Direct Lending Advisors
a Mickelson Capital Consulting Company

Direct Lending Fund I, L.P.

Frequently Asked Questions (FAQs)

Q1: What is direct lending?

A1: Direct lending is a more efficient way for borrowers and lenders to make loans while avoiding the cost and complexity of the traditional banking system. By "cutting out the middle man", the Fund receives much more of the cash flow from its portfolio of loans. We work with a rapidly growing network of Internet-based lending platforms that originate thousands of qualifying consumer loans each month. We sort through these loans to select only those loans that meet our stringent credit standards. We directly fund these loans along with other investors and directly receive our share of the principal and interest each month.

Q2: What does a typical loan look like?

A2: Typical loans have 3 year or 5 year terms over which the loan amount is fully amortized (fixed payment each month like a car loan). The loans we invest in range from $5,000 to $35,000 and over 85% of the loans have a 36 month term with interest rates that vary from 8% to 24%. The average loan is $11,000 over 36 months at 16.5% interest rate with a $390 monthly payment.

Q3: Why do creditworthy borrowers take out loans at 8% - 24% interest rates?

A3: Interest rates on unsecured consumer credit have historically averaged in the mid to high teens. As long as rates are competitive and reasonable, borrowers are more concerned with the affordability of their monthly payment. The difference between a 17% interest rate and a 10% interest rate on a $10,000, 36 month loan is only $34 a month. With banks no longer making small unsecured loans to their customers, there are very few places consumers can turn to when they need cash. We are one of the few options consumers have, and we only lend money when the monthly payment is affordable as a percent of the borrower's monthly income. 60% of the loans we make are to pay off existing credit card debt which typically lowers a borrower's monthly costs and improves their credit rating.

Q4: 8% - 10% net returns sounds high. Are these very risky loans?

A4: No. These projected returns are what institutions in the consumer credit market have achieved for decades through all market cycles. The difference is that with our direct lending model, investors keep most of the profits instead of the banks. We lend to Prime and Super Prime borrowers with FICO scores between 680 and 780 but the real key to risk reduction is creating a highly diversified portfolio. We review thousands of loans each month and this level of diversity delivers extremely predictable returns after expected loan defaults.

Q5: How can consumer loans be safe without collateral?

A5: The simple answer is <u>we make loans to creditworthy people who have proven to be responsible</u>. Even so, we know from the historical performance of over 115,000 loans that a percentage of our borrowers will default on their loan. The interest rates we charge are intended to offset the historical default rate with a substantial cushion. The security of principal and predictability of returns is driven by the large diversification over thousands of small loans. For investor principal to be at risk, loan defaults would have to significantly exceed any previously recorded historical level, including the recent recession, for an extended period of time.

Collateralized loans have fared much worse in recent years because banks and investors forgot that, at the end of the day, you rely on people to repay their loans. Investors in collateralized loans also forgot that you must incur significant expense to take control of and sell the collateral, often in a distressed environment. The defaults (think mortgage crisis) on "collateralized" loans have been much greater over the past 5 years than on unsecured consumer loans.

Q6: What is the expected default rate and what if it is higher?

A6: We know from the historical performance of over 120,000 similar consumer loans issued over the past 6 years that a percentage of our borrowers will default on their loan. Default rates tend to vary by credit rating and other factors which we monitor carefully. Overall default rates are influenced by the national unemployment rate and other economic factors. The interest rates we charge are intended to offset the historical default rate with a substantial cushion. For investor principal to be at risk, loan defaults would have to significantly exceed any previously recorded historical level, including the recent recession, for an extended period of time. By way of example, the Federal Reserve reported that defaults on unsecured consumer credit peaked in the 1st quarter of 2009 at a rate of 10.8%. This rate was double the average 5% default rate over the prior 30 years. However, by the 3rd quarter of 2009, the default rate had fallen below 6% and is currently approaching 5%. Even at the peak level of defaults reached in the 1st quarter of 2009, an investor in a well-diversified portfolio of loans like the Fund would have continued to have positive monthly income.

Q7: *Are there enough creditworthy borrowers to build a safe portfolio?*

A7: The market is robust and growing rapidly. In Q2 2012 consumer lending platforms originated $175 million in over 15,000 small loans. Currently, we review over 4,000 loans each month to find those loans that meet our stringent investment standards. In addition, the Fund achieves further diversification by buying fractional interests in loans. Instead of allocating $20,000 to a single loan, we may allocate $2,000 to 10 different loans.

Q8: *What is a fractional loan?*

A8: Each loan is held in a special trust account separate from the originating platform lender and divided into small fractional interests (Notes) which are registered with the SEC. Fractional loans share the risk of each loan among numerous investors like the Fund. This allows us to invest in a much greater number of individual loans per dollar of investment capital creating greater diversification and further reducing the risk of default relating to each borrower.

Q9: *What do you mean by a diversified portfolio and how do you measure it?*

A9: We look at over 4,000 loan applications each month. We sort through these loans to select only those loans that meet our stringent credit standards and our diversification goals. We measure diversification by FICO score, credit rating, type of employer, annual income, length of employment, past credit history, geography (both size of city and state), education, homeownership, education, and other psychographic variables. The Fund adds 300 – 600 new loans to its portfolio each month.

Q10: *How can lending platforms do a reliable credit check on so many borrowers?*

A10: Platform Lenders have taken full advantage of changes in technology and banking regulations to automate a significant portion of the traditional credit checking historically done by banks. Platforms are authorized to pull tax returns directly from the IRS database; pull W-2 information from ADP and Paychex (70% of all payroll checks); pull credit files from each of the credit bureaus. This provides the primary basis for data collection and happens within minutes of a loan application. Additional information may be requested such as physical copies of W-2s that are not from ADP or Paychex, access to bank records to determine consistency and amount of monthly deposits, and explanation or documentation of additional sources of income or investment income. In addition, the Platform Lenders perform a number of data verification calls with employers. Lastly, the Platforms review social media sites to check a borrower's status and other public information.

Q11: *Who services the loans?*

A11: All loan payments are set up via automatic direct debit from the borrower's bank account (ACH), so a missed payment is similar to a bounced check. As soon as a payment does not clear, the lending platform contacts the borrower to make arrangements to reprocess the payment. If, by the end of the 1st 30 days after a payment is missed, the payment has not been processed, the account is turned over to a professional and licensed collection agency.

Q12: *Who selects the loans?*

A12: The Fund is actively managed by the portfolio management team which is overseen by the Investment Policy Committee. The Fund uses a proprietary system of credit variables related to each borrower to determine whether to make an investment in each loan. On average, less than 25% of the loans offered to the Fund by the lending platforms meet the Fund's stringent lending criteria and diversification criteria. In addition, the Fund seeks to maximize its diversification by variables such as location, employer, term, loan size, and loan purpose.

Q13: *How do I get paid monthly income from the fund?*

A13: The Fund's investment in loans generates monthly cash flow comprised of principal and interest. Investors can chose one of four options for their share of monthly principal and interest income: (1) fully re-invest all principal and interest into new loans each month; (2) elect to receive a fixed monthly cash payment each month; (3) elect to receive a percentage of their capital account paid each month; or (4) elect to receive all of their earned income each month.

Q14: How do I liquidate my position to withdraw from the fund?

A14: Investors can request a withdrawal at any time, there is no lock-up period. Once a withdrawal request has been received, investors will receive 100% of their *pro-rata* share of monthly principal and interest until their capital account reaches zero. The General Partner of the Fund may offer to accelerate a Partner's withdrawal at any time. Under no circumstances will a complete withdrawal take more than 36 months.

Q15: Who does the Fund use to oversee operations?

A15: The Fund has contracted with best in class institutions to manage the Fund's operations. Opus Fund Services is the Fund's third-party administrator responsible for fiscal controls, accounting and Partner reporting. Rothstein Kass is the auditor and prepares the Fund's tax returns. Paul Hastings handles the Fund's required legal and regulatory filings.

Q16: Where are the Fund's assets held?

A16: Notes representing our fractional interest in each loan are held in a special trust account for the benefit of the Fund. We do not directly handle any investor cash or assets and all Fund assets are held by our custodian Millennium Trust or in an account at J.P. Morgan independently overseen by our third-party administrator, Opus Fund Services.

Q17: What are the costs of the Fund?

A17: We expect that investors will receive an annual return of 9% - 11% net of all defaults, fees and fund expenses such as legal and accounting. Investors pay a monthly management fee of 16 basis points (0.16%) and an acquisition fee on all new loans of 25 basis points (0.25%) per month for the four months following a new loan being funded. On an annual basis, the management fees are 2% and all other expenses are expected to be ½% to 1%.

Q18: What will happen if interest rates rise?

A18: The Fund invests in 3 year and 5 year fixed interest, fully amortizing notes which are not impacted by rising rates. Rising rates may alter the relative attractiveness of other income oriented assets such as treasuries, municipal bonds, and CD's in comparison with the Fund.

Q19: How is the Fund's income taxed?

A19: All of the Fund's income is ordinary interest income. The Fund is not "tax efficient".

Q20: What are the risks associated with this investment?

A20: Direct Lending Fund I, LP is intended to be a conservative, income generating investment with no expected volatility. The Fund's performance will be influenced by two key factors which are (1) selection of portfolio loans; and (2) general economic conditions which may influence overall default rates. There are other risks associated with an investment in the Fund which are discussed in detail in our offering materials. Investors considering an investment should read them carefully.

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