

Notes to Consolidated Financial Statements

CharterMac & Subsidiaries

NOTE 1 • Organization and Significant Accounting Policies

CharterMac, which we refer to herein as “we”, “us”, “our”, and “our Company”, is a Delaware statutory trust, which commenced operations in October 1997. We and our subsidiaries are in the business of (i) portfolio investing, which includes acquiring and holding (directly and indirectly through our subsidiaries) federally tax-exempt multi-family housing revenue bonds issued by various state or local governments, agencies or authorities and other investments designed to produce federally tax-exempt income; (ii) mortgage banking, which includes originating and servicing mortgage loans on behalf of third parties such as the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) and the Federal Housing Authority (“FHA”); (iii) credit enhancement, which includes guaranteeing tax credit equity returns and mortgage loans; and (iv) fund management, which includes sponsoring investment programs for a fee.

We and a majority of our subsidiaries, are each either treated as partnerships or disregarded for federal income tax purposes. Therefore, we pass through to our shareholders, in the form of distributions, income (including federally tax-exempt income) derived from our investments without paying federal income tax on that income. We intend to operate so that a substantial portion of our ordinary income will be excluded from gross income for federal income tax purposes. Other income, such as capital gains and taxable interest income, as well as any dividend income from CharterMac Corporation (“CM Corp.”) our wholly owned subsidiary, generally will be subject to tax.

In 1999, we formed CharterMac Equity Issuer Trust, a wholly owned subsidiary, (collectively, with its subsidiaries, “Equity Issuer”) which holds a substantial portion of our revenue bonds. From time to time, Equity Issuer may issue Series A and Series B Cumulative Preferred Shares (cumulatively, “Preferred Shares”) to institutional investors. The Preferred Shares have a senior claim to the tax-exempt income derived from the investments owned by Equity Issuer. Any income in Equity Issuer after the payment of the cumulative distributions on its Preferred Shares, and after the fulfillment of certain covenants, may then be allocated to CharterMac. The assets of Equity Issuer, while included in our consolidated financial statements, are legally owned by Equity Issuer and are not available to any creditors of our Company outside of Equity Issuer.

In July 2001, we formed CM Corp. as a wholly owned, consolidated taxable subsidiary to help us more efficiently manage our taxable businesses. CM Corp. and its subsidiaries conduct most of our taxable business, including many of the fee-generating activities in which we may engage. CM Corp. isolates a substantial portion of the taxable income and expenses of our Company. Unlike CharterMac, CM Corp. is a corporation which

is subject to both Federal and State income tax.

In December 2001, our Company, through CM Corp. acquired 80% of the outstanding capital stock of PW Funding Inc. and its subsidiaries (“PWF”). Under the acquisition agreement, the stockholders of PWF were granted the right to put their remaining 20% stock interest to CM Corp. after an initial period of 24 to 36 months. The agreement also grants CM Corp. the right to call the remaining 20% stock interest of PWF from PWF's stockholders after the same initial period of 24 to 36 months. Subsequent to the initial purchase of 80% of PWF's outstanding stock, and pursuant to terms of individual employee stock purchase agreements, we have purchased additional PWF stock. At December 31, 2003, we owned approximately 87% of the outstanding shares of PWF stock.

On November 17, 2003, we acquired 100% of the ownership interests in and substantially all of the businesses operated by Related Capital Company (“Related”) (other than specific excluded interests). Related had previously acted as our external manager (“Manager”). The acquisition was structured so that the selling principals of Related contributed their ownership interests in Related to CharterMac Capital Company, LLC, a newly formed subsidiary of CM Corp. which we refer to as “CCC”, in exchange for 15,854,505 special common units (“SCUs”) in CCC. The special common units are exchangeable for cash or, at our option, common shares on a one-for-one basis. All of the selling principals were also issued one special preferred voting share of our Company for each special common unit they received. The special preferred voting shares have no economic interest, but entitle the holder to one vote per special preferred voting share on all matters subject to a vote of the holders of our common shares. One of the selling principals also received \$50 million in cash. The selling principals of Related included its four executive managing partners (Stuart J. Boesky, Alan P. Hirmes, Marc D. Schnitzer and Denise L. Kiley), all of whom are members of our board of trustees, and an affiliate of The Related Companies, L.P., a New York limited partnership (“TRCLP”) with a majority of its equity controlled by Stephen M. Ross, who is also the non-executive Chairman of our board of trustees. As a result of the acquisition, the economic interest in our Company of (i) TRCLP equals approximately 15.4% and (ii) our management and employees equals approximately 7.1%. We conduct our fund management business through Related.

We are governed by a board of trustees comprised of eight independent managing trustees and seven managing trustees who are affiliated with Related.

Basis of Presentation

Our consolidated financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in conformity with