducted for corporate bonds and other debt, if Hudson determines that the company might not survive, it calculates the liquidation value of the company and determines the price of the

debt based on that liquidation value. If Hudson determines that the company should survive past the maturity of the subject debt, then it typically determines the price by discounting the contractual repayment schedule (although Hudson may, as an alternative scenario, determine the price based on the company's liquidation value). Hudson also runs sensitivities on a range of financial variables to comprehend the effects on returns.

### ***Methods of Analysis – Whole Loans***

In evaluating investments related to whole loan assets (including primarily non-performing mortgage loans backed primarily by residential properties, but excluding commercial real estate-secured loans), Hudson uses a loan-level model that generates and projects loan level cash flows taking into account the borrower's credit profile and, if applicable, the projected cash flows of the underlying collateral under various probability-weighted liquidation scenarios.

For loans secured by property, the model considers the underlying property's updated value analyzed using traditional residential real estate valuation methods including, among other methods, the comparable sales approach, broker price opinions and automated valuation models. After establishing the current value of the underlying property, the model considers future price projections based on the property's specific geographical area and property type. Additionally, advance balances, foreclosure timelines, property marketing timelines, and various liquidation expenses are factored into the model assumptions. When evaluating these loans, Hudson also uses internally sourced market information, such as home price reports and sales reports, as well as real-time empirical data from a related loan servicer regarding modifications and liquidation strategies.

For all of the whole loan assets, Hudson stress tests the resulting cash flow projections to account for various factors including macroeconomic uncertainty, various price depreciation paths, and asset management strategies.

### ***Methods of Analysis – Commercial Real Estate Assets***

Hudson uses similar methods of analysis and investment strategies for CMBS, commercial real estate loans and commercial real estate properties. Hudson first analyzes the property itself by employing traditional real estate valuation methods, including the comparable sales approach, the income approach, the replacement cost approach and the development approach. Each of these methods entails a detailed analysis of the particular markets and attributes of the particular investment, including location, structural and environmental characteristics and current and forecasted demographic characteristics. Additionally, Hudson has developed a model that incorporates the information from the methods noted above and aggregates the information to evaluate potential commercial real estate investments in whole loans, structured loans or securitized mortgages.

As part of its evaluation of commercial real estate loans and CMBS, Hudson reviews the underlying collateral and conducts a fundamental analysis and evaluation of the collateral. Hudson evaluates data from vendors as well as public data from trustees of the securities and servicers of the loans. Hudson also uses third-party analysis solutions to perform necessary analytics. Hudson utilizes a Bloomberg application to obtain the latest market pricing of certain securities, interest rate curves, interest rate projections by market participants, and general sentiments regarding market pricing. For commercial real estate, Hudson also evaluates real time empirical data. Hudson cultivates relationships with a network of local sales/leasing brokers and real estate developers who are knowledgeable regarding the local market. Additionally, Hudson runs sensitivity analyses to comprehend the effects of alternative market assumptions should events turn out differently than projected.

### ***Methods of Analysis – Hedging Services***

Because the Funds are U.S. dollar-based funds that invest on a global basis, Hudson provides foreign- currency hedging services, employing currency strategies that aim to reduce the foreign currency exposure of the Funds' investments (the goal, in principle, is to maintain a "currency neutral" position). Similarly, where the Funds invest in assets that have identified interest rate exposures or other risks, Hudson may provide interest rate hedging

services or other hedging services related to those investments where such hedging services are deemed appropriate and cost effective. Lone Star provides regular advice and guidance to Hudson regarding the appropriate hedging strategy to follow with respect to a particular Fund or investment.

Hudson may hedge less than the full amount of an investment's currency, interest rate, or other risk exposure. Hudson's foreign exchange and interest risk management services encompass hedging review, selection of hedging counterparties, trading and related accounting functions. Hudson implements the Funds' hedging activities through a variety of derivatives. In connection with non-U.S. dollar denominated investments by the Funds, Hudson typically uses forward foreign exchange contracts and foreign currency options to manage foreign currency exposure. Additionally, if Hudson hedges the interest rate exposure of an investment, it typically uses interest rate swaps and interest rate options.

### ***Valuation of Investments***

The Funds report their investments at fair value. As part of its ancillary services to the Funds, Hudson oversees the valuation process by managing the flow of information received once an investment is closed and as Business Plans are updated. Hudson's employees who perform the valuations coordinate with Hudson's regional asset management employees for both asset- and investment-level reporting. Hudson's valuation employees, along with Hudson's investment reporting employees, study, analyze and report on the trends and projections of cash flows for the Funds' investments.

The initial fair value of an investment is reported based on the Fund's equity portion of the purchase price in the quarter capital is called for the investment from the Fund's investors. Hudson prepares an initial projected, detailed cash flow model for the investment as part of the initial Business Plan. Quarterly, Hudson's asset managers analyze and update the timing of future cash flows. The projected cash flows for all investments are approved on a quarterly basis by the applicable Region Heads and by the President of LSGA. Annually (or when there is a change in circumstances that would cause a material change in an investment's valuation), as the Business Plan for an investment is updated, the cash flow model for the investment will also be modified as needed.

In determining fair value for the Funds, Hudson uses various approaches. Hudson follows the guidance in ASC 820-10, Fair Value Measurements – Overall, which emphasizes fair value is a market-based measurement and should be determined based on the assumptions that market participants would use in pricing an investment. The ability to observe market prices is affected by a number of factors, including the type of investment, the characteristics specific to the investment and the viability of the marketplace including the existence and transparency of transactions between market participants. ASC 820-10 establishes a hierarchy for inputs used in measuring fair value based on the following categories:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets and liabilities
- Level 2: Observable prices based on inputs not quoted on active markets but corroborated by market data
- Level 3: Unobservable inputs used when little or no market data is available

In certain cases, the inputs used to measure fair value for individual assets and liabilities may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls will be determined based upon the lowest level input that is significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement in its entirety requires management judgment and considers factors specific to the individual assets and liabilities.

Where available, Hudson uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. However, because many of the Funds' investments are opportunistic or otherwise illiquid, valuation of most investments is expected to require the use of significant unobservable inputs. For investments with little or no market data available, the determination of fair value is then based on the best information available in the circumstances and incorporates management's own assumptions, including appropriate risk adjustments for non-performance and liquidity risks.

Due to the fact that a quoted market exchange does not typically exist for the Funds' investments, the fair value is generally based on management's estimate of fair value in the most advantageous exit market. The most significant inputs to the estimates involve (1) the amount of expected future cash flows, (2) the timing of receipt of those cash flows, and (3) the discount rate applied to the overall cash flows. In estimating expected future cash flows from the Funds' investments, Hudson considers cash expected to be distributed during the Fund's holding period and expected cash on exit or liquidation. The significant inputs into the investment's expected future cash flows depend on the category and nature of the investments and the underlying assets. For mortgage related securities (including RMBS and CDOs), Hudson considers the nature of the underlying loans, expected modifications, expected default rates and related loss severity, estimated prepayments and related market transactions. For nonperforming and other loans, Hudson considers expected default rates, expected loan recovery rates, market value of the underlying collateral and other observable market data. For financial and other operating companies, Hudson considers recent comparable share prices, EBITDA, or earnings multiples and expected operating results. The discount rates applied to these expected future cash flows are estimates of market rates based on the nature, location, risks and leverage inherent in the investments and the underlying assets. The expected future cash flows are then discounted to arrive at the estimated present fair value.

Each quarter, the Fair Value Review Committee is responsible for the review of the valuation methodology for each Fund investment, including cash flow projections and discount rates. Depending on the investment, the Committee's analyses may include a review of key assumptions, comparison to actual cash flows, and historical liquidation results, review of material performance changes and consideration of market comp data. The Fair Value Review Committee is comprised of senior managers in Hudson's Fund and Investment Reporting Department.

After the Fair Value Review Committee has approved quarterly valuations for each investment, the valuations are submitted to the Fair Value Approval Committee. The Fair Value Approval Committee is comprised of the President/Chief Operating Officer of HAL, the Managing Director/Chief Financial Officer of HAL and the President of LSGA. The Fair Value Approval Committee must approve the fair value balance and discount rate for each investment before such valuations are reported to investors of the Funds. Only valuations approved by the Fair Value Approval Committee are presented in the quarterly investor reports (which are discussed further in Item 13).

## **Risks**

All investments involve the risk of loss that the Funds and their underlying investors should be prepared to bear. A more detailed discussion of the risks relating to an investment in one of the Funds can be found in the Fund's Offering Documents.

### ***Material Risks Relating to Investment Strategies***

**Opportunistic Investment Strategy.** The Funds make opportunistic investments within the scope of the investment program set out in their Offering Documents. The opportunistic investment strategy utilized by Hudson and Lone Star on behalf of the Funds generally does not incorporate consideration of other investments held in a Fund's investment portfolio. Accordingly, portfolio risk controls such as value at risk metrics, investment diversification across regions or industries or avoidance of risk concentration at the investment portfolio level are typically not considered when assessing the merits of a potential investment. Instead, the Funds' opportunistic

investment strategy focuses on the expected returns of each potential investment on an individual basis. This opportunistic investment strategy may result in a significantly higher risk profile of the Funds compared to a strategy that actively diversifies investments across type, sector, location, and/or other risk factors.

**Risk of Limited Number of Investments.** As a result of the Funds' opportunistic investment strategy, they may participate in a limited number of investments or a limited number of asset classes and, as a consequence, the aggregate return of the Funds may be substantially adversely affected by the unfavorable performance of even a single investment. In addition, the diversification of the Funds' investments could be further limited and proportionately more capital employed to the extent a Fund invests a significant portion of its capital in a limited number of transactions.

**Limited Current Return.** The return of capital and the realization of gains, if any, will generally occur only upon the partial or complete disposition of a Fund's investment. Developments in global financial markets over the past few years and new developments in global and local markets, if they occur, may adversely impact the ability of the Funds to dispose of investments at their expected returns. Current returns from investments may vary, as Lone Star generally attempts to maximize realized returns on the disposition of the Funds' investments, and as such, will generally not favor early liquidation of an investment or foregoing potential disposition upside to maximize current returns.

**Investing in Troubled Assets.** The Funds may make investments in secured and unsecured non-performing loans or other troubled assets that involve a significant degree of legal and financial risk and, particularly in the international context, political risks. Furthermore, investments in assets operating in workout modes or under bankruptcy reorganization laws may, in certain circumstances, be subject to certain additional potential liabilities that may exceed the value of a Fund's original investment. Moreover, particularly with respect to international investments in secured and unsecured non-performing loans or other troubled assets, there are additional risks and uncertainties related to litigation, bankruptcy, and other laws and regulations affecting the rights and remedies of the Funds, which can create additional financial risks to the Funds.

**Risks of Investing in Real Estate-Related Assets.** Investments in real estate assets and real estate-related investments are subject to various risks associated with the real estate industry generally, including adverse changes in the financial conditions of tenants, buyers, and sellers of properties; the availability of financing; real estate taxes, interest rates and other operating expenses; insurance; environmental laws and regulations, zoning laws, and other governmental rules and fiscal policies; the relative popularity of certain property types and locations; and the availability of certain construction materials. Developments in global and local financial and real estate markets over the past few years, and new developments in those markets, if they occur, may result in reductions in the value of real property interests. The real estate assets associated with the Funds' investments may be or become non-performing after acquisition for a wide variety of reasons. Such non-performing real estate investments may require a substantial amount of workout negotiations and/or restructuring, which may entail, among other things, a substantial write-down of such loans or assets.

**Risks of Investing in Commercial Mortgage Loans.** The value of the Funds' commercial mortgage loans and the underlying real estate will be influenced by the historical rate of commercial mortgage loan delinquencies and defaults and by the severity of resulting losses. Commercial mortgage loans are generally viewed as exposing a lender to a greater risk of loss through delinquency and foreclosure than lending on the security of single-family residences. The ability of a borrower to repay a loan secured by income-producing property typically is dependent primarily upon the successful operation and operating income of such property rather than upon the borrower's other income or assets, as most commercial mortgage loans provide recourse only to the property itself.

**Credit Risks.** A Fund's investment could lose money if the issuer or guarantor of a fixed income security is unable or unwilling, or is perceived by market participants, ratings agencies, pricing services or others as unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. Securities are subject to varying degrees of credit risk, which are often reflected in their credit ratings. The downgrade of the

credit of a security held by a Fund may decrease its value. “Opportunistic” assets are generally considered to have significant credit risk. With respect to the financing strategies and hedging services described above, the Funds may also be subject to the risk that a counterparty to a financing arrangement or derivatives contract may be unable or unwilling to honor its obligations as a result of the counterparty’s financial condition or insolvency.

**Risks Associated with Mortgage-Backed Securities.** In general, risk factors discussed herein pertaining to mortgage loans (and the type of property securing such mortgage loans), would similarly pertain to any mortgage-backed security in which the Funds invest. Some or all of the potential mortgage-backed securities to be acquired by the Funds may not be rated, or may be rated lower than investment grade by one or more nationally recognized statistical rating organizations. The majority of the mortgage-backed securities acquired by the Funds are typically lower-rated or unrated, and the original ratings of many of these securities were withdrawn or downgraded to levels that are significantly below investment grade. Lower-rated or unrated mortgage-backed securities in which the Funds may invest have speculative characteristics that can involve substantial financial risks. Securities rated lower than “B” can be regarded as having extremely poor prospects of ever attaining any real investment standing and may be in default. Existing credit support and the owner’s equity in the property may be insufficient to protect the Funds from loss. If the Funds invest in subordinated mortgage-backed securities in particular, the Funds will be first in line among debt holders to bear the risk of loss from collateral delinquencies and defaults. To the extent that the mortgage loans that underlie specific mortgage-backed securities are prepayable, the value of such mortgage securities may be negatively affected by increasing prepayments, which generally occur when interest rates decline.

**International Investing.** Hudson performs services for the Funds on a global basis, and in particular, in North America, Europe and Asia. The Funds may also make significant investments in countries that are considered “emerging markets”. Risks to the Funds’ investments may result from differences between U.S. and non-U.S. countries, such as the absence of uniform accounting, auditing, and disclosure requirements; less government oversight and other legal and regulatory differences, including weaker investor protections and fiduciary duties; less advanced bankruptcy laws; and difficulty in enforcing contractual obligations. Further risks may involve a country’s potential economic, political, or social instability, which can lead to expropriation or confiscatory taxation, higher inflation, nationalization, confiscation without fair compensation, or war and can necessitate reliance on a country’s diminished economic and physical infrastructure to support investment activity. Such instability may also lead to fluctuations in currency exchange rates that affect the value of the Fund’s investments, and foreign currency and other restrictions imposed to prevent capital flight, which may make it difficult or impossible to exchange or repatriate foreign currency.

Hudson and Lone Star analyze risks in the applicable countries before recommending investments for the Funds, but no assurance can be given that a country’s political, social or economic climate, or particular tax, legal, or regulatory risk might not adversely affect an investment by the Funds. Hudson, on behalf of the Funds, will generally also attempt to maintain a “currency neutral” position for the Funds by hedging where practicable, directly or indirectly, certain currency risks, but there is no assurance that Hudson can minimize currency risk perfectly where the magnitude and timing of future cash flows can only be estimated and are not known with certainty. Further, in certain jurisdictions, Hudson may conclude that it is not practicable to hedge currency risk. Hudson’s currency hedging procedures are conducted only as an attempt to minimize or reduce risk, and there can be no assurance that such hedges will be available, be available at a reasonable cost, or be sufficient to actually eliminate the risk of fluctuations in currency exchange rates. Despite efforts by Hudson and Lone Star to mitigate some of the foregoing risks, these risks may ultimately limit the Funds’ ability to dispose of certain investments or to dispose of certain investments profitably.

**Risks Associated with Investments in Finance Companies, Banks, Bank Holding Companies and other Regulated Institutions.** The Funds may invest in finance companies, banks, bank holding companies or other regulated institutions, which operate in highly competitive environments and are subject to extensive regulation. These institutions compete against one another for loans, deposits, and other financial services. The Funds may invest in finance companies that may be subject to a larger degree of governmental regulatory oversight and

periodic examination than their competitors. Investments in certain types of institutions that provide secured and unsecured loans are highly speculative and subject to various risks, including adverse changes in national or international economic conditions; adverse local market conditions; changes in availability of debt financing; changes in interest rates, governmental rules, and fiscal policies; risks due to dependence on cash flow; risks and operating problems arising out of acts of God and other unanticipated events; uninsurable losses; and other factors that are beyond the control of Lone Star or the Funds.

**Financing and Use of Leverage.** The Funds' ability to achieve or surpass target rates of return on the investments recommended by Lone Star may depend on the ability to access sufficient financing sources on desirable terms. The Funds' investments are typically financed by initially borrowing under the Funds' lines of credit, subsequently to be replaced with SPV level financing that is secured by the specific investment that is being financed. This leverage will increase the exposure of such investments to adverse economic factors such as significantly rising interest rates, increased risk spreads, severe economic downturns or deterioration in the condition of the investment or its corresponding market. Generally, the presence of leverage in the Funds' investments will magnify their volatility and may substantially increase the Funds' risk profile. In the event a specific investment is unable to generate sufficient cash flow to meet a margin call or a principal or interest payment required to maintain the financing arrangements related to that investment, the value of a Fund's equity position in that investment could be significantly reduced or even eliminated.

The Funds and the SPVs use a variety of financing sources including, without limitation, bank loans and repurchase agreements. The repurchase agreements used by the SPVs for financing purposes may have various terms ranging from a month or less to five or more years. In the event that any given financing arrangement is terminated prior to its expected term, the SPV may not be able to refinance the underlying investment in a timely manner, or on the same terms as the prior financing arrangement, or on any terms.

In addition to the enhanced portfolio volatility and risk that may arise from the use of leverage, each financing instrument is subject to credit risk with respect to the counterparty. Financing transactions typically involve the transfer of legal title, pledge, or other encumbrance of the underlying investment of the Fund. Accordingly, the insolvency or bankruptcy of a financing counterparty may result in legal action that impairs the value or marketability of the underlying investment, or the Fund's ownership rights. There can be no assurance that the Fund will recover all or any of the economic value of the investment under such circumstances, and any such recovery may require the payment of substantial legal costs.

**Illiquidity of Investments.** Most of the Fund's investments are highly illiquid, and there can be no assurance that the Funds will be able to realize these investments in a timely manner. It is unlikely that there will be a public market for most of the investments held by the Funds. The Funds generally will not be able to sell securities held in their investment portfolios publicly unless their sale is registered under applicable securities laws, or unless an exemption from such registration requirements is available. In some cases the Funds may be prohibited by contract or regulatory requirements from selling investments for a period of time. In addition, the types of investments held by the Funds may be such that they require a substantial length of time to liquidate. In the event of a margin call or other loan repayment at a time in which a Fund does not have sufficient cash assets to cover such call or payment, the Funds may have to liquidate certain investments at less than their expected returns, thereby resulting in lower realized proceeds to the Funds.

**Swaps and Derivative Investments.** The Funds may utilize swaps and other derivative transactions to obtain a desired exposure. Notional amounts of swap transactions are not subject to any limitations, and swap contracts, when equivalent to a short position in the underlying instrument, may expose the Funds to unlimited risk of loss. To the extent the Funds invest in repurchase agreements, swaps, and other "synthetic" or derivative instruments, counterparty exposures can develop and the Funds take the risk of nonperformance by the other party on the contract. Transactions such as these, which are entered directly between two counterparties, may expose the parties to the risk of counterparty default.



Derivatives are a financial contract with a value that depends on, or is derived from, an underlying product. Some of the risks generally associated with derivatives include the risks that: (1) the value of the derivative will change in a manner detrimental to the Funds; (2) another party to the derivative may fail to comply with the terms of the derivative contract; (3) the derivative may be difficult to purchase or sell; and (4) the derivative may involve indebtedness or economic leverage, such that adverse changes in the value of the underlying asset could result in a loss substantially greater than the amount invested in the derivative itself or in heightened price sensitivity to market fluctuations. Derivatives markets can be highly volatile. The profitability of investments by the Funds in derivatives depends on the ability of Lone Star and/or Hudson to correctly analyze these markets, which are influenced by, among other things, changing supply and demand relationships, governmental, commercial, and trade programs and policies designed to influence world political and economic events, and changes in interest rates. In addition, the assets of the Funds may be pledged as collateral in derivatives transactions. Thus, if the Funds default on such an obligation, the counterparty to such transaction may be entitled to such collateral.

**Reuse of Collateral.** In connection with swaps and other derivative transactions, a Fund is frequently required to post collateral to transaction counterparties or clearing firms. The amount of such collateral may be material to the Fund. Such collateral may, from time-to-time and without notice to the Fund, be carried in the general account of the counterparty or clearing firm and may be sold, pledged, rehypothecated, assigned, invested, loaned, commingled or otherwise disposed of, or otherwise used in the business of the counterparty or clearing firm without any claim or right of any nature whatsoever of the Fund. A counterparty or clearing firm holding collateral in connection with a swap or other derivative transaction is obligated to return to the Fund assets equivalent to those provided as collateral. Although the Funds seek to enter into transactions with creditworthy counterparties and clearing firms on favorable terms, there can be no assurance that collateral posted to such parties will be returned to the Funds in a timely manner. The insolvency or bankruptcy of a counterparty or clearing firm may result in partial or full loss of collateral posted and may require the payment of substantial legal costs to enforce the right of the Funds to the return of equivalent assets.

**Use of SPVs.** Each Fund will use various SPVs to hold the Fund's investments. The use of these SPVs may involve additional costs of formation, structuring, and operating such entities. Because of the worldwide reach of the investments made by the Funds, these SPVs could be of a type with which Lone Star and Hudson have less familiarity, and therefore provide additional informational and operational uncertainty or difficulties in managing and disposing of investments through such entities. Some of these entities may be controlled by boards of directors, one or more members of which may, for tax, regulatory, or other reasons, not be affiliated with Lone Star or Hudson or subject to their (or their affiliates') supervision and control. An SPV that holds interests in investments on behalf of a Fund may be structured such that its board of directors must approve asset dispositions. A Fund may not be able to execute the exit strategies recommended by Hudson and Lone Star if the directors of an SPV do not approve asset dispositions in accordance with such recommendations. The Funds may incur investment losses or lost opportunities, may not be able to distribute capital in accordance with their projections, and may incur additional costs as a result of the decisions of directors of such SPVs.

**Investments through Partnerships and Joint Ventures.** The Funds will generally make investments through partnerships, joint ventures, operating companies, corporations, companies, or other entities. Such investments may involve risks not present in direct investments, including, for example, the possibility that an operating company, co-venturer, or partner of a Fund may commit fraud, become bankrupt, or have economic or business interests or goals which are inconsistent with those of the Fund, or that any such operating company, co-venturer, or partner may be in a position to take action contrary to the Fund's objectives. Furthermore, if a co-venturer or partner defaults on its funding obligations, it may be difficult for the Fund to make up the shortfall from other sources. The limited partners of the Fund may be required to make additional contributions to replace such shortfall, thereby reducing the diversification of their investments. Any default by such co-venturer or partner could have a deleterious effect on the Fund, its assets, and the interests of the limited partners. In addition, the Fund may be liable for actions of its co-venturers or partners.

## ***Material Risks of Loss Related to Methods of Analysis***

### **General Risks Related to Hudson's Methods of Analysis**

Hudson seeks to perform reasonable and proper due diligence and analysis on each prospective investment, in an effort to identify, based on relevant facts and circumstances, investment opportunities and possible risks related to those opportunities. In conducting due diligence and analysis services, Hudson depends on available resources, including Lone Star, information disclosed by the investment counterparty, and possibly other third parties involved in a potential investment transaction. The methods of analysis that Hudson employs to assist Lone Star in determining whether to recommend that a Fund make a particular investment may be subjective and cause the Funds to lose money over short or long periods. As a result, as well as due to other risks inherent in investments generally, there can be no assurance that Lone Star's recommendations will satisfy the investment objectives of any particular Fund or that any Fund will be able to carry out its investment strategy successfully.

The due diligence and analysis services performed by Hudson may frequently be required to be undertaken on an expedited basis, as may investment decisions made by the Investment Committees at LSGA, to take advantage of investment opportunities. In such cases, the information available at the time of an investment decision may be limited, and neither Hudson nor Lone Star may have access to detailed information regarding the investment opportunity, such as physical characteristics, structural or environmental matters, zoning regulations, or other local conditions affecting an investment. With respect to real estate-related investments, Hudson may not be able to undertake all appropriate inquiries into the previous ownership and uses of a property consistent with typical commercial or customary practice. Therefore, no assurance can be given that Hudson or Lone Star will have knowledge of all circumstances that may adversely affect an investment. In addition, Hudson and Lone Star may rely upon independent consultants in connection with their evaluation of proposed investments; however, no assurance can be given that these consultants will accurately evaluate such investments, and the Funds may incur liability as a result of such consultants' actions.

### **Specific Risks Related to Hudson's Methods of Analysis**

**Analysis of Residential Mortgage-Backed Securities.** The material risks related to evaluating mortgage-backed securities and CDOs backed primarily by mortgage-backed securities, using a credit-based model, include: (1) changes affecting the model inputs used to project performance (such as prepayment speeds, delinquency rates, loss severities and interest rate assumptions); and (2) the potential for new variables (such as foreclosure moratoriums, new governmental programs, legislative or regulatory changes) to impact actual performance. To address these risks, Hudson performs regular model validation tests and adjusts the models to account for changes in the market, including credit trends, servicing trends and legislative and regulatory developments.

Other material risks related to evaluating mortgage-backed securities and CDOs include events that either diminish the total recovery amount on the underlying asset or significantly extend the timing of collection of such recovery amount from the sale of the underlying property. To assess these risks, Hudson performs multi-scenario valuations (including what Hudson believes to be stress-case valuations) in an attempt to determine potential downside risks of the investment.

These securities also carry the risk of document ambiguities, errors or omissions. Additionally, investments in CDOs include the risk of potential conflicts of interest among the holders of various classes of notes of the CDO. To help mitigate these risks, Hudson works with internal counsel and, when appropriate, engages external counsel to review associated documents and evaluate these potential risks.

**Analysis of Single-Family Residential Whole Loans.** The material risks related to evaluating loans include: (1) changes affecting the model inputs used to project loan performance; and (2) the potential for new variables to significantly impact the likelihood of loan repayment. To address these risks, Hudson performs periodic model validation tests and adjusts the models to account for changes in the market, including housing trends. Hudson

performs multi-scenario valuations in an attempt to assess downside risk. Non-performing residential mortgage loans also have increased risk of litigation in connection with the foreclosure process. To help mitigate this risk, Hudson may engage third-party due diligence vendors to review a sample of loans purchased.

**Analysis of Commercial Real Estate Assets.** The material risks related to evaluating CMBS, commercial real estate loans and properties include: (1) changes affecting the model inputs used in the valuations; and (2) the potential for new variables to significantly impact the ability to realize a profit on the investment. To assess these risks, Hudson uses on-going surveillance of the market to adjust the model for a particular investment, and performs multi-scenario valuations in an attempt to assess downside risk. Commercial real estate loans and properties also have increased risk of litigation in connection with the foreclosure process. To help mitigate this risk, Hudson may engage third-party due diligence vendors to review a sample of loans purchased.

**Hedging Services.** Hudson or Lone Star may recommend that a Fund enter into hedging and similar transactions with respect to foreign currency, interest rate, and other risks where deemed appropriate and cost effective. There is, however, no assurance that foreign exchange risk and/or interest rate risk can be perfectly hedged or minimized where the magnitude and timing of future cash flows can only be estimated and not known with certainty. Thus, prudent currency and interest rate hedging policies only serve to minimize or reduce these risks, but not to eliminate them completely. There can be no assurance that a Fund will have sufficient liquidity or credit capacity to support the hedging services provided by Hudson, and no assurance that hedging techniques will be available, be available at a reasonable cost, or be sufficient to eliminate these risks. In addition, Hudson or Lone Star may recommend that a Fund hedge the investment's currency or interest rate exposure at an amount less than the expected value of that investment. In such cases, the Fund may suffer losses from changes in foreign exchange rates or interest rates that may have been recouped through hedging transactions if the investment had been fully hedged. With any hedging transaction there exists a risk that any counterparty to a hedging transaction will not perform as expected. There may also be complications in the enforcement of hedging transactions in the event of partial or total dissolution of a currency block such as the Euro, the imposition of currency controls, or similar currency market disruption to a hedged currency, and litigation between the Funds and the hedging counterparty may result from such complications. Such a disruption to the currency markets may also cause the Funds to be unable to implement hedging transactions in the affected markets for an indefinite period of time.

### ***General Risk Factors***

**Market Risks.** The Funds may have some investments that are publicly traded or traded in active private markets. The values of such investments are particularly susceptible to fluctuations based on market trends. Certain worldwide government bodies and central banks have responded to recent financial market turmoil with extraordinary intervention programs, the success of which has yet to be measured. As a result, credit availability has contracted and financing costs have increased, which have acted as barriers to new, sizeable, leveraged transactions. This reduced (or more expensive) credit availability, along with equity and debt security valuation declines, has negatively impacted the private equity sector. Further changes in stock prices, interest rates, currency exchange rates, or commodity prices could result in changes in the broader marketplace that adversely affect the value of publicly traded investments, particularly with respect to investments located in emerging markets or traded on relatively volatile exchanges. The Funds, based on the due diligence and analysis services provided by Hudson, and at the recommendation of Lone Star, may invest in publicly traded securities on markets that are relatively illiquid or volatile. The values of such investments are particularly susceptible to fluctuations based on market trends. The Funds may have difficulty disposing of such investments at a price and on terms that are attractive to the Funds.

**Currency Risk.** The Funds may make investments in assets denominated or valued in non-U.S. currencies. To the extent that the Funds invest in securities or assets denominated in or indexed to foreign currencies, changes in currency exchange rates bring an added dimension of risk. Currency fluctuations could negatively impact investment gains or add to investment losses. Although the Funds may attempt to hedge against currency risk, the hedging instruments may not always perform as the Funds expect and could produce losses. Suitable hedging

instruments may not be available for currencies of emerging market countries, and an investment may not be adequately hedged with respect to its currency exposure even if suitable hedging instruments are available.

**Valuation Risks.** The Funds' investments include numerous illiquid, subordinate, non-traded, or lightly traded investments held in a variety of countries for which a traditional fair market value would be difficult and expensive, if not impossible, to determine. Therefore, Lone Star and Hudson will typically use discounted cash-flow value as a surrogate for traditional fair market value calculations, and may use valuations based on discounted cash-flow projections even when market values are available. Discounted cash flow estimates involve calculations of expected future cash flows, the timing of receipt of those expected cash flows, and the discount rate applied to the overall cash flows. The discounted cash-flow value of a Fund asset includes unrealized gains and losses, and may be adjusted by any cash distributed or contributed to the Fund or to reflect any permanent impairments to the asset values as determined by the Fund's General Partner, Lone Star or Hudson. Therefore, the value of assets based on discounted cash flows may vary from actual amounts realized upon the disposition of those assets being valued. There can be no assurances that valuation determinations based on discounted cash flow, or the assumptions used to make those determinations, will prove to be accurate. The Funds may, in limited situations such as with larger investments comprised of a single asset, rely on valuations they receive from third parties in determining the price paid for assets or the value of such asset. Such valuations may turn out to be inaccurate and therefore affect the Funds' returns with respect to such assets. There can be no certainty that the price paid for an asset by a Fund will be equal to or less than the determined fair value, and as such, this may have an impact on the fair value as it is calculated on a discounted cash-flow, rather than a price-paid, basis, and may have an impact on the performance reported to the Funds' investors with respect to individual assets and a Fund's entire portfolio.

**Taxation.** Investments in operating companies, real estate, and real estate-related assets may be subject to numerous taxes, fees, and duties imposed by the jurisdiction in which such assets reside or operate. Each investor in a Fund will be required to take into account its allocable share of the Fund's items of income, gain, loss, deduction, and credit, without regard to whether the investor has received or will receive any distributions from the Funds. Accordingly, an investor's tax liability for any taxable year associated with an investment in the Funds may exceed (perhaps to a substantial extent) the cash distributed to that investor during the taxable year.

A significant portion of a Fund's investments may be made outside of the U.S. While Lone Star will endeavor to structure foreign investments to minimize foreign taxes subject to withholding or payable by the Funds with respect to those investments, foreign taxes incurred with respect to those investments could be substantial. If such a structure fails to operate as intended, it could expose the Funds to unexpected taxation that may reduce the returns of the Funds. Under certain circumstances, these tax liabilities could be incurred by the limited partners of the Funds directly.

**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 and other environmental pollutants (including, without limitation, petroleum products, asbestos, and polychlorinated biphenyls) released on, about, under, or in the 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 or other environmental pollutants. The presence of hazardous substances or other environmental pollutants, or the failure to remediate hazardous substances or other environmental pollutants properly, may adversely affect the owner's ability to sell or use real estate or to borrow outside funds using real estate as collateral. Environmental liabilities with respect to a specific real estate asset may exceed the value of such asset, and under certain circumstances, subject the other assets of the Funds to such liabilities.

**Regulatory Risks.** There is no assurance that the Funds, their General Partners, Lone Star, Hudson or the SPVs will be able to: (i) obtain all required regulatory approvals not yet acquired, or that may need to be acquired in the future; (ii) obtain any necessary modifications to existing regulatory approvals; or (iii) maintain required regulatory approvals. Delay in obtaining or failure to obtain and maintain in full force and effect any regulatory approvals, or amendments thereto, or delay or failure to satisfy any regulatory conditions or other applicable

requirements could prevent operations of a portfolio company, impede the development of real estate assets, delay the completion of a previously announced acquisition or sale to third parties, or otherwise result in additional costs to a portfolio company, or other investment, and in turn the Funds. The global investment strategy of the Funds is subject to complex, changing, and sometimes competing legal, tax, and regulatory regimes throughout the world, and there is a possibility that new or changing regulatory requirements could potentially have adverse effects on the Funds.

Derivative contracts, repurchase agreements, and similar instruments used to implement hedging and financing activities of the Funds are generally subject to limited regulation. New regulation in the U.S. or in non-U.S. jurisdictions relating to such instruments may limit the ability of the Funds to engage in the same or similar transactions in the future, and there is a possibility that regulatory agencies may treat these instruments differently than the manner intended by the Funds. Such developments may prevent or delay the implementation of hedging or financing transactions, or result in the termination of existing arrangements. The Funds may not be able to re-establish similar arrangements in a timely manner, or on the same terms as the prior financing arrangement, or on any terms.

### **Item 9: Disciplinary Information**

In 2003, LSF IV, together with certain co-investors, purchased, through various non-U.S. entities, a controlling interest in Korea Exchange Bank (“KEB”), a South Korean commercial bank. LSF IV held its interest in KEB through a special purpose vehicle, LSF-KEB Holdings SCA (“KEB Holdings”), whose statutory manager was Lone Star Capital Management SPRL. The permanent representative of Lone Star Capital Management SPRL was Michael Thomson, previously the Executive Managing Director and General Counsel of HAL. After KEB Holdings assumed control of KEB, several persons affiliated with Lone Star were elected to the Board of Directors of KEB, including Paul Yoo, Ellis Short, Michael Thomson, and Steven Lee (together, the “Lone Star Directors”). Shortly thereafter, KEB, with the unanimous authorization of its Board of Directors, rescued its failing credit card affiliate (“KEB Credit”), in order to avert the latter’s impending insolvency, by merging it into the bank.

In late 2006 and early 2007, the Korean Supreme Prosecutor’s Office (“SPO”) charged Paul Yoo, who was also a senior officer of LSGA’s Korean subsidiary at that time, Lone Star Advisors Korea, L.L.C. (“LSAK”), and, vicariously, KEB and KEB Holdings with violations of the Korean Securities and Exchange Act (“SEA”) in connection with KEB’s merger with KEB Credit, alleging essentially that Mr. Yoo and the other Lone Star Directors conspired to unlawfully drive down the share price of KEB Credit’s shares in advance of the merger, to enable KEB to merge with KEB Credit on more favorable terms. Ultimately (in late 2011 and early 2012), after several decisions and appeals, Paul Yoo and, vicariously, KEB Holdings, were convicted of this charge. Paul Yoo was also found guilty of various other charges relating to (i) failure to appear before the Korean National Assembly, (ii) breach of fiduciary duty relating to manipulation of the reported rates of return for certain investments made in Korea by prior Funds (as discussed in more detail below), and (iii) tax evasion relating to the transactions involved in clause (ii) above. Paul Yoo was sentenced to three years imprisonment and a fine of KRW 4.295 billion (approximately USD 3.6 million, which was suspended). The Seoul High Court also imposed a criminal fine of KRW 25 billion (approximately USD 21 million) on KEB Holdings.

Under the SEA as applied in line with the Korean Constitutional Court’s prior rulings, a court must find that a company’s legal “representative” was involved in alleged violations in order to convict the company. The Seoul High Court’s decision against KEB Holdings was based on the activities of Michael Thomson, whom the Court considered to be the legal “representative” of KEB Holdings for purposes of the SEA. No charges were brought against Ellis Short, Michael Thomson, or Steven Lee, the other Lone Star Directors. No Lone Star Director other than Paul Yoo participated in the proceedings. The Registered Advisers have been advised by Korean counsel that the court’s finding against KEB Holdings is not a conviction against these individuals personally.

In December 2011, the Korean Financial Services Commission (“FSC”) issued a Resolution Notice to KEB that

required KEB to consider the dismissal of the Lone Star Directors at a shareholders meeting within two months of the Resolution Notice. The FSC based this action on the findings of the Seoul High Court. In February 2012, KEB Holdings sold its remaining interests in KEB, and the Lone Star Directors resigned prior to any action being taken by KEB with respect to the Lone Star Directors.

In 2005, LSAK and Hudson Advisors Korea, Inc. (HAL's affiliate in Korea at that time) ("HAK") discovered that a senior officer of LSAK had embezzled substantial amounts from LSAK, HAK, and certain related entities of the Funds over a period of several years, mainly through fictitious invoices for services ostensibly provided by third parties. The officer was terminated, confessed to the embezzlement, and made restitution of the amounts embezzled plus costs and damages. Following the reporting of these events, the FSC conducted its own investigation, and upon its findings (1) issued a "business improvement order" to HAK based on HAK's alleged violation of the Asset-Backed Securities Act ("ABSA") and (2) imposed a sanction of "suspension of payment of service fees to non-residents for one year" on HAK for violation of the Foreign Exchange Transaction Act ("FETA") relating to the fraudulent money transfers that were made offshore. The FSC also imposed a sanction of "suspension of payment of service fees to non-residents for one year" on LSAK.

With respect to the business improvement order, the FSC alleged that HAK improperly serviced and managed the assets of certain ABS specialty companies in which certain Funds were invested and caused these companies to violate provisions of the ABSA. As part of the business improvement order, HAK was required to return a service fee improperly charged to the ABS specialty companies. The FSC also required HAK to (1) establish an internal control system with respect to services and (2) establish an external control system, including retaining an external auditor to provide an auditor's report, which would be delivered to the FSC for two years (the "Covered Period"), and providing the FSC with statements regarding certain transactions by the ABS specialty companies during the Covered Period. Additionally, HAK was required to submit to the FSC a plan for taking measures against the officers/employees involved in the acts related to the ABS specialty companies.

The FSC imposed the sanction of "suspension of payment of service fees to non-residents for one year" on HAK and LSAK for their alleged violations of the FETA relating to the former employee's improper offshore money transfers. As background, the FETA requires that a Korean resident who makes a third-party payment must submit a report thereof to the Governor of the Bank of Korea, and submit certain documents to the president of a foreign exchange bank. The FSC determined that HAK and LSAK violated these provisions because they made some third-party payments without submitting a report to the Governor of the Bank of Korea and submitted a forged consulting agreement with a non-resident to the president of a foreign exchange bank.

In addition, the SPO charged (i) Mr. H.C. Cheong, the President of HAK, with breach of fiduciary duty for manipulation of the reported rates of return for certain investments made in Korea by certain prior Funds (similar to the charge above against Mr. Yoo), embezzlement and tax evasion, and (ii) an entity that was 50% owned by LSF III, vicariously for Mr. Cheong's tax evasion charge. Although Mr. Cheong has been acquitted on most of these charges, including the one for which the LSF III investment affiliate was vicariously charged, he has been convicted of certain of the breach of fiduciary duty charges and certain of the tax evasion charges.

On November 21, 2012, certain related entities of the Funds initiated arbitration against the government of the Republic of Korea with the International Center for Settlement of Investment Disputes, claiming damages suffered as a result of the Korean government's unlawful interference with those entities' investments in Korean companies (including KEB). The claims arise out of the government's failure to comply with its obligations under the investment treaty between Belgium and South Korea. The parties are in the middle of hearings before the appointed arbitration tribunal. A decision is not expected from the tribunal until late 2016, at the earliest.

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

Neither the Registered Advisers nor their management persons are registered as broker-dealers, nor do they have any applications pending to register with the SEC as a broker-dealer or registered representative of a broker-dealer.

HAL is registered with the Commodity Futures Trading Commission (the “CFTC”) as a commodity trading advisor and is a member of the National Futures Association (the “NFA”). LSGA is registered with the CFTC as a commodity pool operator and commodity trading advisor and is also a member of the NFA.

The Funds currently rely on an exemption from registration provided by Rule 4.13(a)(3) under the Commodity Exchange Act (the “CEA”). In addition, LSGA relies on an exemption provided by Rule 4.7 under the CEA to pools whose participants are limited to “qualified eligible persons” with respect to certain investment entities that are subsidiaries of the Fund and that may be defined as commodity pools. Pursuant to this exemption, offering memoranda for the Funds as well as such subsidiaries are not required to be, and will not be, filed with the CFTC.

HAL is the parent entity of a number of direct and indirect subsidiaries, including HAM and the Participating Affiliates. With respect to HAL’s advisory services, each Participating Affiliate is registered, or believes it is exempt from registration, under the laws of the jurisdiction in which it is located. The Participating Affiliates are (1) Hudson Advisors Luxembourg S.a.r.l.; (2) Hudson Advisors Ireland Limited; (3) Hudson Advisors Germany GmbH; (4) Hudson Advisors UK Limited; (5) Hudson Japan K.K.; (6) Hudson Advisors Europe Limited; (7) Hudson Advisors Spain S.L.U.; (8) Hudson Advisors France S.a.r.l.; and (9) Hudson Advisors Netherlands, B.V. Hudson Advisors UK Limited is registered as a corporate finance advisory firm with the Financial Conduct Authority in the United Kingdom. Hudson Japan K.K. is licensed in Japan as an asset management company and registered investment advisor with the Financial Services Agency and as a debt servicer with the Ministry of Justice. Hudson Advisors Ireland Limited is registered as a credit servicing firm with the Central Bank of Ireland.

As noted above in Item 4, HAL has material business relationships with the Funds, HAM, and the Participating Affiliates. The Funds have entered into contracts with HAL that grant HAL the authority to provide advisory and other services to the Funds. HAL sub-contracts, on a regional basis, certain obligations owed to the Funds. Specifically, HAL has entered into agreements with HAM to provide due diligence and analysis services, asset management services, and certain ancillary services in the Americas region, and with each Participating Affiliate to provide those services within its respective region. The applicable Hudson entity providing the services is determined based on the geographical location of the Fund’s existing and potential investments. HAM and the Participating Affiliates may also contract directly with the Funds’ SPVs to provide certain of these services.

In reliance on a series of SEC no-action letters, HAL has entered into arrangements with each of its Participating Affiliates whereby HAL utilizes the investment advisory capabilities and related services, including certain personnel, of these Participating Affiliates in providing advice to HAL’s clients. The Participating Affiliates are not registered with the SEC as investment advisers. However, employees of the Participating Affiliates that assist in providing investment advice to HAL are subject to the oversight of both HAL and the SEC, and are subject to the Registered Advisers’ Code of Ethics and other compliance policies and procedures adopted by the Registered Advisers pursuant to the requirements of the Investment Advisers Act of 1940, as amended (“Advisers Act”).

Hudson is under common control with LSGA, LSAA and LSGA’s participating affiliates, which are: (1) Lone Star Japan Acquisitions Ltd. (Japan kabushiki kaisha); (2) Lone Star Germany GmbH (German company with limited liability); (3) Lone Star Europe Acquisitions LLP (United Kingdom limited liability partnership); (4) Lone Star Netherlands Acquisitions B.V. (Netherlands limited liability company); and (5) Lone Star Spain Acquisitions S.L.U. (a Spanish limited liability company). As discussed above, these entities perform origination, investment management, and investor relations services with respect to certain investments made by the Funds. LSGA and LSAA are both SEC-registered investment advisers.

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

### **Code of Ethics Adopted Pursuant to SEC Rule 204A-1**

The Registered Advisers have adopted the following three codes, which set forth certain standards for the Registered Advisers' employees, certain employees of the Participating Affiliates, and certain other persons subject to the Code ("Covered Persons"): (1) a Code of Ethics; (2) a Personal Trading Policy; and (3) an Insider Trading Policy (collectively, the "Code"). The Registered Advisers adopted the Code in accordance with Advisers Act Section 204A. The Code has been adopted in recognition of the Registered Advisers' fiduciary duty to place the interests of the Funds before the interests of the Registered Advisers and their employees, which must be upheld, in part, by addressing both actual and perceived conflicts of interest. The Code is intended to promote ethical conduct, provide guidelines and reporting requirements to help ensure compliance by the Registered Advisers and Covered Persons with applicable federal and state securities laws and regulations, and reinforce the fiduciary principles that govern the conduct of the Registered Advisers and Covered Persons.

While the Registered Advisers' clients and Covered Persons may invest, or have already invested, in obligations and/or other securities that are identical to or senior to, or have interests different from or adverse to, eligible client investments, the Code includes certain provisions regarding transactions in certain securities ("Reportable Securities") and other investments by Covered Persons. The Code, among other things, restricts the purchase and sale by Covered Persons for their own account of Reportable Securities that are purchased by the Registered Advisers' clients. It requires Covered Persons to pre-clear the purchase or sale of Reportable Securities, including transactions in initial public offerings and limited offerings or private placement securities. Requests for trading authorization will be denied when, among other reasons, the proposed personal transaction would be contrary to the provisions of the Code. Covered Persons are required to provide initial and annual reports of holdings of Reportable Securities and quarterly reports of transactions involving Reportable Securities. Transactions in Reportable Securities are reviewed for compliance with the Code. In addition, the Code requires disclosure by the Registered Advisers' personnel of potential conflicts of interest with respect to the Registered Advisers' clients, and establishes policies regarding other matters, such as the giving or receiving of gifts and entertainment. Under appropriate circumstances, the Registered Advisers' Chief Compliance Officer may grant waivers of certain provisions of the Code to one or more Covered Persons. In such circumstances, the Registered Advisers will endeavor to establish adequate controls regarding the activities of Covered Persons to comply with the principles set forth in the Code. If a personal securities holding, outside affiliation or other arrangement creates a material conflict of interest with respect to the interests of the Registered Advisers' clients, the Registered Advisers may require the affected Covered Person to recuse themselves from involvement with related transactions or impose other restrictions to mitigate the conflict.

The Registered Advisers may, from time-to-time, come into possession of material, nonpublic and other confidential information which, if disclosed, might affect an investor's decision to buy, sell or hold a security. Under applicable law, the Registered Advisers and Covered Persons are prohibited from improperly disclosing or using this information for their personal benefit or for the benefit of any other person, regardless of whether such other person is an advisory client. Accordingly, should the Registered Advisers and/or Covered Persons come into possession of material, nonpublic or other confidential information with respect to any company, issuer or security, they may be prohibited from communicating such information to, or using such information for the benefit of, their respective clients. The Registered Advisers and Covered Persons have no obligation to disclose the information to or use such information for the benefit of clients. The Registered Advisers and Covered Persons also do not have any responsibility or liability for failing to disclose such information to clients as a result of following the Registered Advisers' policies and procedures designed to ensure that the Registered Advisers and Covered Persons comply with their obligations with respect to such information.

Further, by reason of their responsibilities to the Funds, and notwithstanding procedural safeguards including restricted securities and watch lists, Lone Star and Hudson may come into possession of confidential or material nonpublic information that would limit their ability to direct the purchase or sale of certain investments. Lone Star



and Hudson may, therefore, be restricted from initiating transactions in certain securities on a client's behalf, due to the acquisition of confidential or material nonpublic information, at a time when action would otherwise be taken.

The Code establishes procedures to prevent the misuse of material nonpublic information by all of the Registered Advisers' employees, officers, directors and other Covered Persons. Any member, officer, director, or employee of the Registered Advisers or other Covered Person who fails to observe the above-described policies risks serious sanctions, including dismissal and personal liability.

The Registered Advisers will provide a copy of the Code to any client, prospective client, or Fund investor or prospective investor upon written request to the Chief Compliance Officer, Hudson Americas L.P./Hudson Advisors L.P., 2711 N. Haskell Avenue, Suite 1800, Dallas, Texas 75204.

### **Participation or Interest in Client Transactions**

#### ***Participation or Interest in General***

None of the Registered Advisers, their Covered Persons, Lone Star, or their related persons invest in opportunities recommended to the Funds, except for (1) investments in the Employee Investment Vehicles, investments in certain other co-investment structures authorized by the limited partnership agreement(s) of the relevant Fund(s), (3) interests held directly by General Partners in the Funds, (4) limited partnership and other ownership interests in the General Partners held by certain Covered Persons and by certain associated persons of Lone Star and (5) limited partnership interests in certain Funds held by certain associated persons of Lone Star. Additionally, the Registered Advisers, their Covered Persons, Lone Star, and their related persons may be restricted from investing in certain securities for themselves or their clients due to the receipt of confidential or material nonpublic information. In accordance with anti-fraud provisions of the Advisers Act and the Registered Advisers' internal compliance policies and procedures, the Registered Advisers will not, as principal, transact in securities with the Funds without first disclosing in writing the Registered Advisers' capacity in the transaction and obtaining the consent of the Advisory Committee(s) of the relevant Fund(s), which are defined and discussed below.

HAL or an affiliated entity may, from time to time and in limited circumstances, advance funds to a Fund as necessary for the Fund to pay its operating expenses and/or satisfy margin calls or other financing needs. Such advancements are generally deemed to be loans under the Advisers Act. HAL will not make advances for investment purchases by a Fund. Additionally, any such advances by HAL or an affiliated entity will not be included in the Fund's assets under management for purposes of calculating fees for asset management services. Such advances are at HAL's or its affiliates' sole discretion, and there can be no assurance that HAL or its affiliates will continue to provide such advances in the future. If HAL is unwilling or unable to make such advances in the future, a Fund may be required to seek other sources of funds in order to meet its financing needs, and may be required to pay interest on such funds.

HAL may engage in non-securities hedging transactions to help mitigate foreign currency risk on its compensation earned in currencies other than the U.S. dollar. HAL may conduct these hedging transactions, in what are traditionally liquid currency markets, in HAL's own accounts. As a result of this hedging activity, HAL may hold the same or different positions than the Funds in a given currency.

#### ***Employee Investment Vehicles***

Certain Key Employees of Hudson and Lone Star are given the opportunity, through an Employee Investment Vehicle, to co-invest with each Fund, on a side-by-side basis and on the same economic terms (on a pro rata basis, taking into account the size of the investment), in each investment that the Funds acquire. When Key Employees agree to participate in the Employee Investment Vehicle, they consent to the terms of co-investment transactions

in which the Employee Investment Vehicle will participate. Distributions to Key Employees who participate in an Employee Investment Vehicle are net of certain asset management fees paid to Hudson. The Employee Investment Vehicles do not pay any other fees or allocate any carried interest to the Registered Advisers, to Lone Star or the General Partners of the Funds. The terms of the Employee Investment Vehicles are disclosed in the Offering Documents of the Funds.

The Funds other than LSRMF I, LSF IX, LSF VIII, LSF VII, LSREF II, LSREF III, and LSREF IV made financing available to Key Employees participating in co-investment opportunities through a promissory note that bears interest at a commercial rate and on a full recourse basis with the Key Employee's interest in the co-investment as collateral. The amounts borrowed are generally repaid from a portion of any and all distributions from the co-investment. The General Partner of a Fund may, under certain circumstances such as the death or incapacity of a Key Employee, and in its sole discretion, purchase such a loan from the Fund for an amount equal to the outstanding principal and accrued interest of the loan. In such cases, the General Partner will enter into arrangements to ensure that any profit associated with such a purchase is repaid to the Fund. With respect to LSRMF I, LSF IX, LSF VIII, LSF VII, LSREF II, LSREF III, and LSREF IV, HAL and/or one of its affiliates may provide financing, directly or indirectly, to Key Employees who participate in an Employee Investment Vehicle.

The Employee Investment Vehicles are designed to align the interests of Hudson's and Lone Star's Key Employees with those of the Registered Advisers' clients, the Funds. The Key Employees who participate in the Employee Investment Vehicles have personal assets at risk alongside the investors in the applicable Fund. These arrangements do, however, present conflicts of interest. For example, the financing provided to Key Employees may be extensive, may have a significant effect on the net worth of these employees, and may influence employees responsible for the provision of investment advice to recommend higher risk investments than they otherwise would. The personnel of Hudson, Lone Star, and their related persons who participate in an Employee Investment Vehicle may have an incentive to recommend the acquisition or disposition of assets based on their personal interests (which could include the obligation to repay financing provided by HAL and/or one of its subsidiaries) rather than the best interests of the applicable Fund. Also, because participants in the Employee Investment Vehicles typically decide whether to invest at a later time than the investors in the Funds, the participants in the Employee Investment Vehicle may, at the time of their investments, have information regarding potential investments that may be more comprehensive than information known by the Funds' underlying investors at the time they made their investments. In addition, employees who participate in the Employee Investment Vehicles may not be financially able to meet capital calls.

The Registered Advisers believe, however, that there are factors with respect to the Employee Investment Vehicles that mitigate the conflicts of interest discussed above. Once a Key Employee decides to participate in an Employee Investment Vehicle with respect to the Funds currently in their investment periods, that Key Employee has no ability to opt out of the Employee Investment Vehicle's future investments. HAL will decide on the amount of the Employee Investment Vehicle's participation in each investment (within a range of 0.2% to 1.5% for LSREF IV, 0.2% to 1.5% for LSF IX and 0.2% to 1.0% for LSRMF I). Accordingly, the maximum contribution an Employee Investment Vehicle can make to an investment is immaterial in relation to the total investment made by the participating Fund. The Registered Advisers have implemented policies and procedures, including the Code, that are designed to help mitigate any conflicts of interest and direct the Registered Advisers' personnel to act in the best interests of the Registered Advisers' clients at all times.

Consistent with the limited partnership agreement of each Fund, the Fund may temporarily fund the entire cost of the initial acquisition of an investment, subject to the Employee Investment Vehicle's obligation to reimburse the Fund after the Fund calls capital from its investors for the investment. Amounts temporarily funded by the Fund accrue interest that is paid to the Fund together with the reimbursement of capital. With respect to an initial investment, the Employee Investment Vehicle shares in the risks and benefits of hedging and financing transactions that occur prior to reimbursement of the Fund, although the Fund is directly exposed to the Employee Investment Vehicle's share of these risks, as well as investment-related risks, prior to reimbursement. The

employees who participate in an Employee Investment Vehicle are required to fund their weighted average share of any unconsummated transaction costs.

When executing certain hedging transactions, HAL aggregates orders for the applicable U.S./Bermuda Funds and any Employee Investment Vehicle invested in an asset. When aggregating orders, HAL determines the total amount to be hedged for such investment, executes the hedging transaction for the applicable U.S./Bermuda Funds on a collective basis, and then allocates the trade among the U.S./Bermuda Funds and any Employee Investment Vehicle invested in the asset, based on their respective capital commitments.

### **Investment Opportunity Allocations and Cross Transactions**

When a Fund invests, its U.S./Bermuda Funds invest on a side-by-side basis in proportion to the respective capital commitments of each fund pursuant to a side-by-side investment agreement. Likewise, the Employee Investment Vehicles invest on a side-by-side basis with the U.S./Bermuda Funds pursuant to co-investment agreements. Pursuant to these agreements, certain expenses of an investment transaction may be paid by one of the U.S./Bermuda Funds, and subject to reimbursement by the other U.S./Bermuda Fund and any associated Employee Investment Vehicle. In such circumstances, the U.S./Bermuda Fund that has paid these expenses bears the risk that the other U.S./Bermuda Fund or the Employee Investment Vehicle will not have sufficient capital to reimburse the expenses in a timely fashion, or at all.

The limited partnership agreements of the Funds currently in their investment periods provide contractual safeguards regarding how a potential investment is chosen for a particular Fund. Specifically, each of the limited partnership agreements describes the types of investments that each of the Funds can make without overlap between them. In situations where a potential investment may be suitable for more than one Fund, the portfolio may be purchased by the Fund whose permitted investments are most predominantly aligned with the potential investment (even though the investment may contain some assets that could be purchased by the other Fund).

In limited circumstances, a Fund may sell assets to, purchase assets from, or otherwise share in an investment transaction with another Fund. For example, in limited situations Hudson may concurrently assist two Funds in sales of similar investments (such as the same tranche of CDO bonds), and Lone Star may provide advice with respect to such a transaction. To address conflicts of interest, the Registered Advisers have implemented procedures to require that all clients be treated fairly and equitably. The limited partnership agreement of each applicable Fund requires prior approval of conflicts of interest between Hudson and a Fund or among Funds, including proposed cross or principal transactions, by an advisory committee of investors created pursuant to the Fund's limited partnership agreement (each, an "Advisory Committee"). Neither the Registered Advisers nor any of their supervised persons serve as voting members of the Advisory Committee of any of the Funds.

In some circumstances, an operating company owned by one or more Funds ("Portfolio Company") will be engaged to provide services to one or more other Funds, Lone Star, or Hudson. As an example, Portfolio Companies that provide loan servicing or property management have been engaged to provide services with respect to assets owned by Funds that do not own the Portfolio Companies. Such arrangements pose conflicts of interest similar to cross or principal transactions. Pursuant to the terms of the limited partnership agreement(s) of the applicable Fund(s), the terms of such arrangements must be commercially reasonable and competitive with amounts that would be paid to third parties on an "arms-length" basis. Such arrangements must also be either approved by the limited partners as part of the limited partnership agreement(s) of the applicable Fund(s) or approved by the Advisory Committee(s) of the applicable Fund(s).

The Advisory Committee of each Fund meets with the Fund's General Partner throughout the year to consider and advise on conflicts of interest, the Fund's investment strategy and other matters relating to the business of the Fund. When a conflict of interest is presented, including a prospective cross or principal transaction or engagement of a Portfolio Company by another Fund, information on the transaction is presented to the Advisory Committee(s) of the Fund(s) involved to determine if the transaction is in the best interest of the Fund(s), and the Advisory

Committee approves or rejects the transaction. If there is a purchase by one Fund of another Fund's assets, either Lone Star, Hudson and/or a third party would determine the fair market value of the assets involved, subject to the review and approval of the Advisory Committee of each Fund.

## **Item 12: Brokerage Practices**

### **Counterparty Selection**

Hudson seeks to trade assets on behalf of its clients in a manner that is fair and equitable to all clients, and to exercise diligence and care throughout the transaction process. The majority of the Funds' assets are not market-traded instruments and even in the limited circumstances where a client invests in market-traded instruments, often these are unique assets that are only available from one or a limited number of counterparties (i.e., there is no meaningful market). The investment counterparty is typically chosen as part of the Investment Committee's approval of the investment, and Hudson then assists in implementing the investment decision. Therefore, the traditional best execution concepts that apply to market-traded instruments do not easily apply to the majority of the assets that Hudson trades on behalf of its clients.

In those cases where Hudson selects broker-dealers or other counterparties for transactions in market-traded instruments (including hedging services) on behalf of its clients, Hudson will do so consistent with its duty of best execution. Hudson defines "best execution" as seeking to obtain the best terms for their clients under the particular circumstances occurring at the time of a transaction and taking into account the overall objective for the investment to which the transaction relates. It is the policy of Hudson to seek to achieve the best qualitative execution under the circumstances. Best execution does not require Hudson to obtain the lowest possible price, commission or transaction cost. Transactions may involve specialized services or considerations (such as the type of assets the client is seeking to purchase or sell, or the availability of financing opportunities to the applicable client) that must be considered when selecting a counterparty, and thereby entail higher markups or commissions than would be the case with transactions that do not involve any specialized services or considerations. Furthermore, because Hudson's clients typically invest in assets that may be purchased from only one or a small number of counterparties, Hudson may not be able to obtain terms that are as favorable as those that may be available in a market with more potential counterparties.

In seeking best execution, Hudson may consider the full range and quality of a counterparty's services, including, among other things, one or more of the following factors, as applicable:

- the counterparty's ability to present Hudson with a transaction that meets the investment objectives of the relevant client for whom the transaction is executed, including a counterparty's ability to source unique assets that may be held by a limited number of entities or by a single entity;
- the best price possible under the particular circumstances of the transaction (for example, for a sale transaction, Hudson may determine that the best price may be obtained through a competitive auction process open to a number of counterparties or, alternatively, Hudson may determine that the best price may be achieved through price negotiations with a limited number of counterparties);
- the ability of the counterparty to provide financing on the assets purchased, including either bridge financing until permanent financing can be obtained or long-term financing at inception on terms which Hudson believes are in the best interests of the relevant client (which considerations may include, amongst others, rate, term, recourse and asset management flexibility) (for a sale transaction, Hudson may take any breakage costs related to a financing and the willingness of a counterparty to waive such breakage costs into consideration);
- the counterparty's credit terms prior to requiring the posting of margin;
- the counterparty's ability to commit capital needed to execute the transaction;
- the ability and history of the counterparty to maintain confidentiality of a transaction (or prior transactions);

- the ability of the counterparty to execute quickly and the ability to commit capital and/or financing quickly in light of the size of the transaction;
- the reliability, integrity, reputation and execution capability of the counterparty for effecting transactions in light of the size and difficulty of executing the order;
- the financial strength and creditworthiness of the counterparty; and
- the counterparty's specialized knowledge or experience in a particular market.

### **Research, Other Soft Dollar Arrangements and Client Referrals**

Hudson receives proprietary research and other services from certain broker-dealers, which Hudson may use to service one or more of the Funds. Hudson does not, however, cause the Funds to pay increased commissions in order to obtain the research and services provided by broker-dealers, and Hudson does not consider the provision of such research and services in the recommendation or selection of broker-dealers. When identifying potential transactions and selecting counterparties for those transactions, neither Lone Star nor Hudson considers whether a potential counterparty provides referrals of investors to the Funds. Hudson does not enter into commission sharing agreements with broker-dealers relating to transactions executed for the benefit of the Funds, or participate in directed brokerage arrangements. Further, Hudson will not accept directed brokerage instructions from the Funds or their underlying investors.

During the fundraising periods of LSF VII and LSREF II, which are now closed to new investors, the General Partners of those Funds used the services of a placement agent. The General Partners' payments to the placement agent for its services have been and will be made from the General Partners' own assets, and not from those Funds' assets. To date, the placement agent has also served as a significant counterparty in financing transactions executed by Hudson and/or Lone Star on behalf of one or more Funds, pursuant to financing terms negotiated by Hudson and/or Lone Star with the counterparty. As noted above, neither Hudson nor the Lone Star considers, when selecting counterparties, whether a potential counterparty provides referrals of investors to the Funds; Hudson and Lone Star selected this counterparty pursuant to one or more factors described above under "Counterparty Selection."

### **Other Third Parties**

In addition to transactions with banks and broker-dealers, Hudson may engage other service providers on behalf of the Funds with respect to the execution of transactions, such as lenders and real estate brokers and agents. These service providers are subject to similar selection criteria as described above for counterparties, but may also be selected based on the geographic location of the assets and the service provider's experience with the type of assets involved.

When purchasing insurance as part of the ancillary services, HAL selects insurance brokers based on factors including premium price and the insurance broker's ability to service and provide resources with respect to the insurance policy.

### **Aggregation of Client Transactions**

Hudson generally does not aggregate orders for the Funds, although Hudson and Lone Star do aggregate the transactions of a Fund among its U.S./Bermuda Funds and Employee Investment Vehicle(s) as described in Item 11. In addition, because the hedging services are provided on a specific investment basis, HAL aggregates orders for the applicable U.S./Bermuda Funds and any Employee Investment Vehicle invested in such investment. Because the U.S./Bermuda Funds invest together on a side-by-side basis in every investment they make, in providing the hedging services, HAL determines the total amount to be hedged for such investment, executes the hedging transaction for the applicable U.S./Bermuda Funds on a collective basis and then allocates the trade among the U.S./Bermuda Funds and any Employee Investment Vehicle invested in the investment, based in proportion to their respective capital commitments.

## **Trade Errors**

Although Hudson seeks to exercise diligence and care when trading assets on behalf of the Funds, errors may occur during the trading process. Hudson attempts to minimize trade errors by promptly reconciling confirmations with trade tickets or similar transaction documentation. To the extent that a trade error occurs, Hudson works to correct the error as soon as practicable and in such a manner that any resulting loss is minimized. If a trade error results in a gain, the affected Fund(s) will retain the gain. As described in the applicable Fund's Offering Documents, any loss caused by a trade error will be borne by the affected Fund(s) unless the error is the result of bad faith, gross negligence or willful misconduct by Hudson. Hudson does not use commitments of future brokerage business to compensate any broker-dealer for absorbing the cost of a trade error. If, however, to the extent Hudson can demonstrate that a counterparty was partly or entirely responsible for a trade error, Hudson may ask that counterparty to bear part or all of the cost of the error.

## **Item 13: Review of Accounts**

### **Asset Management Services**

Ongoing management of each investment is typically performed by the Hudson entity that operates in the geographic region where the investment is located. Hudson's asset management teams generally complete detailed Business Plans on every asset within 90 days after closing an acquisition. After the investment has been closed and integrated into Hudson's asset management program, senior management of Hudson will meet regularly with representatives of Lone Star to discuss the status of assets under management and address any proposed changes to the underlying Business Plans as needed. This review typically occurs on a quarterly basis. Hudson analyzes whether the investment is performing as anticipated, highlights any positive or negative information related to the investment and takes any necessary action based on its analysis. In addition to formal quarterly reviews, Hudson periodically reviews investments of the Funds on a more frequent basis to consider financing opportunities and sales opportunities, or to develop additional asset management strategies for the investments. Quarterly and periodic reviews are supervised by the head of asset management for the asset class being reviewed in the relevant region.

Hudson discusses the quarterly reviews with the applicable Region Head, and provides the Region Head with quarterly reports and other information regarding performance of the investment. The Region Head analyzes whether the investment is performing as anticipated, and provides strategic and related advice based on that analysis. In addition to formal quarterly reviews, Hudson frequently discusses periodic investment reviews with the applicable Region Head, who provides strategic and related advice with respect to the specific investment under review.

### **Hedging Services**

HAL typically reviews foreign currency hedging on behalf of the Funds on a monthly basis, and interest rate hedging on a weekly basis. The purpose of these reviews is to analyze whether there have been any changes to a Fund's investment forecast and/or strategy that require hedging modifications. In the event of such changes, HAL will typically execute any necessary changes to the hedging strategy for such investment(s). HAL provides the Funds with summary reports regarding the hedging services as part of its regular review process. HAL's President, Chief Financial Officer, Director of Global Portfolio Management, and other individuals in the Global Markets Department are involved in the review process.

### **Reports to Investors**

On a quarterly basis, HAL prepares for the General Partner of each Fund an unaudited balance sheet, statement of operations, portfolio cash flow summary and status reports of the Fund's investments and

activities during the applicable period, including summary descriptions of material new acquisitions and material dispositions. LSGA, on behalf of the General Partner, distributes (1) the unaudited statements and accompanying reports to the limited partners in each Fund on a quarterly basis (typically within 45 days after the end of each quarter) and (2) audited financial statements on an annual basis (typically within 90 days of the Fund's fiscal year end).

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

The Registered Advisers do not receive economic benefits from a non-client for providing investment advice or other advisory services to their clients. Lone Star, Hudson, the General Partners, or their affiliates may on occasion receive certain fees from third parties with respect to the business of the Funds, including financial advisory, director, or transaction-related fees ("Additional Fees"). Any such Additional Fees will be offset against management fees or expenses payable by the affected Fund(s) to its General Partner or to LSGA.

Neither the Registered Advisers nor their related persons directly or indirectly compensate any third party for client referrals. A General Partner may pay for third-party referrals of investors into the Funds.

#### **Item 15: Custody**

Hudson generally has custody (as defined in the Advisers Act) of the assets of the Funds. The Funds and their underlying investors receive annual audited financial statements from the Funds' auditor.

#### **Item 16: Investment Discretion**

The Registered Advisers provide asset management services and HAL provides hedging services involving a significant amount of investment discretion to the Funds. Although each General Partner may impose restrictions on the Registered Advisers, it is not anticipated that a General Partner would do so. The Registered Advisers advise the Funds pursuant to the terms of agreements to which HAL and the Funds are parties, and pursuant to the terms of HAL's agreements with HAM.

#### **Item 17: Voting Client Securities**

As part of the Ancillary Services, HAL performs treasury and cash management services on behalf of the Funds. As part of these services, HAL may invest funds not presently needed for a Fund's operations in money market funds. HAL votes proxies related to these holdings on behalf of the Funds. The Funds do not direct proxy votes with respect to particular solicitations.

HAL has adopted a Policy Regarding Proxy Voting ("Proxy Voting Policy") and related procedures that require HAL to vote the Funds' proxies with diligence, care and loyalty and in accordance with HAL's fiduciary duty to the Funds, which generally means voting proxies in a way that maximizes the value of the Funds' assets.

As applicable, the HAL authorized officer voting a proxy will consider whether HAL is subject to any material conflict of interest in connection with that proxy vote. The authorized officer must notify HAL's Chief Compliance Officer if the authorized officer is aware of any material conflict of interest (or potential material conflict of interest) associated with a proxy vote. The authorized officer and HAL's Chief Compliance Officer will consult with internal and/or outside legal counsel, as appropriate, regarding an appropriate course of action, and will document their basis for whatever voting decision is chosen.

HAL will provide a client with information about how a proxy was voted, or with a copy of the Proxy Voting Policy and related procedures, upon written request to the Chief Compliance Officer, Hudson Advisors L.P., 2711 N. Haskell Avenue, Suite 1800, Dallas, Texas 75204.

**Item 18: Financial Information**

Hudson does not require or solicit prepayment of fees six months or more in advance.

The Registered Advisers have never filed for bankruptcy and are not aware of any financial condition that is expected to affect or is reasonably likely to impair their ability to meet their contractual obligations to their clients.