

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(Greenbelt Division)

In re:

*

KH FUNDING COMPANY,

*

Case No. 10-37371-TC
(Chapter 11)

Debtor.

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**SECOND AMENDED JOINT DISCLOSURE STATEMENT
OF KH FUNDING COMPANY
AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS**

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**SECOND AMENDED JOINT DISCLOSURE STATEMENT
OF KH FUNDING COMPANY
AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS**

**(Second Amended Joint Plan of Liquidation of KH Funding Company and the Official
Committee of Unsecured Creditors Pursuant to Chapter 11 of the Bankruptcy Code)**

(Date: February 9, 2012)

I. INTRODUCTION

KH Funding Company, a corporation organized and existing under the laws of the State of Maryland (hereinafter referred to as “KH Funding”), filed a voluntary petition seeking relief under Chapter 11 of the Bankruptcy Code (“Bankruptcy Code”) in the United States Bankruptcy Court for the District of Maryland (the “Bankruptcy Court”) on December 3, 2010 (the “Petition Date”). The Chapter 11 case commenced thereby has been pending since that time before the Honorable Thomas J. Catliota, United States Bankruptcy Judge, under Case No. 10-37371-TJC. From and after the Petition Date, KH Funding has continued to operate its business as a debtor-in-possession under 11 U.S.C. §§ 1107 and 1108.

This Second Amended Disclosure Statement (“Disclosure Statement”) is provided pursuant to Section 1125 of the Bankruptcy Code to all of KH Funding’s known creditors, Interest holders and other parties in interest in connection with the solicitation of acceptances of the Second Amended Joint Plan of Liquidation of KH Funding Company and the Official Committee of Unsecured Creditors Pursuant to Chapter 11 of the Bankruptcy Code dated January 12, 2012, which has been filed with the Bankruptcy Court (the “Plan”).¹ The purpose of this

¹ KH Funding and the Committee initially filed a Joint Plan of Liquidation of KH Funding Company and the Official Committee of Unsecured Creditors Pursuant to Chapter 11 of the Bankruptcy Code on September 26, 2011 [Paper No. 323] (the “Original Plan”). Subsequently, certain non-substantive amendments were made to the Original Plan and an

(continued...)

Disclosure Statement is to provide such information as will enable a hypothetical, reasonable investor typical of the holders of Claims or Interests to make an informed judgment in exercising his, her or its right either to accept or reject the Plan. A copy of the Plan is attached to this Disclosure Statement and is incorporated herein by this reference as **Exhibit "A"**. As used herein, the term "Plan Proponents" shall mean KH Funding and the Official Committee of Unsecured Creditors ("Committee").

For the reasons set forth herein, the Plan Proponents recommend that Holders of Claims who are entitled to vote on the Plan vote to accept the Plan. Your acceptance of the Plan is important. In order for the Plan to be deemed "accepted" by creditors, at least sixty six and two-thirds percent (66 2/3%) in amount of Allowed Claims and a majority in number of Allowed Claims voting in each class of Claims must accept the Plan. As set forth in Section 4.11 of the Plan, all Interests will be deemed cancelled as of the Effective Date, and Holders of Interests will receive no distributions under the Plan. Accordingly, Holders of Interests are deemed to reject the Plan and are not entitled to vote. Whether or not you expect to be present at the hearing to consider confirmation of the Plan, you are urged to fill in, date, sign and properly mail the ballot accompanying the Plan and this Disclosure Statement to Patricia L. Adams, Legal Assistant, Gordon Feinblatt LLC, 233 East Redwood Street, Baltimore, Maryland 21202. For your vote to count, your ballot must be received by Ms. Adams prior to the date and time shown thereon.

NO REPRESENTATIONS CONCERNING KH FUNDING ARE AUTHORIZED BY THE PLAN PROPONENTS OTHER THAN THOSE SET FORTH IN THIS DISCLOSURE STATEMENT. ANY REPRESENTATION OR INDUCEMENT MADE TO SECURE YOUR ACCEPTANCE OR REJECTION OF THE PLAN WHICH IS NOT CONTAINED IN THIS DISCLOSURE STATEMENT SHOULD NOT BE RELIED UPON BY YOU IN REACHING YOUR DECISION ON HOW TO VOTE ON THE PLAN.

THE PLAN PROPONENTS DO NOT WARRANT OR REPRESENT THAT THE INFORMATION CONTAINED HEREIN IS ACCURATE, ALTHOUGH GREAT EFFORT HAS BEEN MADE TO BE ACCURATE. THIS STATEMENT CONTAINS ONLY A SUMMARY OF THE PLAN. THE PLAN WHICH ACCOMPANIES THIS DISCLOSURE STATEMENT IS AN INTEGRAL PART OF THE DISCLOSURE STATEMENT, AND EACH CREDITOR IS URGED TO REVIEW THE PLAN PRIOR TO VOTING ON IT.

Amended Joint Plan was filed on November 4, 2011 [Paper No. 354]. Thereafter, contemporaneous with the filing of this Second Amended Disclosure Statement, KH Funding and the Committee have filed the Second Amended Joint Plan of Liquidation of KH Funding Company and the Official Committee of Unsecured Creditors Pursuant to Chapter 11 of the Bankruptcy Code.

II. DEFINITIONS

Unless otherwise indicated, by context or otherwise, undefined capitalized terms appearing in this Disclosure Statement shall have the meanings ascribed to them under Article I (Definitions), Section 1.1 through 1.64 of the Plan. See Exhibit “A” attached hereto.

III. EVENTS LEADING TO CHAPTER 11 FILING

KH Funding was established in 1994 to engage in business activities primarily consisting of originating, acquiring, and servicing mortgage loans. Specifically, KH Funding originated commercial real estate mortgage loans and investment property residential mortgage loans and also purchased residential first and second mortgage loans from other lenders. These lending activities were concentrated primarily in Washington, D.C., the Maryland counties of Anne Arundel County, Baltimore County, Frederick County, Howard County, Montgomery County, and Prince Georges County, and Baltimore City, Maryland and, to a lesser degree, Northern Virginia.

KH Funding historically funded its operations by raising investor capital through the private and public sale and issuance of interest-bearing debt securities. Pursuant to an Indenture dated as of August 2, 2004, as amended and supplemented to date, by and between KH Funding and Wells Fargo Bank, N.A. (the “Series 3 Trustee”), KH Funding issued certain Series 3 Senior Secured Investment Debt Securities (“Series 3 Notes”) and Series 4 Subordinated Unsecured Investment Debt Securities (“Series 4 Notes” and, together with the Series 3 Notes, the “Notes”).² As of the Petition Date, KH Funding was indebted to the holders of the Series 3 Notes and Series 4 Notes in aggregate amounts of more than \$38,350,000 and \$1,330,000, respectively.

KH Funding’s ability to meet its debt service obligations under the Indenture was dependent both on the income from its lending activities and its continued ability to raise investment capital. As a result of an investigation by the Maryland Securities Division and significant delays starting in the second quarter of 2006 in obtaining orders of effectiveness from securities regulators in respect of its registration statement covering the public offer and sale of its Notes, the economic downturn and the collapse of the financial markets, KH Funding was unable to generate sufficient cash to support its ongoing operations. KH Funding’s operating income also declined as a result of a proliferation of defaults by its borrowers. At the same time, due to the expiration of its registration statement covering the Notes in 2006, the aforementioned delays in obtaining new orders of effectiveness for an amended registration statement, and a limited selling window in late 2008 and early 2009, KH Funding was unable to obtain sufficient new investment capital.

² The indenture trustee for the Series 4 Notes is Law Debenture Trust Company of New York.

The confluence of the foregoing circumstances caused KH Funding to experience a significant cash flow shortfall, which in turn resulted in KH Funding's default on its debt service obligations in connection with the Indenture and ultimately led to KH Funding's decision to seek relief under Chapter 11. KH Funding's Chapter 11 filing was timed so as to enable it to pursue a claim to avoid the lien of the Series 3 Trustee as a preferential transfer (see discussion below in Section IV).

IV. THE CHAPTER 11 CASE AND RELATED PROCEEDINGS

Since the Petition Date, KH Funding has continued in possession of its property and operated as a debtor in possession pursuant to 11 U.S.C. §§ 1107(a) & 1108. KH Funding has actively pursued an orderly liquidation strategy in this case, culminating with the filing of the Plan by the Plan Proponents. The following is a summary of significant events in KH Funding's bankruptcy case leading to the filing of the Plan.

A. Use Of Cash Collateral/Avoidance Of Series 3 Trustee's Lien

As of the Petition Date, the Series 3 Trustee asserted a security interest in substantially all of KH Funding's personal property and proceeds thereof, including property constituting "cash collateral" within the meaning of 11 U.S.C. § 363(a). KH Funding asserted that the Series 3 Trustee's security interest was avoidable in substantial part because it was perfected within the 90 day preference avoidance period before the Petition Date. Accordingly, before KH Funding filed this case, KH Funding and the Series 3 Trustee negotiated the terms of a Preliminary Consent Order Authorizing Debtor's Use of Cash Collateral and Granting Adequate Protection (the "Preliminary Order") and, on the Petition Date, KH Funding filed an Emergency Motion for Entry of the Preliminary Order (the "Cash Collateral Motion"). The Bankruptcy Court entered the Preliminary Order on December 8, 2010. Pursuant to the Preliminary Order, KH Funding obtained authority to use cash collateral, consisting of income from its operations, pending a final hearing on the Cash Collateral Motion. The Bankruptcy Court scheduled a final hearing on the Cash Collateral Motion for December 30, 2010.

Prior to the final hearing, on December 13, 2010, KH Funding commenced the adversary proceeding styled *KH Funding Company v. Wells Fargo Bank, N.A.*, Adv. No. 10-00930-TJC by filing a Complaint to Avoid Preferential Transfer and Lien, pursuant to which KH Funding sought to avoid the Series 3 Trustee's lien in KH Funding's personal property on grounds that perfection of such lien occurred within 90 days before the Petition Date and therefore constituted a preferential transfer within the meaning of 11 U.S.C. § 547(b). Thereafter, KH Funding and the Series 3 Trustee commenced good faith discussions concerning a consensual resolution of the adversary proceeding in order to avoid the unnecessary expenditure of resources that would otherwise be available for distribution to Holders of Allowed Claims. The Series 3 Trustee informed the Plan Proponents that in recognition of, among other things, the fact that if the lien in favor of the Series 3 Trustee were avoided the Series 3 Note Claims would comprise approximately 91% of aggregate amount of all unsecured claims against KH Funding and, consequently, the ultimate recovery of the Holders of Series 3 Note Claims would not be materially impacted by the avoidance of the lien, the Series 3 Trustee determined a

consensual settlement was in the best interests of the holders of the Series 3 Notes. Accordingly, the Series 3 Trustee, KH Funding and the Committee negotiated the terms of the Stipulation and Consent Order Avoiding Preferential Transfer and Preserving Such Transfer for the Benefit of the Debtor's Bankruptcy Estate (the "Order Avoiding Transfer"), pursuant to which (i) the lien securing the claim of the Series 3 Trustee was avoided as to substantially all of KH Funding's personal property, and (ii) such claim remains secured only by the funds on deposit in KH Funding's operating account at Sandy Spring Bank and a deposit account with LFA Investment Services in the aggregate amount, as of the Petition Date, of \$54,823 (defined in Section 1.57 of the Plan as the Series 3 Note Secured Claim). On February 28, 2011, KH Funding moved for entry of the Order Avoiding Transfer and, on May 11, 2011, the Court entered the Order Avoiding Transfer.

KH Funding's and the Series 3 Trustee's approach to KH Funding's authority to use cash collateral during this case was simplified by the recognition that the Series 3 Note Secured Claim was limited to \$54,823. To protect the Series 3 Trustee's interest in those funds, KH Funding and the Series 3 Trustee reached agreement as to the terms of the Final Consent Order Authorizing Debtor's Use of Cash Collateral and Granting Adequate Protection, which was entered by the Court on December 27, 2010 (the "Cash Collateral Order"). Pursuant to the Cash Collateral Order, KH Funding acknowledged the validity of the Series 3 Trustee's security interest in funds on deposit in KH Funding's operating account and agreed to provide adequate protection to the Series 3 Trustee on account of that interest by, *inter alia*, preparing and delivering periodic financial reporting to the Series 3 Trustee and granting the Series 3 Trustee a replacement lien in KH Funding's property to the same extent and priority as the Series 3 Trustee's lien as of the Petition Date.

The term of the Cash Collateral Order initially extended through and including March 31, 2011. Pursuant to the terms of a certain Stipulated First Amended Final Consent Order Authorizing Debtor's Use of Cash Collateral, which was entered by the Court on May 13, 2011, KH Funding and Series 3 Trustee agreed that if the lien of the Series 3 Trustee was avoided, then most of the restrictions on KH Funding's use of cash collateral would no longer be in effect. As a result of the Order Avoiding Transfer, KH Funding's use of cash is no longer restricted.

B. Order Authorizing Payment Of Prepetition Wages, Salaries, Taxes and Benefits

On the Petition Date, KH Funding had three full-time and three part-time employees, all of whom were owed accrued but unpaid wages and benefits when this case was filed. Accordingly, on the Petition Date, KH Funding filed the Emergency Motion for Authority to Pay Prepetition Wages and Salaries, Payroll Taxes Associated Therewith and Other Prepetition Employee Benefits and Request for Immediate Hearing (the "Wage Motion"). Following an emergency hearing on the Wage Motion on December 7, 2010, the Court entered an Order granting the Wage Motion on December 8, 2010. Pursuant to the Order granting the Wage Motion, KH Funding obtained authority to pay certain wages, salary, employee benefits, and payroll taxes with respect to KH Funding's employees.

C. Appointment of Creditors' Committee and Committee Professionals

On or about January 20, 2011, the Office of the United States Trustee appointed the Committee pursuant to 11 U.S.C. § 1102. The members of the Committee are as follows:

Ruth Gresser (Chair)

Tom Bauer

Law Debenture Trust Company of New York, in its capacity as Series 4 Trustee

Michelle Marcello

Bernard Repeta

Wells Fargo Bank, N.A., in its capacity as Series 3 Trustee

Kevin Willes

On February 17, 2011, the Committee filed the Application for Entry of an Order Authorizing and Approving the Employment of Pachulski Stang Ziehl & Jones LLP as Counsel to the Official Committee of Unsecured Creditors Nunc Pro Tunc to January 31, 2011. By Consent Order entered April 11, 2011, the Bankruptcy Court authorized the Committee to employ Pachulski Stang Ziehl & Jones LLP as counsel. Contact information for the Committee's counsel is as follows:

PACHULSKI STANG ZIEHL & JONES LLP

Bradford J. Sandler

Michael R. Seidl

919 N. Market Street, 17th Floor

P.O. Box 8705

Wilmington, DE 19899-8705

Telephone: 302-652-4100

Facsimile: 302-652-4400

bsandler@pszjlaw.com

mseidl@pszjlaw.com

On February 23, 2011, the Committee filed the Application of the Official Committee of Unsecured Creditors for Authority to Employ McGuire Woods LLP as its Co-Counsel Nunc Pro Tunc to February 14, 2011. By Order entered April 14, 2011, the Bankruptcy Court authorized the Committee to employ McGuire Woods, LLP as co-counsel. Contact information for the Committee's co-counsel is as follows:

McGUIRE WOODS LLP
James E. Van Horn
7 Saint Paul Street, Suite 1000
Baltimore, MD 21202
Telephone: (410) 659-4468
Facsimile: (410) 659-4488
Email: jvanhorn@mcguirewoods.com

On March 23, 2011, the Committee filed the Application by the Official Committee of Unsecured Creditors for Order Authorizing the Retention and Employment of BDO Consulting, a Division of BDO USA, LLP Nunc Pro Tunc to February 7, 2011, as Financial Advisor Pursuant to Sections 328(a) and 330 of the Bankruptcy Code and Rule 2014 of the Federal Rules of Bankruptcy Procedure. By Consent Order entered May 27, 2011, the Bankruptcy Court authorized the Committee to employ BDO Consulting, a Division of BDO USA, LLP as its Financial Advisor. Contact information for the Committee's Financial Advisor is as follows:

BDO CONSULTING
David Berliner, Partner, CPA, CIRA, CTP
100 Park Avenue
New York, New York 10017
Tel: (212) 885-8347
Email: DBerliner@bdo.com

D. KH Funding's Engagement of Professionals

On the Petition Date, KH Funding filed the Application to Employ Gordon, Feinblatt, Rothman, Hoffberger & Hollander, LLC as Counsel to the Debtor. By Consent Order entered January 14, 2011, the Bankruptcy Court authorized KH Funding to employ Gordon, Feinblatt, Rothman, Hoffberger & Hollander, LLC (now known as Gordon Feinblatt LLC) as counsel. Contact information for KH Funding's counsel is as follows:

GORDON FEINBLATT LLC
Lawrence D. Coppel
233 East Redwood Street
Baltimore, Maryland 21202
Tel: (410)576-4000
Facsimile: (410)576-4040
Email: lcoppel@gflaw.com

As will be described in greater detail below, KH Funding's assets consist primarily of its loan portfolio and its real estate owned ("REO"). An integral part of KH Funding's strategy in this case has been to evaluate the marketability of these assets and devise ways to increase their value. KH Funding has taken action to engage professionals to assist KH Funding in this regard, as follows:

1. On the Petition Date, KH Funding filed the Debtor's Application for Authority to Employ Gray & Associates, LLC ("Gray") as Asset Disposition Consultant. The Court entered an Order authorizing KH Funding to engage Gray on January 21, 2011. During this case, Gray assessed the feasibility of a sale of KH Funding's loan and real estate portfolios and prepared a report which has assisted KH Funding's development of a strategy for managing KH Funding's assets with a view toward increasing their value in an orderly liquidation.

2. On February 15, 2011, KH Funding filed an Application for Authority to Employ Kollman & Saucier, P.A. as Special Counsel to perform services in connection with foreclosure with respect to real property securing loans made by KH Funding. The Court entered an Order granting this Application on March 23, 2011.

3. On April 14, 2011, KH Funding filed the Application to for Authority to Employ Eric A. Zoellner as Loan Portfolio/REO Manager. The Court entered an Order granting this Application on May 18, 2011. Mr. Zoellner was employed for the purpose of (i) identifying and addressing deficiencies in KH Funding's loan and REO files; (ii) where appropriate, procuring and reviewing title searches, appraisals, credit reports, among other necessary records; (iii) analyzing budgets and documenting budget issues with respect to KH Funding's REO; (iv) interacting with borrowers to obtain records and, where appropriate, negotiate workouts; (v) monitoring and evaluating the status of construction and renovation of REO; and (vi) reviewing and analyzing loan accounts involving 1st Equitable Funding, LLC.

4. On June 7, 2011, KH Funding filed an Application for Authority to Employ Stegman & Company as Accountants to prepare certain state and federal tax returns and perform certain related services. On June 30, 2011, the Court entered the Order Authorizing Employment of Stegman & Company as Accountants.

E. Plan Exclusivity Period

Pursuant to 11 U.S.C. § 1121(b) and (c)(3), KH Funding had the exclusive right after the Petition Date to file a plan of reorganization for an initial 120-day period ending April 2, 2011, and to solicit acceptances of such plan for an initial 180-day period through and including June 1, 2011. On April 1, 2011, KH Funding filed the Consent Motion for Order Extending the Exclusive Periods for Debtor to File Plan of Reorganization and Solicit Acceptances of Plan (the "Exclusivity Motion"), pursuant to which KH Funding sought to extend the periods for filing and obtaining acceptances of the Plan (a) as to all creditors and parties in interest other than the Committee, through and including August 31, 2011 and October 31, 2011, respectively; and (b) as to the Committee, through and including June 1, 2011 and August 31, 2011, respectively. The Committee consented to the extensions requested by KH Funding in the Exclusivity Motion. On April 22, 2011, the Bankruptcy Court entered the Consent Order Extending Exclusive Periods During Which Debtor may File a Plan of Reorganization and Solicit Acceptances of Plan (the "Consent Order").

Following the Exclusivity Motion, KH Funding and the Committee engaged in extensive discussions with respect to the preparation of the Plan. The discussions between KH Funding, the Committee, and other interested parties with respect to the formulation of the Plan took more time than KH Funding and the Committee anticipated. As a result, to preserve KH Funding's exclusivity periods while these discussions were taking place, KH Funding (with the Committee's consent) sought and obtained entry of a series of consent orders extending the exclusive periods. On September 9, 2011, KH Funding filed the Eighth Consent Motion for Order Extending Exclusive Periods for Debtor to File Plan of Reorganization and Solicit Acceptances of Plan, pursuant to which KH Funding sought entry of an Eighth Consent Order extending KH Funding's exclusive periods for filing and obtaining acceptances of the Plan as to all creditors and parties in interest including the Committee until and including September 26, 2011 and November 28, 2011, respectively. The Eighth Consent Motion was granted on October 4, 2011. Subsequently, on December 20, 2011 the Court entered a Consent Order extending the exclusive period for obtaining acceptance of the Plan to March 30, 2012.

F. Sales of Real Property

Since the Petition Date, KH Funding has actively sought to market and sell (with Bankruptcy Court approval) REO. KH Funding's efforts in this regard have produced the following results:

1. On January 25, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 821 Snider Lane, Silver Spring, Maryland Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Consent Order entered March 14, 2011 [Paper No. 157], the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$312,000. As a result of the sale, KH Funding's estate realized net proceeds (after payment of the costs of sale, broker's commission, and a mortgage lien on the property) in the amount of \$20,124.

2. On March 22, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 2614 Foster Avenue, Baltimore, Maryland Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered April 18, 2011 [Paper No. 220], the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$295,000. Though KH Funding did not receive any net proceeds of this sale, the claim of the mortgagee, whose claim was also secured by a mortgage on real property located at 632 Fagley Street, Baltimore, Maryland (another property owned by a limited liability company that is solely owned by KH Funding), was reduced to approximately \$30,000. As a result, KH Funding's estate benefited by the reduction in the amount of the mortgage lien encumbering the 632 Fagley Street property.

3. On June 24, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 6421 Taylor Road, Riverdale, Maryland Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered August 19, 2011 [Paper No. 304], the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$179,000. As a result of the sale, KH Funding's estate realized net proceeds (after payment of the costs of

sale, broker's commission, and a mortgage lien on the property) in the amount of \$7,160, plus reimbursement of expenses incurred since June 1, 2011.

4. On August 12, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 3513 Greenly Street, Silver Spring, Maryland Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered September 20, 2011 [Paper No. 316], the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$247,500. As a result of the sale, KH Funding's estate received net proceeds (after payment of the costs of sale, broker's commission, and a mortgage lien on the property) in the amount of \$9,900, plus reimbursement of expenses incurred since June 1, 2011.

5. On September 20, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 1487 Morris Road, S.E. Washington, D.C. Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered October 21, 2011 [Paper No. 337], the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$133,000. This property is not encumbered by a mortgage lien. KH Funding anticipates that its estate will realize net proceeds (after payment of the costs of sale, broker's commission) from the sale of this property in the approximate amount of \$110,000.

6. On September 27, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property Located at 2500 Fleet Street, Baltimore, Maryland Free and Clear of Liens Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered November 4, 2011 [Paper No. 356] the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$425,000. As a result of the sale, KH Funding's estate received or will receive net proceeds (after payment of the costs of sale, broker's commission, and a mortgage lien on the property) from the sale of this property in the amount of \$11,189.

7. On October 20, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property located at 3935 Southmount Drive, Montgomery, Alabama Free and Clear of Interests Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered November 18, 2011 [Paper No. 372] the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$3,500. As a result of the sale, KH Funding's estate received net proceeds (after payment of the costs of sale and a broker's commission) from the sale of the property in the amount of \$1,945.

8. On December 2, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Debtor's Membership Interest in 2609 Bauernschmidt Drive LLC Free and Clear of Interests Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered January 3, 2012 [Paper No. 397] the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$444,522.50. KH Funding anticipates that its estate will realize net proceeds (after credit of the purchase price to the first and second mortgages held by the buyer) in the approximate amount of \$25,000.

9. On December 9, 2011, KH Funding filed the Debtor's Motion for Authority to Sell Real Property located at 3503 Esther Place, Baltimore, Maryland Free and Clear of Interests Pursuant to 11 U.S.C. § 363(b) and (f). By Order entered January 5, 2012 [Paper No.

399] the Bankruptcy Court granted the Motion and authorized the sale for a purchase price of \$21,000. KH Funding anticipates that its estate will realize net proceeds (after payment of the costs of sale and a broker's commission) in the approximate amount of \$17,000.

10. On January 6, 2012, KH Funding filed the Debtor's Motion for Authority to Sell Real Property located at 632 Fagley Street, Baltimore, Maryland Free and Clear of Interests Pursuant to 11 U.S.C. § 363(b) and (f) for a purchase price of \$195,900. A hearing on the Motion is scheduled on February 13, 2012. KH Funding anticipates that its estate will realize net proceeds (after payment of the costs of sale, a broker's commission and a mortgage lien on the property) in the approximate amount of \$121,000.

G. Other Chapter 11 Matters

In addition to the matters described above, KH Funding has taken the following actions:

1. Moved for and obtained entry of an Order approving of an agreement by and between KH Funding and the Committee to modify the compensation to be paid by KH Funding to its President, Robert L. Harris. By virtue of such Agreement, Mr. Harris' annual salary was reduced from \$168,900 to \$100,000, and Mr. Harris may be entitled to earn "incentive compensation" based on the extent to which KH Funding's liquidation is successful.

2. Moved for and obtained entry of an Order Authorizing Debtor to Assume Unexpired Lease of Headquarters Premises, Subject to Lease Amendment. By virtue of this Order, the Court approved of KH Funding's assumption of the lease of KH Funding's sole business premises, subject to an amendment negotiated by KH Funding which provided for, *inter alia*, reduction of the size of the premises and monthly rent for such premises, and enabled either KH Funding or the landlord to terminate the Lease on 90 days' written notice.

3. Engaged in litigation with creditor Melissa Chappell-White in a successful effort to avoid a garnishment lien asserted by Ms. White with respect to funds on deposit in KH Funding's operating account. By the Order (i) Vacating Certain Provisions of Order Pertaining to Alleged Garnishment Lien of Melissa Chappell-White, and (ii) Determining that Ms. Chappell-White's Claim Against the Debtor is Unsecured Pursuant to 11 U.S.C. § 506(a), entered by the Court on June 16, 2011, Ms. Chappell-White's claim against KH Funding, to the extent allowable, was declared to be an unsecured claim.

4. Moved for and obtained entry of a Consent Order Approving Protocol for Approval of Disposition of Loans which authorizes KH Funding to modify its loans, or pursue legal remedies against borrowers or guarantors, upon notice to the Committee.

5. Investigated claims against certain third parties to avoid and recover prepetition transfers of loans and real property.

V. ASSETS, OPERATIONS AND LIABILITIES OF KH FUNDING

REFERENCE IN THIS DISCLOSURE STATEMENT TO THE AMOUNT OF ANY CLAIM IS NOT AN ADMISSION OR ACKNOWLEDGEMENT OF THE ALLOWED AMOUNT OF SUCH CLAIM, NOR IS REFERENCE TO THE VALUE OF ANY ASSET OR AMOUNT OF ANY CAUSE OF ACTION AN ADMISSION OF SUCH VALUE OR AMOUNT. NO CREDITOR SHOULD VOTE FOR THE PLAN ON THE ASSUMPTION THAT AN OBJECTION TO ITS, HIS OR HER CLAIM WILL NOT BE MADE.

A. Assets

1. Operating Assets

KH Funding's Assets consist primarily of its interest as lender or participant in certain mortgage loans and its direct or indirect ownership interests in real estate. As of October 31, 2011, KH Funding had 111 loans outstanding with principal balances ranging from \$431 to \$4,589,010. In addition, as of October 31, 2011, KH Funding owned, directly or indirectly (through limited liability companies) 13 properties of which 11 were improved by single- or multi-family dwellings.

The liquidation value of KH Funding's mortgage loan portfolio and real estate assets is difficult to assess with certainty due to a variety of factors, including, *inter alia*, the unfavorable real estate market. In addition, before KH Funding's Assets can be sold at maximum value, KH Funding and its professionals must take certain steps to improve the market value and salability of those Assets. As more fully explained in Section VI, (i) the value of much of KH Funding's real estate may increase if KH Funding invests funds to perform maintenance and repair work, and (ii) KH Funding's loan portfolio would be more marketable if KH Funding is able to obtain current documentation, including title reports and appraisals (among other things), to improve the condition of the loan files and take steps to improve the borrowers' performance in connection with such loans.

A list of loans in connection with which KH Funding is a lender or participant (the "Loan List") is attached hereto as **Exhibit "B"**. With respect to each such loan, the Loan List identifies the KH Funding loan number, principal loan balance, and collateral (if any) securing repayment of such loan. A list of real estate owned directly or indirectly by KH Funding is attached hereto as **Exhibit "C"**.

As of October 31, 2011, KH Funding had cash in its operating account in the approximate amount of \$259,300.

2. Litigation

Pursuant to Section 5.7 of the Plan, all rights, claims or causes of action (including, without limitation, Litigation as defined in Section 1.36 of the Plan) belonging to KH Funding or the Committee against any Person or Entity, shall be vested in and retained by the

Post-Confirmation Debtor for the benefit of the Estate upon the Effective Date. The term Litigation includes Avoidance Actions (as that term is defined in Section 1.4 of the Plan) and all claims, rights and causes of action of KH Funding and the Estate that arise under the terms of the Bankruptcy Code, whether or not litigation with respect to any such claims, rights or causes of action has been commenced as of the Effective Date. The Plan Administrator shall pursue, settle, or release all reserved Litigation, as appropriate, in accordance with the best interest of and for the benefit of the Creditors entitled to receive distributions under the Plan.

In not describing any potential Litigation herein, the Plan Proponents do not in any way intend to indicate that any Litigation does not exist, and the failure to include any description of specific Litigation in this Disclosure Statement should not be considered an admission or acknowledgement by the Plan Proponents that any Litigation will not be pursued, since the Plan Proponents have not fully investigated potential Litigation. All such Litigation will vest in and be retained by KH Funding and may be prosecuted by the Plan Administrator on behalf of KH Funding after confirmation of the Plan. No holder of a Claim or Interest should vote to accept the Plan based upon the Plan Proponents' failure to describe or assert any Litigation not otherwise disclosed herein.

B. Operating Performance

While in Chapter 11, KH Funding has focused primarily on reducing its operating expenses, abandoning or otherwise disposing of burdensome assets, selling REO, increasing collections on account of its mortgage loans through the restructuring of loans and pursuing collection remedies, and generally implementing a strategy to realize the value of its loan and real estate assets. As a result of KH Funding's performance in Chapter 11, KH Funding has increased the amount on deposit in its accounts from approximately \$55,000 on the Petition Date to approximately \$259,300 as of October 31, 2011.

C. Liabilities of KH Funding

1. Professional Fees³

The Plan Proponents anticipate that professional fees as of the Confirmation Date will consist primarily of the fees and expenses of professionals that represent KH Funding and the Committee. KH Funding anticipates that the firm of Gordon Feinblatt LLC, which serves as KH Funding's bankruptcy counsel, will have a claim for its services in connection with this case of approximately \$145,000 in excess of the interim payments made to it by KH Funding during this case. KH Funding further anticipates that the firm of Kollman &

³ Pursuant to Orders entered by the Bankruptcy Court, KH Funding has been paying the fees and expenses of Eric Zoellner and Gray without further Order on a periodic basis. Such professionals are required by the terms of the Orders to obtain approval of all fees and expenses paid to them by the conclusion of the case.

Saucier, P.A. will have a claim of approximately \$15,000.

The Committee anticipates that the firms of Pachulski Stang Ziehl & Jones LLP, McGuire Woods LLP and BDO Consulting will have claims as of the Confirmation Date of approximately \$100,000, \$25,000, and \$185,000, respectively.

2. Other Administrative Claims

KH Funding has been paying its post-petition operating expenses as they come due and anticipates that it will have only nominal unpaid operating administrative expenses (if any) as of the Effective Date of the Plan.

3. Tax and Other Priority Claims

KH Funding estimates that it has approximately \$57,000 in Priority Tax Claims consisting primarily of the claim of the Internal Revenue Service for unpaid withholdings (Medicare, Social Security, and Unemployment) which was filed in the amount of \$55,150, together with nominal Claims of the Maryland Comptroller and the Office of Unemployment Insurance.

KH Funding does not believe it will have any other Priority Claims except for Claims by tenants of its REO for security deposits, which are being held in escrow.

4. Secured Claims

As of the Petition Date, KH Funding owed holders of Series 3 Notes an aggregate amount exceeding \$38.5 million, secured by a lien against all of KH Funding's personal property. By virtue of the Stipulation and Consent Order Avoiding Preferential Transfer and Preserving Such Transfer for the Benefit of the Debtor's Bankruptcy Estate, entered by the Bankruptcy Court on May 17, 2011 in the adversary proceeding styled *KH Funding Company v. Wells Fargo Bank, N.A.*, Adv. No. 10-00930-TJC [Paper No. 19], the Series 3 Trustee's lien was avoided as to all of its collateral except for certain funds on deposit in KH Funding's deposit accounts with Sandy Spring Bank and LFA Investment Services. The aggregate balance of those accounts as of the Petition Date was \$54,823.

Certain of the real estate owned directly or indirectly by KH Funding is subject to liens securing claims of mortgagees who loaned money to KH Funding. The aggregate amount of the claims of mortgagees holding liens in KH Funding's real property is approximately \$1,936,792 as of October 31, 2011. **Each such claim is secured only to the extent of the value of the real property securing such claim, and nothing contained in this Disclosure Statement or any exhibit or attachment hereto shall be construed as an admission as to the value of any such property or the amount of any such secured claim, the Plan Proponents reserve all rights as to such matters.**

5. General Unsecured Claims

It is estimated that the total amount of General Unsecured Claims as of the Petition Date, including scheduled and filed claims, was approximately \$46,600,000. Of this amount, the unsecured portion of the Series 3 Note Claims exceeded \$38.4 million in the aggregate as of the Petition Date and that the Series 4 Note Claims exceeded \$1.3 million in the aggregate as of the Petition Date. The total amount also includes other scheduled General Unsecured Claims and Claims that KH Funding may dispute.

VI. SUMMARY OF THE PLAN

A. Plain English Summary

The Bankruptcy Court has required that a “plain English” summary of the Disclosure Statement and Plan be provided. If there is any conflict between the below summary and the Plan, the terms of the Plan will control:

1. Plan Concept

Liquidation

The Plan calls for an orderly liquidation of all of the Assets of KH Funding over a 12 to 24 month time-frame with the goal of maximizing the Assets’ fair market value. KH Funding and the Committee believe that the value of KH Funding’s Assets can be best maximized through an orderly liquidation as opposed to an immediate sale of the Assets by a Chapter 7 trustee. See **Exhibit “D”**. The liquidation process will be supervised by a Plan Administrator who will be appointed when the Plan is confirmed. Subject to the Court’s approval, the Plan Administrator will be BDO Consulting (“BDO”). BDO has been serving in this case as the Financial Advisor for the Committee and, as a result, is familiar with the Assets and liabilities of KH Funding. See Section B (Overview) below.

Assets

The Assets of KH Funding primarily consist of its loans and owned real estate and any causes of action. A list of the loans of KH Funding as of October 31, 2011 is attached as **Exhibit “B”**. A list of the real estate owned by KH Funding is attached as **Exhibit “C”**.

2. Payments to Creditors

Secured Creditors

Under the Plan, secured creditors (i.e. creditors holding mortgages on KH Funding's real estate) will be paid the value of the property securing their respective claims. Any deficiency will be an unsecured claim (unless previously waived) which will share *pro rata*⁴ with other unsecured creditors. See Section D (Treatment of Claims) below.

Unsecured Creditors

Creditors holding Series 3 and Series 4 Notes, together with other unsecured creditors, will be paid a *pro rata* amount from funds available to the Plan Administrator after payment of administrative expenses and any claims which have a higher priority in payment such as tax claims. KH Funding and the Committee estimate that unsecured creditors will be paid between 10% and 15% of the amount of their claims. See Section B (Overview) below. However, distributions to Series 3 and Series 4 Note creditors will be reduced by the fees and expenses of the Series 3 Trustee and Series 4 Trustee. The amount of any such fees and expenses is not known by KH Funding or the Committee.

Timing and Amount of Payments

The timing and amount of a distribution will be decided by the Plan Administrator who may consider factors such as the amount of funds on hand and future operating expenses. Distributions on account of Series 3 and Series 4 Note claims will be made to the Series 3 Trustee or Series 4 Trustee, as the case may be. As a result, the timing of payments to individual creditors who hold Series 3 and Series 4 Note Claims will also be determined by the Series 3 Trustee and Series 4 Trustee. KH Funding and the Committee do not know when distributions will be made by the Series 3 Trustee or Series 4 Trustee.

⁴ The term "*pro rata*" means money will be divided proportionately among Creditors, according to the amount of individual claims.

3. Priority Between Series 3 and Series 4 Note Holders

Subordination

Under the Indenture, Series 4 Note Claims are subordinated in payment to Series 3 Note Claims. This means that all distributions on both Series 3 and Series 4 Note Claims will be made to the Series 3 Trustee (Wells Fargo Bank, N.A.) until the Series 3 Note Claims have been paid in full. The Series 4 Trustee (Law Debenture Company of New York) has reserved the right to challenge the enforceability of the subordination provisions of the Indenture. If distributions to Series 4 Note Claimants are subordinated in payment to distributions of Series 3 Note Claimants, it is unlikely that Series 4 Note Claimants will receive any distribution under the Plan. See footnote 5.

4. The Status of KH Funding's Officers after Confirmation

After the Plan becomes effective, all decisions by KH Funding will be made on its behalf by the Plan Administrator. There is no current agreement between the Plan Administrator and KH Funding's President, Robert Harris, or any other officer, regarding the employment of Mr. Harris or other officer after the Plan becomes effective. The Plan Administrator may seek to employ Mr. Harris or another officer on a consulting basis to the extent the Plan Administrator believes it is necessary. Mr. Harris may be entitled to earn "incentive compensation" based on the extent to which KH Funding's liquidation is successful.

B. Overview

Pursuant to the Plan, KH Funding will continue to own its property and manage its affairs. As set forth in more detail in Article 5 of the Plan, on the Effective Date, BDO, will be appointed Plan Administrator to administer the Plan. Administration of the Plan primarily will involve implementing an orderly liquidation of the Assets. Under the supervision and direction of the Plan Administrator, KH Funding will reduce the Assets to Cash, and such Cash will be distributed periodically to Holders of Allowed Claims in accordance with the provisions of Articles 4 and 6 of the Plan.

To maximize the value of KH Funding's Assets for distribution pursuant to the Plan, KH Funding, under the supervision of the Plan Administrator, will continue to implement measures to maximize the value of the Assets and realize such value through an orderly liquidation strategy. With respect to REO, KH Funding will continue to market and sell such properties as quickly as reasonably possible. To the extent necessary to enhance the marketability of a particular property, KH Funding may make necessary improvements and/or

repairs to such property. With respect to each loan, KH Funding will take some or all of the following steps: (i) confirm the validity of the loan and security agreements in connection with such loan; (ii) investigate the financial strength of the borrower(s) and guarantor(s) by evaluating their tax returns, credit reports, and other indicia of creditworthiness; (iii) obtain appraisals with respect to any collateral securing such loan; (iv) perform physical inspections of such collateral; and (v) ensure that the file with respect to such loan is documented as completely as reasonably possible under the circumstances. Where appropriate to further maximize the value of certain loans, KH Funding will enter into loan modification agreements with particular borrowers to the extent necessary to enable such borrowers to begin performing their loans on a sustained and consistent basis. Upon completing these steps with respect to a particular loan (or group of loans), KH Funding may market and sell such loan(s). **KH Funding and the Committee anticipate that the orderly liquidation process will be completed within 12 to 24 months following the Effective Date and that such orderly liquidation of KH Funding's Assets as proposed in the Plan will generate sufficient Cash to enable the Plan Administrator to (i) pay in full all Allowed Administrative Expenses (including Allowed Fee Claims), Allowed Priority Tax Claims, Allowed Priority Claims, and Allowed Secured Claims; and (ii) make distributions on account of Allowed General Unsecured Claims in an amount of between ten percent (10%) and fifteen percent (15%) of the aggregate amount of such Allowed General Unsecured Claims.⁵ Pursuant to the terms of the Indenture, distributions to Holders of Series 3 and Series 4 Note Claims will be reduced by any fees and expenses owed to the Series 3 Trustee and Series 4 Trustee. The Plan proponents have no knowledge of the fees and expenses of the Series 3 Trustee and Series 4 Trustee.**

Following the Confirmation Date, KH Funding will not engage in any business activities or take any actions except those necessary to effectuate the Plan and wind up the affairs of KH Funding. On and after the Effective Date, the Plan Administrator may, in the name of KH Funding, take such actions without supervision or approval by the Bankruptcy Court and free of

⁵ Under the express terms of the Indenture, distributions to Holders of Series 4 Note Claims are subordinated in payment to distributions to holders of Series 3 Note Claims. In accordance with the Indenture, the Plan provides that distributions on account of the Series 4 Note Claims shall be remitted to the Series 3 Trustee until such time as the Series 3 Note Claims have been paid in full. The Series 4 Trustee has, informally, raised questions concerning whether the subordination provisions of the Indenture are enforceable against the Holders of Series 4 Note Claims. The Series 3 Trustee maintains that the subordination provisions of the Indenture are enforceable and binding in all respects upon the Holders of Series 4 Note Claims. In the event the Series 4 Trustee initiates litigation to challenge the enforceability of the subordination provisions of the Indenture, the distributions to holders of Series 3 Note Claims and Series 4 Note Claims shall be subject to the resolution of any such litigation. **If the distributions to holders of Series 4 Note Claims are subordinated in payment to distributions of Series 3 Note Claims, the distributions to Holders of Series 4 Note Claims shall be remitted to the Series 3 Trustee for distribution in accordance with express terms of the Indenture and the holders of Series 4 Note Claims likely will not receive any distribution under the Plan.**

any restrictions of the Bankruptcy Code or the Bankruptcy Rules, other than any restrictions expressly imposed by the Plan or the Confirmation Order. Without limiting the foregoing, the Plan Administrator may, without application to or approval of the Bankruptcy Court, pay the charges that it incurs after the Effective Date for professional fees and expenses that, but for the occurrence of the Effective Date, would constitute Allowed Administrative Claims

C. Plan Provisions Governing Classification and Treatment Of Claims

THE FOLLOWING IS A SUMMARY OF THE PLAN. THIS SUMMARY IS MODIFIED IN ITS ENTIRETY BY REFERENCE TO THE FULL TEXT OF THE PLAN, A COPY OF WHICH IS ATTACHED HERETO AS EXHIBIT "A". TO THE EXTENT A CONFLICT EXISTS BETWEEN THIS SUMMARY AND THE TERMS OF THE PLAN, THE TEXT OF THE PLAN CONTROLS.

1. Unclassified Claims. Administrative Claims and Priority Tax Claims are not classified in the Plan. Holders of Allowed Administrative Claims and Allowed Priority Tax Claims shall be treated under the Plan as follows:

(a) Administrative Claims Other Than Fee Claims. Except to the extent the Holder of an Allowed Administrative Claim agrees otherwise, each Holder of an Allowed Administrative Claim shall be paid in respect of such Allowed Claim the full amount thereof, without interest, in Cash, as soon as practicable after the later of (i) the Effective Date or (ii) the date on which such Claim becomes an Allowed Claim.

(b) Fee Claims. Any Professional seeking allowance by the Bankruptcy Court of a Fee Claim (a) must file a final application for allowance of compensation for services rendered and reimbursement of expenses incurred by a date that is not later than the date that is forty-five (45) calendar days after the Effective Date; and (b) shall be paid by the Post-Confirmation Debtor, in such amounts as are approved by the Bankruptcy Court (i) upon the later of (x) the Effective Date and (y) ten (10) calendar days after the date upon which the order relating to the allowance of any such Fee Claim is entered, or (ii) upon such other terms as may be mutually agreed upon between the holder of such Fee Claim and the Post-Confirmation Debtor.

(c) Priority Tax Claims. Each Holder of an Allowed Priority Tax Claim shall be paid in respect of such Allowed Priority Tax Claim either (a) the full amount thereof, without post-petition interest or penalty, in Cash, as soon as practicable after the later of (i) the Effective Date or (ii) the date on which such Priority Tax Claim becomes an Allowed Claim or (b) such lesser amount as the Holder of an Allowed Priority Tax Claim and the Post-Confirmation Debtor might otherwise agree or (c) at the election of the Post-Confirmation Debtor, in accordance with Section 1129(a)(9)(C) of the Bankruptcy Code, in Cash, in up to twenty equal quarterly installments (and in such event, interest shall be paid on the unpaid portion of such Allowed Priority Tax Claims at a rate to be agreed to by the Post-Confirmation Debtor and the appropriate governmental unit, or, if they are unable to agree, as determined by the Bankruptcy Court), commencing as soon as practicable after the later of (i) the Effective Date or (ii) the date on which such Priority Tax Claim becomes an Allowed Claim.

2. Classification of Claims and Interests

For purposes of the Plan, all other Claims and Interests are classified as follows:

Class	Status	Voting Rights
Class 1 – Priority Claims	Unimpaired	Not Entitled to Vote
Class 2 – Secured Claim (TSSN Trust)	Impaired	Entitled to Vote
Class 3 – Secured Claim (MSM)	Impaired	Entitled to Vote
Class 4 – Secured Claim (PSM)	Impaired	Entitled to Vote
Class 5 – Secured Claim (Moore)	Impaired	Entitled to Vote
Class 6 – Secured Claim (Boardwalk)	Impaired	Entitled to Vote
Class 7 – Series 3 Note Claims	Impaired	Entitled to Vote
Class 8 – Series 4 Note Claims	Impaired	Entitled to Vote
Class 9 – General Unsecured Claims	Impaired	Entitled to Vote
Class 10 – Interests	Impaired	Not Entitled to Vote

D. Treatment of Claims

1. Class 1 Priority Claims. Class 1 Claims are Unimpaired. Each Holder of an Allowed Class 1 Claim shall receive either (a) payment in full in Cash as soon as practicable after the later of (i) the Effective Date, and (ii) the date on which such Claim becomes an Allowed Claim or (b) as otherwise agreed by the Holder of such Allowed Class 1 Claim. The Holders of Claims in this Class are not entitled to vote.

2. Class 2 Claim - Secured Claim (TSSN Trust). The Class 2 Claim is Impaired. Class 2 consists of the Allowed Secured Claim of the Tiray Spriggs Special Needs Trust (“TSSN Trust”) to the extent such claim is secured by a first priority deed of trust lien on a certain condominium property owned by KH Funding and located at 415 W Street, N.E., Washington D.C. As of the Petition Date, KH Funding owed TSSN Trust approximately \$576,000. In the event KH Funding and TSSN Trust enter into a written agreement prior to the Confirmation Date that is mutually acceptable to KH Funding, the Committee, and TSSN Trust and that is approved by the Bankruptcy Court (including but not limited to in connection with the Confirmation Hearing or Confirmation Order) providing for treatment of the Class 2 Claim, such agreement is incorporated into the Plan as a Plan supplement, and the Class 2 Claim shall be treated as set forth in that agreement. In the absence of a mutually acceptable agreement between TSSN Trust and KH Funding or the Post-Confirmation Debtor, and absent further order of the Bankruptcy Court or agreement among TSSN Trust and KH Funding or the Plan Administrator, and provided that the value of the collateral securing the claim of the TSSN Trust is less than the Class 2 Claim, as soon as practicable following the Effective Date (i) the Plan Administrator shall cause the Post-Confirmation Debtor to surrender to TSSN Trust possession and control of the collateral subject to TSSN Trust’s properly perfected lien in full satisfaction of the Class 2 Claim, (ii) TSSN Trust shall be entitled to enforce its non-bankruptcy law rights and remedies as a holder of such lien, and (iii) neither the automatic stay of 11 U.S.C. § 362(a) nor any injunction

under the Plan shall apply to such property as of the Effective Date. To the extent TSSN Trust's Claim is not a Secured Claim, it shall be treated as a Class 12 Claim.

3. Class 3 Secured Claim (MSM). The Class 3 Claim is Impaired. Class 3 consists of the Allowed Secured Claim of Market Street Mortgage, LLC ("MSM") to the extent such claim is secured by a first priority deed of trust lien on improved real property owned by KH Funding and located at 1323 Gallatin Street, N.W., Washington D.C. 20011. As of the Petition Date, KH Funding owed MSM approximately \$210,516. MSM shall retain its lien on the property securing the Class 3 Claim. Beginning the first calendar month following the Effective Date, interest shall accrue under the Note evidencing the Class 3 Claim, subject to the following modifications: (i) the interest rate for purposes of paragraph 1 of the Note shall be five percent (5%) per annum; and (ii) the Maturity Date (as defined in paragraph 2 of the Note) shall be December 31, 2014. The Class 3 Claim shall be paid from the proceeds of the sale of the property securing such Claim. If the property securing the Class 3 Claim is not sold prior to the Maturity Date (as modified pursuant to the Plan), and absent further order of the Bankruptcy Court or agreement between MSM and the Plan Administrator, (a) the Plan Administrator shall cause the Post-Confirmation Debtor to surrender to MSM possession and control of such property subject to MSM's properly perfected lien in full satisfaction of the Class 3 Claim, (ii) MSM shall be entitled to enforce its non-bankruptcy law rights and remedies as a holder of such lien, and (iii) neither the automatic stay of 11 U.S.C. § 362(a) nor any injunction under the Plan shall apply to such property as of the Maturity Date. To the extent MSM's Claim is not a Secured Claim, it shall be treated as a Class 9 Claim.

4. Class 4 Secured Claim (PSM). The Class 4 Claim is Impaired. Class 4 consists of the Secured Claim of PSM Properties LLC ("PSM") to the extent such claim is secured by a first priority deed of trust lien on improved real property owned by 2609 Bauernschmidt Drive, LLC (an entity solely owned by KH Funding) and located at 2609 Bauernschmidt Drive, Essex, Maryland 21221. KH Funding is a co-obligor with respect to the Class 4 Claim. As of the Petition Date, KH Funding owed PSM approximately \$339,000. PSM shall retain its lien on the property securing the Class 4 Claim. Beginning the first calendar month following the Effective Date, interest shall accrue under the Line of Credit Loan Agreement evidencing the Class 4 Claim subject to the following modifications: (i) the interest rate for purposes of Section 2.2 of the Line of Credit Loan Agreement shall be five percent (5%) per annum; and (ii) the Maturity Date (as defined in Section 2.1 of the Line of Credit Loan Agreement) shall be December 31, 2014. The Class 4 Claim shall be paid from the proceeds of the sale of the property securing such Claim. If the property securing the Class 4 Claim is not sold prior to the Maturity Date (as modified pursuant to the Plan), and absent further order of the Bankruptcy Court or agreement between PSM and the Plan Administrator, (a) the Plan Administrator shall cause the Post-Confirmation Debtor to surrender to PSM possession and control of such property subject to PSM's properly perfected lien in full satisfaction of the Class 4 Claim, (ii) PSM shall be entitled to enforce its non-bankruptcy law rights and remedies as a holder of such lien, and (iii) neither the automatic stay of 11 U.S.C. § 362(a) nor any injunction under the Plan shall apply to such property as of the Maturity Date. To the extent PSM's Claim is not a Secured Claim, it shall be treated as a Class 9 Claim.

5. Class 5 Secured Claims (Moore). The Class 5 Claim is Impaired. Class 5 consists of the Secured Claims of Patrick Shane Moore (“Moore”) to the extent such claims are secured by a second deed of trust lien on improved real property owned by 2609 Bauernschmidt Drive, LLC (an entity solely owned by KH Funding) and located at 2609 Bauernschmidt Drive, Essex, Maryland 21221, and first and second priority deed of trust liens on improved real property owned by 2500 Fleet Street, LLC (an entity solely owned by KH Funding) and located at 2500 Fleet Street, Baltimore, Maryland 21224. KH Funding is a co-obligor with respect to the Class 5 Claims. As of the Petition Date, KH Funding owed Moore approximately \$390,000. Moore shall retain his liens on the properties securing the Class 5 Claims. Beginning the first calendar month following the Effective Date, interest shall accrue under the Promissory Notes evidencing the Class 5 Claims subject to the following modifications: (i) the interest rate for purposes of the Promissory Notes shall be five percent (5%) per annum; and (ii) the maturity dates of the Promissory Notes shall be December 31, 2014. The Class 5 Claims shall be paid from the proceeds of the sales of the properties securing such Claims. If the properties securing the Class 5 Claims are not sold prior to the maturity date (as modified pursuant to the Plan), and absent further order of the Bankruptcy Court or agreement between Moore and the Plan Administrator, (a) the Plan Administrator shall cause the Post-Confirmation Debtor to surrender to Moore possession and control of such property(ies) subject to Moore’s properly perfected lien(s) in full satisfaction of the Class 5 Claim, (ii) Moore shall be entitled to enforce his non-bankruptcy law rights and remedies as a holder of such lien(s), and (iii) neither the automatic stay of 11 U.S.C. § 362(a) nor any injunction under the Plan shall apply to such property(ies) as of the maturity date. To the extent Moore’s Claims are not Secured Claims, such Claims shall be treated as Class 9 Claims.

6. Class 6 Secured Claim (Boardwalk). The Class 6 Claim is Impaired. Class 6 consists of the Secured Claim of Boardwalk 2001, LLC (“Boardwalk”) to the extent such claim is secured by a first priority deed of trust lien on improved real property owned by 632 Fagley Street, LLC (an entity solely owned by KH Funding) and located at 632 Fagley Street, Baltimore, Maryland 21224. KH Funding is a co-obligor with respect to the Class 6 Claim. As of the Petition Date, KH Funding owed Boardwalk approximately \$245,000. Boardwalk shall retain its lien on the property securing the Class 6 Claim. Beginning the first calendar month following the Effective Date, interest shall accrue under the Promissory Note evidencing the Class 6 Claim subject to the following modifications: (i) the interest rate for purposes of the Promissory Note shall be five percent (5%) per annum; and (ii) the maturity date of the Promissory Note shall be December 31, 2014. The Class 6 Claim shall be paid from the proceeds of the sale of the property securing such Claim. If the property securing the Class 6 Claim is not sold prior to the maturity date (as modified pursuant to the Plan), and absent further order of the Bankruptcy Court or agreement between Boardwalk and the Plan Administrator (a) the Plan Administrator shall cause the Post-Confirmation Debtor to surrender to Boardwalk possession and control of such property subject to Boardwalk’s properly perfected lien in full satisfaction of the Class 6 Claim, (ii) Boardwalk shall be entitled to enforce its non-bankruptcy law rights and remedies as a holder of such lien, and (iii) neither the automatic stay of 11 U.S.C. § 362(a) nor any injunction under the Plan shall apply to such property as of the Maturity Date. To the extent Boardwalk’s Claim is not a Secured Claim, it shall be treated as a Class 9 Claim.

7. Class 7 Series 3 Note Claims. The Class 7 Claims are Impaired. Class 7 consists of the Allowed Claims of holders of Series 3 Notes. It is estimated that such Allowed Claims in the aggregate exceeded \$38,350,000 on the Petition Date. Such Claims will constitute Secured Claims to the extent of \$54,823. It is not anticipated that Class 7 Claims will be paid in full. On the Effective Date, in satisfaction of the Series 3 Note Secured Claim, the Plan Administrator shall cause to be released and paid to the Series 3 Trustee the funds securing the Series 3 Note Secured Claims for distribution in accordance with the applicable provisions of the Plan and the Indenture. The balance of the Series 3 Note Claims, to the extent they are Allowed Claims, shall be Allowed General Unsecured Claims and shall receive *pari passu* with Allowed Class 8 Claims (subject to the subordination provisions set forth in the Indenture and implemented by the Plan as noted and subject to the qualifications set forth in the Plan) and Allowed Class 9 Claims a Pro Rata distribution of the liquidated assets of the estate after the payment or reserve for Administrative Claims, Priority Tax Claims, Priority Claims, Secured Claims, and Plan Expenses. All distributions on account of Series 4 Note Claims shall be remitted to the Series 3 Trustee until the Series 3 Note Claims have been paid in full and, thereafter, any such distributions in respect of Series 4 Note Claims shall be remitted to the Series 4 Trustee for distribution to the holders of Series 4 Note Claims as provided in the Plan. Distributions that the Holders of Series 3 Notes are entitled to receive under the Plan shall constitute the sole source of recovery from the bankruptcy estate for the Holders of Series 3 Note Claims. The Holders of the Series 3 Notes are entitled to vote on the Plan.

Allowance of Proofs of Claim. Consistent with Bankruptcy Rule 3003(c), KH Funding, the Plan Administrator and Committee, as applicable, shall recognize proofs of claim timely filed by the Series 3 Trustee in respect of the Series 3 Notes and Series 3 Note Claims. Accordingly, any claim arising under the Series 3 Notes or Indenture, proof of which is filed by the registered or beneficial holder of Series 3 Notes, shall be disallowed as duplicative of the Claim of Series 3 Trustee, without any further action of the Bankruptcy Court.

Payment of Distributions. In accordance with Article 6 of the Plan, all distributions relating to or on account of the Series 3 Note Claims and Series 4 Note Claims (until the Series 3 Note Claims have been paid in full) shall be made to the Series 3 Trustee subject to the express terms of the Plan, including, without limitation, the satisfaction of all fees and expenses secured by the Series 3 Trustee Charging Lien and Series 4 Trustee Charging Lien. After satisfaction of such fees and expenses secured by the Series 3 Trustee Charging Lien and the Series 4 Trustee Charging Lien, any funds received by the Series 3 Trustee and/or the Series 4 Trustee shall be distributed in accordance with the Plan. In the event the Series 3 Note Claims are paid in full, any subsequent distributions in respect of Series 4 Note Claims shall be remitted to the Series 4 Trustee for distribution to the holders of Series 4 Note Claims in accordance with and subject to the express terms of the Plan.

Distributions on Account of Series 4 Note Claims. Any rights of the Series 4 Trustee under the Indenture or applicable law to challenge the provisions of the Indenture providing for the subordination in payment of the Series 4 Note Claims to the Series 3 Note claims shall be preserved and shall not be prejudiced by the terms of the Plan that recognize and respect the subordination provisions set forth in the Indenture. Nothing contained in the Plan

shall prejudice the rights of the Series 3 Trustee to seek to enforce the subordination provisions set forth in the Indenture and assert any defenses available under applicable law in response to any claims asserted by the Series 4 Trustee or otherwise. See footnote 4.

8. Class 8 Series 4 Note Claims. The Class 8 Claims are Impaired. Class 8 consists of the Allowed Claims of holders of Series 4 Notes. It is estimated that, as of the Petition Date, Claims of holders of Series 4 Notes exceeded \$1.3 million in the aggregate. The Series 4 Note Claims, to the extent they are Allowed Claims, shall be Allowed General Unsecured Claims and shall receive *pari passu* with Allowed Class 7 Claims (subject to the subordination provisions set forth in the Indenture and implemented by the Plan as noted and subject to the qualifications set forth herein) and Allowed Class 9 Claims a Pro Rata distribution of the liquidated assets of the estate after the payment or reserve for Administrative Claims, Priority Tax Claims, Priority Claims, Secured Claims, and Plan Expenses. All distributions on account of Series 4 Note Claims shall be remitted to the Series 3 Trustee until the Series 3 Note Claims have been paid in full and, thereafter, any such distributions in respect of Series 4 Note Claims shall be remitted to the Series 4 Trustee for distribution to the holders of Series 4 Note Claims as provided in the Plan. Distributions that the Holders of Series 4 Notes are entitled to receive under the Plan shall constitute the sole source of recovery from the bankruptcy estate for the Holders of Series 4 Note Claims. The Holders of the Series 4 Notes are entitled to vote on the Plan.

Allowance of Proofs of Claim. Consistent with Bankruptcy Rule 3003(c), KH Funding, the Plan Administrator and Committee, as applicable, shall recognize proofs of claim timely filed by the Series 4 Trustee in respect of the Series 4 Notes and Series 4 Note Claims. Accordingly, any claim arising under the Series 4 Notes or Indenture, proof of which is filed by the registered or beneficial holder of Series 4 Notes, shall be disallowed as duplicative of the Claim of Series 4 Trustee, without any further action of the Bankruptcy Court.

Payment of Distributions. In accordance with Article 6 of the Plan, all distributions relating to or on account of the Series 3 Note Claims and Series 4 Note Claims (until the Series 3 Note Claims have been paid in full) shall be made to the Series 3 Trustee subject to the express terms of the Plan, including, without limitation, the satisfaction of all fees and expenses secured by the Series 3 Trustee Charging Lien and Series 4 Trustee Charging Lien. After satisfaction of such fees and expenses secured by the Series 3 Trustee Charging Lien and the Series 4 Trustee Charging Lien, any funds received by the Series 3 Trustee and/or the Series 4 Trustee shall be distributed in accordance with the Plan. In the event the Series 3 Note Claims are paid in full, any subsequent distributions in respect of Series 4 Note Claims shall be remitted to the Series 4 Trustee for distribution to the holders of Series 4 Note Claims in accordance with and subject to the express terms of the Plan.

Distributions on Account of Series 4 Note Claims. Any rights of the Series 4 Trustee under the Indenture or applicable law to challenge the provisions of the Indenture providing for the subordination in payment of the Series 4 Note Claims to the Series 3 Note claims shall be preserved and shall not be prejudiced by the terms of the Plan that recognize and respect the subordination provisions set forth in the Indenture. Nothing contained in the Plan

shall prejudice the rights of the Series 3 Trustee to seek to enforce the subordination provisions set forth in the Indenture and assert any defenses available under applicable law in response to any claims asserted by the Series 4 Trustee or otherwise. See footnote 4.

9. Class 9 General Unsecured Claims. The Class 9 Claims are Impaired. Class 9 consists of General Unsecured Claims other than Class 7 or Class 8 Claims. Excluding the Claims of holders of Series 3 Notes and Series 4 Notes, it is estimated that General Unsecured Claims against KH Funding will not exceed \$6.6 million as of the Petition Date. Each Holder of an Allowed Class 9 Claim shall receive in respect of such Claim its Pro Rata distribution of the liquidated assets of the estate after the payment or reserve for Administrative Claims, Priority Tax Claims, Priority Claims, Secured Claims, and Plan Expenses.

10. Class 10 Interests. Class 10 Interests are Impaired. Class 10 consists of Interests in KH Funding. The Holders of Class 10 Interests shall receive no distribution. On the Effective Date, all Class 10 Interests shall be deemed canceled, null and void, and of no force and effect. The Holders of Class 10 Interests are deemed to reject the Plan and are not entitled to vote. The Holders of Class 10 Equity Interests shall not receive any distributions under the Plan and are therefore deemed to reject the Plan and are not entitled to vote.

11. Substantive Consolidation to Facilitate Treatment of Certain Claims. KH Funding is the sole member of 2609 Bauernschmidt Drive, LLC, 2500 Fleet Street, LLC, 632 Fagley Street, LLC, and 3503 Esther Place, LLC (collectively, the “KH LLC’s”). Each of the KH LLC’s owns real property. The assets and liabilities of the KH LLC’s are substantively consolidated with the assets and liabilities of KH Funding. To the extent the Plan Administrator, in its sole discretion, determines that it is necessary to cause the KH LLC’s to transfer such property to KH Funding in aid of consummation of the Plan, such transfer by deed shall be authorized as of the Confirmation Date and may be consummated at any time after the Confirmation Date subject to Section 10.18 of the Plan.

E. Means for Execution of the Plan

1. Appointment of Plan Administrator

As described above, Article 5 of the Plan provides for the appointment of the Plan Administrator. The Plan Administrator will have primary responsibility for implementing and executing the Plan. On the Effective Date, (i) each existing member of the Board of Directors of KH Funding will resign or be terminated by the Plan Administrator, and (ii) the Plan Administrator will be deemed the sole shareholder, officer, and director of KH Funding. The Plan will be administered by the Plan Administrator, and all actions taken in the name of KH Funding shall be taken through the Plan Administrator. The purpose of the Plan is to implement the orderly liquidation of the Assets. Accordingly, following the Confirmation Date, KH Funding is barred from engaging in any business activities or actions except those necessary to effectuate the Plan and wind up the affairs of KH Funding under the supervision and direction of the Plan Administrator.

The Plan Administrator will be compensated at its normal and customary rates and may be paid without further order of the Bankruptcy Court. The Plan Administrator will not be liable for any action it takes or omits to take that it believes in good faith to be authorized or within its rights or powers, absent gross negligence or willful misconduct on its part. All distributions to be made to Creditors under the Plan shall be made by the Plan Administrator, who shall deposit and hold all Cash in trust for the benefit of Creditors (including Professionals) receiving distributions under the Plan.

Subject to the review of an Oversight Committee, the duties and powers of the Plan Administrator shall include (a) to continue operating KH Funding's business to the extent necessary to conduct an orderly liquidation of the Assets including, but not limited to, the collection or sale of loans, negotiation and entry into loan modifications or agreements, sale of real property, and any other action that the Plan Administrator may deem necessary and appropriate to maximize the value of and return on KH Funding's Assets; (b) to exercise all power and authority that may be exercised, to commence all proceedings (including the power to continue any actions and proceedings that may have been commenced by KH Funding or the Committee prior to the Effective Date) that may be commenced, and to take all actions that may be taken by any officer, director, or shareholder of KH Funding with like effect as if authorized, exercised, and taken by unanimous action of such officers, directors, and shareholders, including consummating the Plan and all transfers thereunder on behalf of KH Funding; (c) to maintain all accounts, make distributions, and take other actions consistent with the Plan, including the maintenance of appropriate reserves, in the name of KH Funding; (d) to take all steps necessary to terminate the corporate existence of KH Funding; (e) to prosecute objections to Claims and compromise or settle any Claims (disputed or otherwise); (f) to prosecute any and all Litigation and compromise or settle any Litigation; (g) to collect the accounts receivable, if any, of KH Funding; (h) to employ and compensate any and all such professionals as the Plan Administrator, in its sole discretion, deems reasonably necessary to perform its duties under the Plan without further order of the Bankruptcy Court; and (i) to take all other actions not inconsistent with the provisions of the Plan that the Plan Administrator deems reasonably necessary or desirable in connection with the administration of the Plan.

On and after the Effective Date, the Plan Administrator may, in the name of KH Funding, take such actions without supervision or approval by the Bankruptcy Court and free of any restrictions of the Bankruptcy Code or the Bankruptcy Rules, other than any restrictions expressly imposed by the Plan or the Confirmation Order. Without limiting the foregoing, the Plan Administrator may, without application to or approval of the Bankruptcy Court, pay the charges that it incurs after the Effective Date for professional fees and expenses that, but for the occurrence of the Effective Date, would constitute Allowed Administrative Claims.

Resignation, Death, or Removal. The Plan Administrator may be removed by order of the Bankruptcy Court upon notice and motion by an Oversight Committee member for good cause shown. In the event of removal for good cause shown of the Plan Administrator, or in the event of the death or incapacity of the Plan Administrator, the Oversight Committee shall appoint a successor upon notice, motion, and approval of the Bankruptcy Court. In the event of

the resignation of the Plan Administrator, the Plan Administrator shall nominate a successor, which nomination shall be deemed accepted by the Oversight Committee and shall be deemed effective upon the filing with the Bankruptcy Court of a Notice of Appointment of Successor Plan Administrator.

2. Release of Liens. Except as otherwise expressly provided in the Plan or in any contract, instrument, or other agreement or document created in connection with the Plan, on the Effective Date, all mortgages, deeds of trust, liens, or other security interests against the property of KH Funding's estate may be released, and all the right, title, and interest of any Holder of such mortgages, deeds of trust, liens, or other security interests shall revert to the Post-Confirmation Debtor and their successors and assigns.

3. Rights of Actions. On the Effective Date, any right, claim, or cause of action belonging to KH Funding or its estate or to the Committee (excluding any claims expressly released pursuant to the Plan) against any Person or Entity, including, without limitation, any Litigation, shall be vested in and retained by KH Funding. The Plan Administrator may pursue, settle, or release all reserved Litigation, as appropriate, in accordance with the best interest of and for the benefit of the Creditors entitled to receive distributions under the Plan.

4. Cancellation of Indenture. Notwithstanding anything to the contrary herein following the Effective Date, any agreement that governs the rights of the Series 3 Trustee, the Series 4 Trustee or the Holders of the Series 3 Notes or the Series 4 Notes will continue in effect solely for purposes of (a) allowing the Series 3 Trustee and the Series 4 Trustee, as applicable, to make distributions under and in accordance with the Plan to Holders of the Series 3 Notes and to the Holders of the Series 4 Notes, (b) permitting the Series 3 Trustee and the Series 4 Trustee, as applicable, to maintain and enforce their respective Series 3 Trustee Charging Lien and Series 4 Trustee Charging Lien (and all rights the Series 3 Trustee and the Series 4 Trustee have with respect thereto) against property distributed pursuant to the Plan by the Plan Administrator or Disbursing Agent, as applicable, pursuant to Sections 4.8 and 4.9 of the Plan on account of the Series 3 Notes and the Series 4 Notes, as applicable, or against any other property received by the Series 3 Trustee or the Series 4 Trustee for fees, costs, and expenses under the Indenture or any other agreement (c) governing the rights and obligations of non-Debtor parties to such agreements, as modified by this Plan, vis-à-vis each other and (d) allowing the Series 3 Trustee and the Series 4 Trustee to enforce their respective rights under the Plan, including, but not limited to their respective rights related to a Subordination Challenge (as defined in Section 6.4(b) of the Plan). Upon the expiration of the Subordination Challenge Period (as defined in Section 6.4(b) of the Plan), the Indenture shall be automatically deemed terminated, extinguished and of no further force and effect without further act or action under any applicable agreement, law, regulation, order or rule and the Series 3 Trustee and the Series 4 Trustee shall have no further obligations under the Indenture thereafter; provided, however, that the compensation, reimbursement and indemnification rights in favor of the Series 3 Trustee and the Series 4 Trustee shall survive and continue in full force and effect; provided further, however, that nothing herein shall alter, impair or affect the rights of the Series 3 Trustee or the Series 4

Trustee, as applicable, to enforce their respective rights to enforce the Series 3 Trustee Charging Lien and the Series 4 Trustee Charging Lien.

5. Professional Fees and Expenses.

(a) Each Professional retained or requesting compensation in the Chapter 11 Case, in connection with fees incurred prior to the Effective Date, shall file an application for allowance of final compensation and reimbursement of expenses in the Chapter 11 Case before the forty-fifth (45th) day after the Effective Date.

(b) Professionals that perform post-Effective Date services for KH Funding and/or the Plan Administrator shall provide monthly invoices to the Plan Administrator describing the services rendered and the fees and expenses incurred in connection therewith, on or before the 20th day following the end of the calendar month during which such services were performed. Professional Persons who tender such invoices shall be paid by the Plan Administrator for such services from the Plan Expense Reserve Fund created under Section 6.7 of the Plan on or after the date that is fifteen (15) days after the submission to the Plan Administrator by such Professional Persons of said monthly invoices, unless, within said fifteen (15) day period, a written objection to said payment is made, in which event such payment shall be made only upon either (a) agreement of the parties or (b) Order of the Bankruptcy Court.

6. Dissolution of Committee. Upon the occurrence of the Effective Date, the Committee shall be dissolved, and each individual member and any retained Professional shall be discharged from any further activities in the Chapter 11 Case.

7. Formation and Powers of the Oversight Committee.

(a) As of the Effective Date, the Oversight Committee shall be deemed formed and shall be comprised of three (3) members of the Committee prior to the Effective Date. In the event of the resignation or inability to perform for any reason of any member of the Oversight Committee after the Effective Date, the remaining members of the Oversight Committee shall have the right to designate a successor from among the holders of Allowed Class 7 or Class 9 Claims. If an Oversight Committee member assigns its Claim or releases KH Funding from payment of the balance of its Claim, such act shall constitute a resignation from the Oversight Committee. Until a vacancy on the Oversight Committee is filled, the Oversight Committee shall function in its reduced number.

(b) The individual members of the Oversight Committee shall serve without compensation, except that they shall be entitled to reimbursement of reasonable, actual and necessary out-of-pocket expenses (which shall not include any professional fees and expenses for attorneys or other professionals retained by an individual committee member) from the Plan Administrator.

(c) Following the Effective Date, the powers and duties of the Oversight Committee shall include (i) to approve any release or indemnity in favor of any third party granted or agreed to by the Plan Administrator; (ii) to authorize Plan Administrator to

commence any Litigation in excess of \$500,000; (iii) to approve the settlement of any Litigation in excess of \$250,000; (iv) to approve the allowance of any Disputed Claim in excess of \$500,000; (v) to approve the sale of any assets by the Plan Administrator in excess of \$250,000; (vi) to review financial information relating to KH Funding, which shall be promptly provided by the Plan Administrator upon request by the Oversight Committee; (vii) to monitor distributions to Creditors; (viii) to take such other actions as it deems necessary and appropriate with respect to the implementation of the Plan; (ix) prior to the payment of each invoice for services rendered by the Plan Administrator in its capacity as Plan Administrator, to review and approve each such invoice, which invoice shall be deemed approved if not objected to by the Oversight Committee within 10 days of receipt; (x) to remove and replace the Plan Administrator in accordance with Section 5.4 of the Plan; and (xi) to perform such additional functions as may be provided for by further order of the Court entered after the Effective Date.

(d) Following all payments being made to the holders of Allowed Claims under the Plan and the closing of the Chapter 11 Case, the Oversight Committee shall be dissolved and the members thereof shall be released and discharged of and from all further authority, duties, responsibilities and obligations to and arising from their service as Oversight Committee members.

8. Dissolution. As soon as practicable after the Effective Date and consistent with the orderly sale and liquidation of the Assets, KH Funding shall be dissolved for all purposes without the necessity for any other or further actions to be taken by or on behalf of KH Funding or payments to be made in connection therewith, provided, however, that the Plan Administrator shall be authorized (a) to continue such operations as may be necessary to effect the orderly sale and liquidation of the Assets, (b) to file KH Funding's final tax returns, (c) to file and shall file with the official public office for keeping corporate records in KH Funding's state of incorporation a certificate of dissolution or equivalent document, and (d) to perform such other and further activities consistent with the Plan. Except to the extent that operations continue from and after the Effective Date, KH Funding (i) for all purposes shall be deemed to have withdrawn their business operations from any state in which it was previously conducting or are registered or licensed to conduct their business operations, and KH Funding shall not be required to file any document, pay any sum or take any other action, in order to effectuate such withdrawal, (ii) shall not be liable in any manner to any taxing authority for franchise, business, license or similar taxes accruing on or after the Effective Date.

9. Insurance. On or as soon as practicable after the Effective Date, KH Funding and the Plan Administrator may obtain a fidelity bond or similar insurance in the estimated amount of the Assets on the Effective Date. In addition, the Plan Administrator may obtain (if available) directors' and officers' liability insurance or errors and omission insurance (or equivalent insurance).

F. Distributions

1. Disbursing Agent. All distributions under the Plan shall be made by the Plan Administrator as Disbursing Agent or such other entity designated by the Plan Administrator as Disbursing Agent. All distributions on account of Series 3 Note Claims by the

Series 3 Trustee or on account of Series 4 Note Claims by the Series 4 Trustee shall be accomplished in accordance with Section 6.4 of the Plan, and the Series 3 Trustee and the Series 4 Trustee each shall be deemed a Disbursing Agent solely for the purposes of distributions on account of Series 3 Note Claims to be made by the Series 3 Trustee and on account of Series 4 Note Claims to be made by the Series 4 Trustee to the extent provided and limited by Article 6 of the Plan. No Disbursing Agent shall be required to give any bond or surety or other security for the performance of its duties.

2. Expenses of the Disbursing Agent. Except as otherwise ordered by the Bankruptcy Court, any reasonable fees and expenses incurred by the Disbursing Agent (including, without limitation, taxes and reasonable attorneys' fees and expenses) on or after the Effective Date shall be paid in Cash by the Plan Administrator in the ordinary course of business; *provided, however*, that any such reasonable fees and expenses incurred by the Series 3 Trustee or the Series 4 Trustee in their capacity as Disbursing Agent shall be paid from the distributions to Holders of Allowed Series 3 Note Claims and to Holders of Allowed Series 4 Note Claims.

3. Rights and Powers of Disbursing Agent. The Disbursing Agent shall be empowered under the Plan to (a) effect all actions necessary to perform its duties under the Plan, (b) make all distributions contemplated hereby, (c) employ professionals to represent it with respect to its responsibilities and (d) exercise such other powers as may be vested in the Disbursing Agent by order of the Bankruptcy Court, pursuant to the Plan or as deemed by the Disbursing Agent to be necessary and proper to implement the provisions hereof. In furtherance of the rights and powers of the Disbursing Agent, the Disbursing Agent shall have no duty or obligation to make distributions to any Holder of an Allowed Claim unless and until such Holder executes and delivers, in a form acceptable to the Disbursing Agent, any documents applicable to such distributions.

4. Delivery of DistributionsDistributions to Last Known Address. Subject to Bankruptcy Rule 9010, all distributions to any Holder of an Allowed Claim or Allowed Administrative Expense Claim shall be made at the address of such Holder as set forth on the Schedules filed with the Bankruptcy Court or on the books and records of KH Funding or its agent, as applicable, unless KH Funding has been notified in writing of a change of address by the filing of a proof of claim by such Holder that contains an address for such Holder different than the address of such Holder as set forth on the Schedules. Notwithstanding anything herein to the contrary, the current addresses (if known) for all Holders of Series 3 Note Claims and Series 4 Note Claims shall be provided to the Series 3 Trustee and the Series 4 Trustee, respectively, by KH Funding or the Plan Administrator within ten (10) Business Days of the Effective Date and the Series 3 Trustee and the Series 4 Trustee shall be entitled to fully rely upon such information in making distributions under the Plan without being subject to liability of any type or kind concerning or in any way relating to the accuracy or reliability of such information so provided. Nothing in the Plan shall require KH Funding, the Plan Administrator or any Disbursing Agent (including, without limitation, the Series 3 Trustee or the Series 4 Trustee) to attempt to locate any Holder of an Allowed Claim.

(b) Distributions to Series 3 Trustee. The Series 3 Trustee shall be the Disbursing Agent for the Series 3 Note Claims and shall be vested with the rights afforded a

“Disbursing Agent” pursuant to and as limited by the Plan and solely with respect to such matters concerning distributions on account of Series 3 Note Claims, including without limitation the right to receive compensation for and reimbursement of expenses incurred in connection with distribution services rendered pursuant to the Plan in accordance with Section 6.2 the Plan. Accordingly, distributions for the benefit of the Holders of such Claims shall be made to the Series 3 Trustee. The Series 3 Trustee shall, in turn, administer the distribution to the Holders of such Allowed Series 3 Note Claims in accordance with the Plan. However, 180 days prior to administering any such initial distribution to the Holders of Allowed Series 3 Note Claims (the “Series 3 Distribution”), the Series 3 Trustee shall provide written notice to the Series 4 Trustee of any such planned Series 3 Distribution. During the 180 day period that commences to run upon the delivery of such written notice to the Series 4 Trustee (or for any additional period that may be agreed to in writing by the Series 3 Trustee and the Series 4 Trustee) (the “Subordination Challenge Period”), the Series 4 Trustee may, in accordance with the provisions of Article IV of the Plan and subject to all defenses available to the Series 3 Trustee under the Indenture or applicable law, challenge the provisions of the Indenture providing for the subordination in payment of the Series 4 Note Claims to the Series 3 Note claims (a “Subordination Challenge”). The Bankruptcy Court shall retain jurisdiction to resolve any such Subordination Challenge. Upon the expiration of the Subordination Challenge Period, the Series 4 Trustee shall be precluded and barred from commencing a Subordination Challenge or asserting any claims concerning the enforceability of the subordination provisions set forth in the Indenture, all of which claims shall be deemed fully waived and released. The Series 3 Trustee may employ or contract with other Entities to assist in or make the distributions to Holders of Allowed Series 3 Note Claims required under the Plan. Any such Entity designated by the Series 3 Trustee to serve in such capacity shall constitute a “Disbursing Agent” under the Plan and shall be vested with the same rights afforded the Series 3 Trustee in its capacity as Disbursing Agent pursuant to the Plan and as limited by the Plan, including without limitation the right to receive compensation for and reimbursement of expenses incurred in connection with distribution services rendered pursuant to the Plan in accordance with Section 6.2 of the Plan.

(c) Distributions to Series 4 Trustee. The Series 4 Trustee shall be the Disbursing Agent for the Series 4 Note Claims and shall be vested with the rights afforded a “Disbursing Agent” pursuant to and as limited by the Plan and solely with respect to such matters concerning distributions on account of Series 4 Note Claims, including without limitation the right to receive compensation for and reimbursement of expenses incurred in connection with distribution services rendered pursuant to the Plan in accordance with Section 6.2 of the Plan. Accordingly, any distributions to which the Holders of Series 4 Note Claims shall be entitled after the Holders of Series 3 Note Claims shall have been paid in full in accordance with the subordination provisions set forth in the Indenture and implemented by the Plan shall be made to the Series 4 Trustee. The Series 4 Trustee shall, in turn, administer the distribution to the Holders of such Allowed Series 4 Note Claims in accordance with the Plan. The Series 4 Trustee may employ or contract with other Entities to assist in or make the distributions to Holders of Allowed Series 4 Note Claims required under the Plan. Any such Entity designated by the Series 4 Trustee to serve in such capacity shall constitute a “Disbursing Agent” hereunder and shall be vested with the same rights afforded the Series 4 Trustee in its capacity as Disbursing Agent pursuant to the Plan and as limited by the Plan, including without

limitation the right to receive compensation for and reimbursement of expenses incurred in connection with distribution services rendered pursuant to the Plan in accordance with Section 6.2 of the Plan.

5. Record Date for Distributions. As of the close of business on the Effective Date, the registers for Claims and Interests shall be closed, and there shall be no further changes in the Holder of record of any Claim or Interest (including without limitation Series 3 Notes or Series 4 Notes). KH Funding, the Disbursing Agent (including the Series 3 Trustee and the Series 4 Trustee) and the Plan Administrator, as applicable, shall have no obligation to recognize any transfer of Claim or Interest occurring after the Effective Date, and shall instead be authorized and entitled to recognize and deal for all purposes under the Plan and the Indenture with only those Holders of record on the state registers of Claims and/or Interests and in the case of the Holders of Series 3 Notes or Series 4 Notes, on the books and records of KH Funding, as of the close of business on the Effective Date for distributions under the Plan.

6. Reserve for Plan Expenses. Section 6.6 of the Plan requires the Plan Administrator to set aside, deduct, and reserve an amount of Cash equal to the estimated amount of Plan Expenses before making any distributions to Holders of Claims. Any Cash in such Plan Expense reserve that the Plan Administrator deems to be excess prior to the closing of the Chapter 11 Case shall be distributed to Holders of Allowed Claims and Interests pursuant to Article 4 of the Plan.

7. Objections to Claims. Pursuant to Section 6.7 of the Plan, KH Funding or the Plan Administrator (or their authorized representatives), as applicable, shall have the exclusive authority to file, settle, compromise, withdraw or litigate any objections to Claims subject to the express provisions of the Plan. Objections to Claims shall be filed with the Bankruptcy Court and served upon affected Creditors no later than one hundred twenty (120) days after the Effective Date, *provided, however*, that this deadline may be extended by the Bankruptcy Court upon motion of the Plan Administrator. Notwithstanding the foregoing, in the event that a party filing any Claim after the applicable Bar Date shall obtain the written consent of the Plan Administrator to file such Claim late or obtains an order of the Bankruptcy Court upon notice to the Plan Administrator that permits the late filing of the Claim, then the Plan Administrator and Post-Confirmation Debtor shall have one hundred twenty (120) days from the date of such written consent or order to object to such Claim, which deadline may be extended by the Bankruptcy Court upon motion of the Plan Administrator. Subject to Bankruptcy Court approval, objections to Claims may be litigated to judgment, settled, or withdrawn by the Plan Administrator consistent with Section 5.3 of the Plan.

8. Distributions on Disputed Claims. Distributions on account of a Disputed Claim will be made as soon as practicable after an order, judgment, decree or settlement agreement with respect to such Claim becomes a Final Order rendering such Claim an Allowed Claim, provided that (a) the applicable Creditor shall not receive interest on its Allowed Claim, despite anything contained in the Plan to the contrary, from the date the objection is filed and served to the date of allowance of such Claim, and (b) nothing contained in the Plan shall require the Plan Administrator to make a distribution other than in accordance with Article 6 of the Plan.

9. Disputed Claim Reserves. Section 6.9 of the Plan requires the Plan Administrator to establish and maintain reserves for all Disputed Claims from and after the Effective Date. The Plan Administrator shall set aside Cash equal to (i) the amount that would have been distributed to the Holders of Disputed Claims in such Class had their Disputed Claims been deemed Allowed Claims on the Effective Date, or (ii) such other amount as may be approved by the Bankruptcy Court upon motion of the Plan Administrator. To the extent any Disputed Claim becomes an Allowed Claim by Final Order or by settlement between the Holder of such Claim and the Plan Administrator, a portion of Cash held in reserve on account of such Claim shall be distributed by the Plan Administrator to such Holder based on the extent to which such Disputed Claim becomes Allowed. Any Cash remaining after all Disputed Claims have been resolved shall be distributed Pro Rata to all Holders of Allowed Claims in accordance with Article 4 of the Plan. No payments or distributions shall be made with respect to a Claim that is a Disputed Claim pending the resolution of the dispute by settlement or Final Order.

10. Setoffs. Except as otherwise provided for in the Plan, the Plan Administrator may, but shall not be required to, set off against any Claim and the payments to be made pursuant to the Plan in respect of such Claim, claims of any nature whatsoever that KH Funding or its estate may have against the Creditor, but neither the failure to do so nor the allowance of a Claim hereunder shall constitute a waiver or release by KH Funding or its estate of any claim it may have against the Creditor.

11. Miscellaneous Provisions Relating To Distributions. The Plan implements mechanisms for resolving the Post-Confirmation Debtor's rights and obligations with respect to (i) unclaimed property resulting from undeliverable distributions (Section 6.10); (ii) distributions of fractional cents (Section 6.12); and (iii) distributions of less than twenty five dollars (\$25.00) (Section 6.13). Holders of Claims are encouraged to review those provisions of the Plan before voting to accept or reject the Plan.

G. Executory Contracts and Unexpired Leases

1. General Treatment of Executory Contracts and Unexpired Leases. Pursuant to Section 7.1 of the Plan, any and all pre-petition leases or executory contracts not previously rejected by KH Funding, unless specifically assumed pursuant to order(s) of the Bankruptcy Court prior to the Confirmation Date or the subject of a motion to assume or assume and assign pending on the Confirmation Date, shall be deemed rejected by KH Funding on the Confirmation Date; *provided, however*, that nothing in Article 7 of the Plan shall cause the rejection, breach, or termination of any contract of insurance benefiting KH Funding or its estate.

2. Rejection Damages Claims. Pursuant to Section 7.2 of the Plan, all proofs of claim with respect to claims arising from the rejection of executory contracts or leases shall, unless another order of the Bankruptcy Court provides for an earlier date, be filed with the Bankruptcy Court within thirty (30) days after the mailing of notice of entry of the Confirmation Order.

H. Conditions Precedent to the Effectiveness of the Plan. Section 8.1 of the Plan sets forth the conditions precedent to the occurrence of the Effective Date (as that term is defined in Section 1.27 of the Plan). Pursuant to Section 8.1 of the Plan, each of the following is a condition precedent to the occurrence of the Effective Date:

- (a) The Bankruptcy Court shall have entered the Confirmation Order;
- (b) The Confirmation Order shall have become a Final Order; and
- (c) The Plan Proponents shall have reasonably determined that the assets of the estate will be sufficient to satisfy all Allowed Administrative Claims, Allowed Priority Tax Claims, Allowed Priority Claims, and any Allowed Secured Claims and to fund the Plan Expense Reserve Fund and the Disputed Claim reserve.

In the event that the Plan has not become effective on or before 180 days after the Confirmation Date, the Plan Proponents shall file and serve on the Office of the United States Trustee a status report.

1. Waiver of Conditions. Pursuant to Section 8.2 of the Plan, the Plan Proponents, in their sole discretion, may at any time, without notice or authorization of the Bankruptcy Court, waive the condition set forth in Section 8.1(b) of the Plan. The failure of the Plan Proponents to satisfy or waive such condition may be asserted by the Plan Proponents regardless of the circumstances giving rise to the failure of such condition to be satisfied (including any action or inaction by the Committee or KH Funding). The Plan Proponents reserve the right to assert that any appeal from the Confirmation Order shall be moot after consummation of the Plan.

2. Effect of Failure of Condition. Section 8.3 of the Plan provides that, in the event the condition specified in Section 8.1(b) of the Plan has not occurred or been waived on or before ninety (90) days after the Confirmation Date, the Confirmation Order may be vacated upon order of the Bankruptcy Court after motion made by the Committee or any party in interest.

I. Effect of Confirmation

1. **Exculpation.** *Except as otherwise expressly provided by the Plan or the Confirmation Order or other Final Order of the Bankruptcy Court, on the Effective Date, KH Funding (but not its past or current officers, directors, employees, or its past or current counsel, with the exception of Gordon Feinblatt LLC), the Committee and past or current members of the Committee, the Plan Administrator, Gray and Associates, LLC, Eric A. Zoellner, and, except as limited heretofore with respect to KH Funding, each of their past or current officers, directors, employees, accountants, financial advisors, investment bankers, agents, representatives, restructuring advisors, attorneys, parents, subsidiaries and affiliates, and each of their respective agents, representatives, successors and assigns, shall be deemed released by each of them against the other of and from any claims, obligations, rights, causes of action and liabilities for any act or omission in connection with, or arising out of, the Chapter 11 Case, including, without limiting the generality of the*

foregoing, all sales of assets, the Disclosure Statement, the formulation, dissemination and pursuit of approval of the Disclosure Statement, the formulation, dissemination and pursuit of confirmation of the Plan, the consummation of the Plan or the administration of the Plan or the property to be distributed under the Plan, except for acts or omissions that constitute willful misconduct, gross negligence or fraud, and all such Persons, in all respects, shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the Plan and under the Bankruptcy Code.

2. **Limited Releases.** *Except as otherwise expressly provided or contemplated by the Plan or the Confirmation Order, effective as of the Confirmation Date but subject to the occurrence of the Effective Date, and in consideration of the services of and other forms of consideration being provided by (a) KH Funding (but not its past or current officers, directors, employees, or its past or current counsel, with the exception of Gordon Feinblatt LLC); (b) the Committee and past or current members of the Committee; (c) Gray & Associates, LLC; (d) Eric A. Zoellner; and (e) except as limited heretofore with respect to subsection (a), each of their respective past and current officers, directors, employees, agents, restructuring advisors, attorneys, parents, subsidiaries and affiliates, and each of their respective agents, representatives, successors and assigns (the parties set forth in subsections (a) through (e) being the “Released Parties”), KH Funding, KH Funding’s Chapter 11 estate, the Post-Confirmation Debtor and all Holders of Claims or Interests shall release, waive and discharge unconditionally and forever each of the Released Parties from any and all Claims, obligations, suits, judgments, damages, rights, causes of action and liabilities whatsoever (including those arising under the Bankruptcy Code), whether known or unknown, foreseen or unforeseen, existing or hereinafter arising in law, equity, or otherwise, based in whole or in part on any act, omission, transaction, event or other occurrence: (i) taking place before the Petition Date in connection with or relating to KH Funding or any of its direct or indirect subsidiaries; and (ii) in connection with, related to, or arising out of this Chapter 11 Case, the formulation, dissemination or pursuit of approval of the Disclosure Statement, the formulation, dissemination or pursuit of confirmation of the Plan, the consummation thereof, the administration thereof or the property to be distributed thereunder; provided that the foregoing shall not operate as a waiver of or release from any causes of action arising out of the willful misconduct or the gross negligence of any Released Party unless such Released Party acted in good faith and in a manner that such Released Party reasonably believed to be in or not opposed to the best interests of KH Funding, and with respect to any criminal action or proceeding, had no reasonable cause to believe such Released Party’s conduct was unlawful; provided, however, that the foregoing shall not operate as a waiver or release of any rights or obligations arising from and after the Effective Date in respect of any agreements expressly entered into or reaffirmed hereunder as of or following the Effective Date.*

3. **Injunction.** *Except as otherwise expressly provided in the Plan, on and after the Confirmation Date, all Entities who have held, hold or may hold Claims against KH Funding or Interests in KH Funding are permanently enjoined from and after the Confirmation Date from: (a) commencing, conducting or continuing in any manner, directly or indirectly, any suit, action or other proceeding of any kind (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against or affecting KH Funding’s estate, the Post-Confirmation Debtor, or any of the Released Parties, any of their*

property, or any direct or indirect transferee of any property of, or direct or indirect successor in interest to, any of the foregoing Entities, including without limitation the Plan Administrator, or any property of any such transferee or successor, or any of the Released Parties; (b) enforcing, levying, attaching (including, without limitation, any pre-judgment attachment), collecting or otherwise recovering by any manner or means whether directly or indirectly, of any judgment, award, decree or order against KH Funding's estate, the Post-Confirmation Debtor, or any of the Released Parties, any of their property, or any direct or indirect transferee of any property of, or direct or indirect successor in interest to any of the foregoing Entities, including without limitation the Plan Administrator, or any of the Released Parties; (c) creating, perfecting or otherwise enforcing in any manner, directly or indirectly, any encumbrance of any kind against KH Funding's estate, the Post-Confirmation Debtor, or any of the Released Parties, any of their property, or any direct or indirect transferee of any property of, or direct or indirect successor in interest to any of the foregoing Entities, including without limitation the Plan Administrator; (d) asserting any right of setoff, of any kind, directly or indirectly, against any obligation due KH Funding's estate, the Post-Confirmation Debtor, or any of the Released Parties, any of their property, or any direct or indirect transferee of any property of, or successor in interest to, any of the foregoing Entities, including without limitation the Plan Administrator; and (e) taking any actions in any place and in any manner whatsoever that do not conform to or comply with the provisions of the Plan. Unless otherwise provided in the Confirmation Order, all injunctions or stays arising under or entered during the Chapter 11 Case under Sections 105 or 362 of the Bankruptcy Code, or otherwise, that are in existence on the Confirmation Date shall remain in full force and effect until the Effective Date; provided, however, that no such injunction or stay shall preclude enforcement of any interested party's rights under the Plan and the related documents.

J. Retention of Jurisdiction. Pursuant to Article 9 of the Plan, following the Confirmation Date and until such time as all payments and distributions required to be made and all other obligations required to be performed under the Plan have been made and performed by the Plan Administrator, the Bankruptcy Court shall retain jurisdiction as is legally permissible, including, without limitation, for the following purposes:

(a) Claims. To determine the allowability, classification, or priority of Claims against KH Funding upon objection by KH Funding or the Plan Administrator, as applicable.

(b) Injunction, etc. To issue injunctions or take such other actions or make such other orders as may be necessary or appropriate to restrain interference with the Plan or its execution or implementation by any Person, to construe and to take any other action to enforce and execute the Plan, the Confirmation Order, or any other order of the Bankruptcy Court, to issue such orders as may be necessary for the implementation, execution, performance, and consummation of the Plan and all matters referred to herein, and to determine all matters that may be pending before the Bankruptcy Court in the Chapter 11 Case on or before the Effective Date with respect to any Entity.

(c) Fee Claims. To determine any and all applications for allowance of compensation and expense reimbursement of Professionals for periods before or after the Effective Date, as provided for in the Plan.

(d) Dispute Resolution. To resolve any dispute arising under or related to the implementation, execution, consummation or interpretation of the Plan and the making of distributions thereunder, including, without limitation, any dispute concerning payment of Fee Claims and expenses of the Plan Administrator and any dispute between the Series 3 Trustee, the Series 4 Trustee and/or any other entity regarding subordination of Allowed Class 8 Claims to Allowed Class 7 Claims.

(e) Leases and Executory Contracts. To determine any and all motions for the rejection, assumption, or assignment of executory contracts or unexpired leases, and to determine the allowance of any Claims resulting from the rejection of executory contracts and unexpired leases.

(f) Actions. To determine all applications, motions, adversary proceedings, contested matters, actions, and any other litigated matters instituted prior to the closing of the Chapter 11 Cases, including any remands.

(g) Litigation. To determine any and all "Litigation" as defined under Section 1.34 of the Plan.

(h) Taxes. To hear and determine matters concerning state, local, and federal taxes in accordance with Bankruptcy Code §§ 346, 505, and 1146.

(i) General Matters. To determine such other matters, and for such other purposes, as may be provided in the Confirmation Order or as may be authorized under provisions of the Bankruptcy Code, including but not limited to in connection with the sale or liquidation of Assets by KH Funding.

(j) Plan Modification. To modify the Plan under Section 1127 of the Bankruptcy Code, remedy any defect, cure any omission, or reconcile any inconsistency in the Plan or the Confirmation Order so as to carry out its intent and purposes.

(k) Aid Consummation. To issue such orders in aid of consummation of the Plan and the Confirmation Order notwithstanding any otherwise applicable non-bankruptcy law, with respect to any Entity, to the full extent authorized by the Bankruptcy Code.

(l) Implementation of Confirmation Order. To enter and implement such orders as may be appropriate in the event the Confirmation Order is for any reason stayed, revoked, modified, or vacated.

(m) Final Decree. To enter a Final Decree closing this Chapter 11 Case.

VII. LIQUIDATION AS AN ALTERNATIVE TO THE PLAN

Under the Bankruptcy Code, the Plan may not be confirmed by the Bankruptcy Court unless (a) all creditors in an impaired class of Claims have accepted the Plan, or (b) the Plan is in the “best interests” of Creditors. The Plan will be found to be in the “best interests” of Creditors if Creditors will receive a distribution under the Plan as of the Effective Date which is not less than the distribution a Creditor would receive if KH Funding is liquidated in a Chapter 7 case under the Bankruptcy Code.

The starting point in determining whether the Plan would meet the “best interests” test is a determination of the amount of proceeds that would be generated from a liquidation of KH Funding’s Assets in a Chapter 7 liquidation. It is assumed that in a Chapter 7 liquidation of KH Funding, KH Funding’s loan and real estate portfolios would be sold in a distressed sale and that certain of its REO would be surrendered to mortgage holders that hold liens in such properties. Further, it is assumed that under Chapter 7 no further effort would be expended by the Chapter 7 trustee to improve the quality and marketability of KH Funding’s loan files and that little or no maintenance and repairs with respect to KH Funding’s REO would be performed. As a result of these factors, the amount of proceeds that would be realized by a Chapter 7 trustee from KH Funding’s Assets would likely be less in Chapter 7 than would be the case if KH Funding and the Plan Administrator implemented the provisions of the Plan which is based on a going concern liquidation of KH Funding’s Assets.

In addition, distributions in Chapter 7 cases will be further reduced by the administrative costs of a Chapter 7 case including the Chapter 7 trustee’s compensation and the fees and expenses of professionals retained by a Chapter 7 trustee. Moreover, the potential Chapter 7 liquidation distribution in respect of each class would be reduced by costs imposed by the delay caused by conversion of the Chapter 11 case to a Chapter 7 case.

A Liquidation Analysis incorporating the assumptions discussed above is attached hereto as **Exhibit “D”**.

Based on the assumptions discussed above and the attached Liquidation Analysis, the Plan Proponents believe that Creditors will receive a recovery under the Plan which is at least equal in value to the recovery Creditors would receive in a liquidation of KH Funding in a Chapter 7 case and, therefore, the Plan satisfies the “best interests” test under the Bankruptcy Code.

VIII. PERFORMANCE OF THE PLAN AND RISK FACTORS

Following the Effective Date, the primary risk factor bearing on the success or failure of the Plan will be the Plan Administrator’s ability to maximize the value of the Assets and locate purchasers for the Assets who are ready, willing, and able to pay reasonable value in exchange for the Assets. Economic conditions are, at best, uncertain at this time, especially with regard to real estate and housing markets. Tightened credit markets have resulted in fewer potential buyers for real property and mortgage loan assets, and potential buyers who remain active in these markets tend in many cases to be looking for opportunities to purchase assets at a steep discount.

These forces bear on the challenge facing the Plan Proponents in their attempt to recover fair value for KH Funding's Assets. Notwithstanding these factors, the liquidation strategy proposed in the Plan is likely to yield greater value for Creditors than would an immediate liquidation as a result of the emphasis in the Plan on providing KH Funding with an opportunity to increase the value of its Assets and market the Assets for sale.

IX. TAX CONSEQUENCES OF PLAN

A. Introduction. The following discussion summarizes certain of the important federal income tax consequences of the transaction described herein and in the Plan. This discussion is for informational purposes only and does not constitute tax advice. This summary is based upon the Internal Revenue Code and the Treasury Regulations promulgated thereunder, judicial authority and current administrative rulings and practice. Neither the impact on foreign holders of claims nor the tax consequences of any transaction under state or local law is discussed. Also, special tax considerations not discussed herein may be applicable to certain classes of taxpayers, such as financial institutions, broker-dealers, life insurance companies and tax-exempt organizations. Furthermore, due to the complexity of the transactions contemplated in the Plan, and the unsettled status of many of the tax issues involved, the tax consequences described below are subject to significant uncertainties. No opinion of counsel has been obtained and no ruling has been requested from the Internal Revenue Service ("IRS") on these or any other tax issues. There can be no assurance that the IRS will not challenge any or all of the tax consequences of the Plan, or that such a challenge, if asserted, would not be sustained.

HOLDERS OF CLAIMS AGAINST KH FUNDING ARE THEREFORE URGED TO CONSULT WITH THEIR TAX ADVISORS REGARDING THE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF THE TRANSACTIONS DESCRIBED HEREIN AND IN THE PLAN.

B. Tax Consequences to KH Funding. Generally, since the Plan requires the liquidation of all of KH Funding's Assets, KH Funding will not receive a discharge of its debts under 11 U.S.C. § 1141(d)(3), and, as a result, KH Funding will not be deemed to have received a discharge for tax purposes. If in connection with the liquidation of KH Funding's Assets an Allowed Claim is not paid in full, there may be cancellation of indebtedness income to KH Funding at such time. KH Funding is an S Corporation under the Internal Revenue Code for federal income tax purposes and if KH Funding is insolvent at that time, any income corresponding to the satisfaction of claims at a discount in this case should not constitute taxable income. However, KH Funding may be required to reduce certain tax attributes. Section 108(d)(7) of the Internal Revenue Code provides special rules relating to the discharge of indebtedness of an S Corporation.

C. Tax Consequences to Creditors.

1. In General. The federal income tax consequences of the implementation of the Plan to a holder of a Claim will depend, among other things, on: (a) whether its Claim constitutes a debt or security for federal income tax purposes; (b) whether the Claimant receives consideration in more than one tax year; (c) whether the Claimant is a resident of the United States; (d) whether all the consideration by the Claimant is deemed to be received by that

Claimant as part of an integrated transaction; (e) whether the Claimant reports income using the accrual or cash method of accounting; and (f) whether the holder has previously taken a bad debt deduction or worthless security deduction with respect to the Claim.

2. Gain or Loss on Exchange. Generally, a holder of an Allowed Claim will realize a gain or loss on the exchange under the Plan of his Allowed Claim for cash and other property in an amount equal to the difference between (i) the sum of the amount of any cash and the fair market value on the date of the exchange of any other property received by the holder (other than any consideration attributable to accrued but unpaid interest on the Allowed Claim), and (ii) the adjusted basis of the Allowed Claim exchanged therefor (other than basis attributable to accrued but unpaid interest previously included in the holder's taxable income). Any gain recognized generally will be a capital gain if the Claim was a capital asset in the hands of an exchanging Claim holder, and such gain would be a long-term capital gain if the holder's holding period for the debt or security surrendered exceeded one (1) year at the time of the exchange. Any loss recognized by a holder of an Allowed Claim will be a capital loss if the Claim constitutes a "security" for federal income tax purposes or is otherwise held as a capital asset. For this purpose, a "security" is a debt instrument with interest coupons or in registered form.

D. Information Reporting and Backup Withholding

Under the backup withholding rules of the Internal Revenue Code, holders of Claims may be subject to backup withholding at the rate of 28 percent with respect to payments made pursuant to the Plan unless such holder (i) is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact, or (ii) provides a correct taxpayer identification number and certifies under penalties of perjury that the taxpayer identification number is correct and that the holder is not subject to backup withholding because of a failure to report all dividends and interest income. Any amount withheld under these rules will be credited against the holder's federal income tax liability. Holders of Claims may be required to establish exemption from backup withholding or to make arrangements with respect to the payment of backup withholding.

X. CONFIRMATION OF THE PLAN

The Bankruptcy Court will confirm the Plan only if all of the requirements of Section 1129 of the Code are met. Among the requirements for confirmation are that the Plan (i) is accepted by all impaired classes of Claims entitled to vote or, if rejected by an impaired Class, that the Plan "does not discriminate unfairly" and is "fair and equitable" as to such class, and as to the impaired Classes of Claims that are deemed to reject the Plan, (ii) is feasible, and (iii) is in the "best interests" of the holders of Claims impaired under the Plan.

A. No Unfair Discrimination/Fair and Equitable Test

In the event that any impaired Class of Claims does not accept the Plan, the Bankruptcy Court may still confirm the Plan at KH Funding's request if, as to each impaired Class of Claims which has not accepted the Plan, the Plan "does not discriminate unfairly" and is "fair and equitable".

A Chapter 11 plan does not discriminate unfairly, within the meaning of the Code, if the legal rights of a dissenting class are treated in a manner consistent with the treatment of other classes whose legal rights are substantially similar to those of the dissenting class and if no class of claims or equity interests receives more than it legally is entitled to receive for its claims or equity interests.

Under the Code, “fair and equitable” has different meanings for secured and unsecured claims. With respect to a secured claim, “fair and equitable” means (i) the impaired secured creditor retains its liens to the extent of its allowed claim and receives deferred cash payments at least equal in value to the allowed amount of its claim with a present value as of the effective date of the plan at least equal in value to such creditor’s interest in KH Funding’s interest in the property securing its claim, (ii) if property subject to the lien of the impaired secured creditor is sold free and clear of that lien, the lien attaches to the proceeds of the sale, and such lien proceeds are treated in accordance with clause (i) or (ii) of this paragraph, or (iii) if the impaired secured creditor realizes the “indubitable equivalent” of its claim under the plan. With respect to an unsecured claim, “fair and equitable” means either (i) each impaired unsecured creditor receives or retains property of a value, as of the effective date of the Plan, equal to the amount of its allowed claim, or (ii) the holders of claims or interests that are junior to the claims or interests of the dissenting class will not receive or retain any property under the Plan.

Under the Plan, no Holder in a Class of Claims is to receive cash or other property in excess of the full amount of its Allowed Claim. As to the Holders of Secured Claims, the Plan generally provides that such Holders will retain their liens with respect to their collateral until such time as the Collateral is disposed of pursuant to the terms of the Plan or by agreement between a Holder and KH Funding. With the exception of Holders of Allowed Class 11 Claims, it is anticipated that all Holders of Allowed Unsecured Claims will receive some payment on account of such Claims. Holders of Interests will receive no payment under the Plan, and their interests are to be cancelled. Accordingly, KH Funding believes that the Plan does not discriminate unfairly as to any impaired Class of Claims and is fair and equitable with respect to each such Class.

B. “Best Interests” Test

As discussed in Section VII above, the Code provides that unless all holders of impaired Claims have accepted the Plan, the Plan will not be confirmed, regardless of whether or not anyone objects to Confirmation, unless the Bankruptcy Court finds that the Plan is in the “best interests” of all Classes of Claims which are impaired. The “best interests” test will be satisfied by a finding of the Bankruptcy Court that the Plan will provide such a holder that has not accepted the Plan with a recovery at least equal in value to the recovery such holder would receive if KH Funding were liquidated under Chapter 7 of the Code.

For the reasons set forth in Section VII above, and as shown in **Exhibit “D”**, it is believed that each impaired Class will receive under the Plan a recovery at least equal in value to

the recovery such Class would receive pursuant to a liquidation of KH Funding under Chapter 7 of the Code.

C. Feasibility

Section 1129(a)(11) of the Code provides that a Chapter 11 plan may be confirmed only if the Bankruptcy Court finds that such plan is feasible. A feasible plan is one which will not lead to a need for further reorganization or liquidation of KH Funding. The Bankruptcy Court will find the Plan is feasible if it determines that KH Funding will be able to satisfy the conditions precedent to the Effective Date and otherwise have sufficient funds to meet its post-confirmation obligations to pay for the costs of administering and fully consummating the Plan. Subject to the Risk Factors set forth in Section XV, *supra*, of this Disclosure Statement, it is believed that the Plan satisfies the financial feasibility requirement imposed by the Code.

XI. MISCELLANEOUS PROVISIONS

A. Modification. The Plan may be altered, amended or modified by KH Funding or the Committee before the Confirmation Date as provided in Section 1127 of the Bankruptcy Code. The Plan Administrator and/or Post-Confirmation Debtor may, with the approval of the Bankruptcy Court and without notice to all Holders of Claims and Interests, insofar as it does not materially and adversely affect the interest of Holders of Claims, correct any defect, omission, or inconsistency in the Plan in such manner and to such extent as may be necessary to expedite consummation of the Plan. The Plan may be altered or amended after the Confirmation Date by the Plan Administrator and/or Post-Confirmation Debtor in a manner which, in the opinion of the Bankruptcy Court, materially and adversely affects Holders of Claims, provided that such alteration or modification is made after a hearing as provided in Section 1127 of the Bankruptcy Code.

B. Withdrawal. KH Funding and the Committee reserve the right to revoke or withdraw the Plan prior to the Effective Date. If KH Funding and the Committee revoke or withdraw the Plan, then the result shall be the same as if the Confirmation Order had not been entered and the Effective Date had not occurred.

C. Binding Effect. Subject to the occurrence of the Effective Date, on and after the Confirmation Date, the provisions of the Plan shall bind any Holder of a Claim against, or Interest in, KH Funding and such Holder's respective successors and assigns, whether or not the Claim or Interest of such Holder is Impaired under the Plan, whether or not such Holder has accepted the Plan and whether or not such Holder is entitled to a distribution under the Plan. The rights, benefits and obligations of any Entity named or referred to in the Plan shall be binding on, and shall inure to the benefit of, the heirs, executors, administrators, successors and/or assigns of such Entities.

D. Cramdown. To the extent any Impaired Class of Claims or Interest Holders entitled to vote on the Plan votes to reject the Plan, KH Funding and the Committee reserve the right to request confirmation of the Plan under Section 1129(b) of the Bankruptcy Code with respect to such Class(es).

E. Section 1146 Exemption. Pursuant to Section 1146(c) of the Bankruptcy Code, the issuance, transfer, or exchange of any security under the Plan or the making or delivery of any instrument of transfer pursuant to, in implementation of, or as contemplated by, the Plan or the revesting, transfer or sale of any real or personal property of KH Funding pursuant to, in implementation of, or as contemplated by, the Plan shall not be taxed under any state or local law imposing a stamp tax, transfer tax, or similar tax or fee. Without limiting the foregoing, pursuant to Section 1146(c) of the Bankruptcy Code, the sale by the Plan Administrator or Post-Confirmation Debtor of any real property from and after the Effective Date of the Plan shall not be taxed under any state or local law imposing a stamp tax, transfer tax, or similar tax or fee.

F. Waiver of Stay. KH Funding and the Committee will request as part of the Confirmation Order a waiver from the Bankruptcy Court of the fourteen day stay of Bankruptcy Rule 3020(e) and, to the extent applicable, a waiver of the fourteen day stay of Bankruptcy Rule 6004(h).

XII. CONCLUSION

KH FUNDING AND THE COMMITTEE SUBMIT THAT THE PLAN COMPLIES IN ALL RESPECTS WITH CHAPTER 11 OF THE CODE AND KH FUNDING AND THE COMMITTEE RECOMMEND TO HOLDERS OF CLAIMS WHO ARE ENTITLED TO VOTE ON THE PLAN THAT THEY VOTE TO ACCEPT THE PLAN.

Dated: February 9, 2012

KH FUNDING COMPANY

By: /s/ Robert L. Harris
Robert L. Harris, President

OFFICIAL COMMITTEE OF
UNSECURED CREDITORS

By: /s/ Ruth Gresser
Ruth Gresser, Chair

/s/ Lawrence D. Coppel #00180

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