

AMERICAN INSURED MORTGAGE INVESTORS SERIES 85 L P  
Form 10-K  
March 08, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

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For the fiscal year ended December 31, 2004

Commission file number 1-11059

**AMERICAN INSURED MORTGAGE INVESTORS - SERIES 85, L.P.**

(Exact name of registrant as specified in its charter)

**California**  
(State or other jurisdiction of  
Incorporation or organization)

**13-3257662**  
(I.R.S. Employer  
Identification No.)

**11200 Rockville Pike**

**Rockville, Maryland 20852**

(Address of principal executive offices)

Registrant's telephone number,  
including area code **(301) 255-4700**

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Depository Units of Limited Partnership Interest	American Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes  No

As of December 31, 2004, 12,079,514 depository units of limited partnership interest were outstanding. The aggregate market value of such units held by non-affiliates of the Registrant, based on the last reported sale price on June 30, 2004, was \$30,068,030.

**Documents incorporated by Reference**

None

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AMERICAN INSURED MORTGAGE INVESTORS - SERIES 85, L.P.

2004 ANNUAL REPORT ON FORM 10-K

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**PART I**

**ITEM 1. BUSINESS**

**FORWARD-LOOKING STATEMENTS.** When used in this Annual Report on Form 10-K, the words *believe, anticipate, expect, contemplate, may, will,* and similar expressions are intended to identify forward-looking statements. Statements looking forward in time are included in this Annual Report on Form 10-K pursuant to the *safe harbor* provision of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially. Accordingly, the following information contains or may contain forward-looking statements: (1) information included in this Annual Report on Form 10-K, including, without limitation, statements made under Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, (2) information included or incorporated by reference in prior and future filings by the Partnership (defined below) with the Securities and Exchange Commission ( *SEC* ) including, without limitation, statements with respect to growth, projected revenues, earnings, returns, distributions and yields on its portfolio of mortgage assets, the impact of interest rates, costs and business strategies and plans and (3) information contained in written material, releases and oral statements issued by or on behalf of, the Partnership, including, without limitation, statements with respect to disposition of investments, projected revenues, earnings, returns and yields on its portfolio of mortgage assets, the impact of interest rates, costs and business strategies and plans. Factors which may cause actual results to differ materially from those contained in the forward-looking statements identified above include, but are not limited to (i) regulatory matters, (ii) interest rates, (iii) prepayment of mortgages, (iv) defaulted mortgages, (v) errors in servicing defaulted mortgages and (vi) sales of mortgage investments below fair market value. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only of the date hereof. The Partnership undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

**Development and Description of Business**

American Insured Mortgage Investors - Series 85, L.P. (the Partnership) was formed pursuant to a limited partnership agreement, as subsequently amended ( Partnership Agreement ) under the Uniform Limited Partnership Act of the state of California on June 26, 1984. The Partnership's business consists of holding government insured mortgage investments primarily on multifamily housing properties, and distributing the payments of principal and interest on such mortgage investments, including debentures issued by the United States Department of Housing and Urban Development ( HUD ) in exchange for such mortgages, to the holders of its depository units of limited partnership interests ( Unitholders ). During the period from March 8, 1985 (the initial closing date of the Partnership's public offering) through January 27, 1986 (the termination date of the offering), the Partnership, pursuant to its public offering of 12,079,389 depository Units of limited partnership interest ( Units ) raised a total of \$241,587,780 in gross proceeds. In addition, the initial limited partner contributed \$2,500 to the capital of the Partnership in exchange for 125 Units.

CRIIMI, Inc., a wholly-owned subsidiary of CRIIMI MAE Inc. ( CRIIMI MAE ), acts as the General Partner (the General Partner ) for the Partnership and holds a partnership interest of 3.9%. The General Partner provides management and administrative services on behalf of the Partnership. AIM Acquisition Partners L.P. serves as the advisor (the Advisor ) to the Partnership. The general partner of the Advisor is AIM Acquisition Corporation ( AIM Acquisition ) and the limited partners include, but are not limited to, The Goldman Sachs Group, L.P., Sun America Investments, Inc. (successor to Broad, Inc.) and CRI/AIM Investment, L.P., a subsidiary of CRIIMI MAE, over which CRIIMI MAE exercises 100% voting control. AIM Acquisition is a Delaware corporation that is primarily owned by Sun America Investments, Inc. and The Goldman Sachs Group, L.P.

Pursuant to the terms of certain origination and acquisition services, management services and disposition services agreements between the Advisor and the Partnership (collectively the Advisory Agreements), the Advisor renders services to the Partnership, including but not limited to, the management of the Partnership's portfolio of mortgages and the disposition of the Partnership's mortgages. Such services are subject to the review and ultimate authority of the General Partner. However, the General Partner is required to receive the consent of the Advisor prior to taking certain significant actions, including but not limited to the disposition of mortgages, any transaction or agreement with the General Partner or its affiliates, or any material change as to policies regarding distributions or reserves of the Partnership (collectively the Consent Rights). The Advisor is permitted to delegate and has delegated the performance of services to CRIIMI MAE Services Limited Partnership (CMSLP), a subsidiary of CRIIMI MAE, pursuant to a sub-management agreement (the Sub-Advisory Agreement). The general partner and limited partner of CMSLP are wholly-owned subsidiaries of CRIIMI MAE. The delegation of such services by the Advisor to CMSLP does not relieve the Advisor of its obligation to perform such services. Furthermore, the Advisor has retained its Consent Rights.

Prior to December 1993, the Partnership was engaged in the business of originating government insured mortgage loans (Originated Insured Mortgages) and acquiring government insured mortgage loans (Acquired Insured Mortgages) and, together with Originated Insured Mortgages, referred to herein as Insured Mortgages). In accordance with the terms of the Partnership Agreement, the Partnership is no longer authorized to originate or acquire Insured Mortgages and, consequently, its primary objective is to manage its portfolio of mortgage investments, all of which are insured under Section 221(d)(4) or Section 231 of the National Housing Act of 1937, as amended (the National Housing Act). The Partnership Agreement states that the Partnership will terminate on December 31, 2009, unless terminated earlier under the provisions thereof. The Partnership is required, pursuant to the Partnership Agreement, to dispose of its assets prior to this date.

As of December 31, 2004, the Partnership had investments in 8 Insured Mortgages and one debenture with an aggregate amortized cost of approximately \$15.9 million, an aggregate face value of approximately \$16.0 million and an aggregate fair value of approximately \$16.0 million, as compared to December 31, 2003, when the Partnership had investments in 15 Insured Mortgages and five debentures with an aggregate amortized cost of approximately \$51.5 million, an aggregate face value of approximately \$51.6 million and an aggregate fair value of approximately \$52.4 million.

During 2004, three Insured Mortgages were sold, three Insured Mortgages prepaid, five debentures were redeemed and one debenture was issued as assignment proceeds for one mortgage. The net aggregate amortized cost and aggregate face value of these assets was approximately \$35.4 million as of December 31, 2003.

As the Partnership continues to liquidate its mortgage investments and Unitholders receive distributions of return of capital and taxable gains, Unitholders should expect a reduction in earnings and distributions due to the decreasing mortgage base. Based upon the current level of interest rates, the trend in mortgage prepayments over the past year is likely to continue. Such mortgage prepayments, if continued at the trend over the past year, will likely result in a termination and liquidation of the Partnership significantly earlier than the December 2009 stated termination date. Upon the termination and liquidation of the Partnership, distributions to Unitholders will be made in accordance with the terms of the Partnership Agreement. A final distribution will be based on the Unitholders' and the General Partner's pro-rata share of the Partnership's remaining net assets after deducting and setting aside amounts required to satisfy and discharge any existing Partnership obligations and expenses, as stated in the Partnership Agreement. Such distribution to Unitholders will be substantially less than the amount referenced in limited partners' equity in the Partnership's financial statements, since the Partnership's financial statements are prepared in accordance with GAAP and the distributions upon liquidation pursuant to the terms of the Partnership Agreement do not require the General Partner to contribute an amount equal to its General Partner's deficit to the Partnership.

Additional information concerning the business of the Partnership is contained in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and in Notes 1, 5, 6, 7 and 8 of the Notes to Financial Statements (included in Item 8 hereof). See also Schedule IV-Mortgage



Loans on Real Estate for the table of the Partnership's Insured Mortgages as of December 31, 2004.

**Employees and Management of the Partnership**



The Partnership has no employees. The business of the Partnership is managed by its General Partner while its portfolio of mortgages is managed by the Advisor and CMSLP pursuant to the Advisory Agreements and Sub-Advisory Agreement, respectively, as discussed above. An affiliate of the General Partner, CRIIMI MAE Management, Inc. provides personnel and administrative services to the Partnership on behalf of the General Partner. The Partnership reimburses CRIIMI MAE Management, Inc. for these services on an actual cost basis pursuant to the terms of the Partnership Agreement.

The fee paid by the Partnership to the Advisor for services performed under the Advisory Agreements (the Advisory Fee), is equal to 0.95% of the Partnership's Total Invested Assets. (As defined in the Partnership Agreement, Total Invested Assets generally means the aggregate original face value of the Partnership's current mortgage investments.) The Advisor pays CMSLP, as sub-advisor, a fee of 0.28% (the Sub-Advisory Fee) of Total Invested Assets for services performed under the Sub-Advisory Agreement from its Advisory Fee. The Partnership is not liable for paying the Sub-Advisory Fee to CMSLP. Additional information concerning these fees is contained in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 8 of the Notes to Financial Statements (included in Item 8 hereof).

### **Competition**

The Partnership may elect to dispose of its mortgage investments through a sale to third parties subject to the consent of the Advisor. In disposing of mortgage investments, the Partnership competes with private investors, mortgage banking companies, mortgage brokers, state and local government agencies, lending institutions, trust funds, pension funds, and other entities, some with similar objectives to those of the Partnership and some of which are or may be affiliates of the Partnership, its General Partner, the Advisor, CMSLP or their respective affiliates. Some of these entities may have substantially greater capital resources and experience in disposing of mortgages investments than the Partnership.

CRIIMI MAE and its affiliates also may serve as general partners or managers of real estate limited partnerships, real estate investment trusts or other similar entities in the future. The Partnership may attempt to dispose of mortgages at or about the same time that CRIIMI MAE and/or other entities managed by CRIIMI MAE or its affiliates, or the Advisor or its affiliates, are attempting to dispose of mortgages. As a result of market conditions that could have the effect of limiting the number of mortgage dispositions or adversely affecting the proceeds received from such dispositions, CMSLP, the General Partner and the Advisor and their affiliates could be faced with conflicts of interest in determining which mortgages would be disposed of and at which price. CMSLP, the General Partner and the Advisor, however, are required to exercise their fiduciary duties of good faith, care and loyalty when evaluating the appropriate action to be taken when faced with such conflicts.

The General Partner maintains a website for the Partnership at [www.americaninsuredmortgage.com](http://www.americaninsuredmortgage.com). Select [AIM 85](#) to view the Partnership's annual reports, quarterly reports and distribution history. Select the [AMEX](#) button to access current and historical price data for the Partnership's Units. A copy of the General Partner's Code of Business Conduct and Ethics and any other information may be obtained by writing to the General Partner in care of the Partnership at CRIIMI, Inc., 11200 Rockville, 4<sup>th</sup> Floor, Rockville, MD 20852 or email [aimfunds@criimi.com](mailto:aimfunds@criimi.com).

ITEM 2. PROPERTIES

The Partnership does not own or lease any properties. Generally, the mortgages underlying the Partnership's mortgage investments are non-recourse first liens on multifamily residential developments or retirement homes.

ITEM 3. LEGAL PROCEEDINGS

There are no legal proceedings to which the Partnership is a party.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Partnership's Unitholders during the fourth quarter of 2004.

ITEM 5. MARKET FOR REGISTRANT'S SECURITIES AND RELATED SECURITY HOLDER MATTERS

Principal Market and Market Price for Units and Distributions

The Units are listed for trading on the American Stock Exchange ( AMEX ) under the trading symbol of AII. The high and low sale prices for the Units as reported on AMEX and the distributions per Unit, as applicable, for each quarterly period in 2004 and 2003 were as follows:

Quarter Ended	2004		Amount of Distribution Per Unit
	High	Low	
March 31	\$ 5.16	\$ 2.94	\$ 2.010
June 30	3.06	2.45	0.925
September 30	2.64	1.37	0.890
December 31	1.49	1.30	0.030
			\$ 3.855

Quarter Ended	2003		Amount of Distribution Per Unit
	High	Low	
March 31	\$ 5.90	\$ 5.43	\$ 0.310
June 30	5.50	5.36	0.255
September 30	5.50	4.86	0.130

Competition

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December 31	4.95	4.58	0.200
		\$	0.895

There are no material legal restrictions upon the Partnership's present or future ability to make distributions in accordance with the provisions of the Partnership Agreement.

The basis for paying distributions to Unitholders is net proceeds from mortgage dispositions, if any, and cash flow from operations, which includes regular interest income and principal from Insured Mortgages. Although the Partnership's Insured Mortgages pay a fixed monthly mortgage payment, the cash distributions paid to the Unitholders will vary during each quarter due to (1) the fluctuating yields in the short-term money market in which the monthly mortgage payment receipts are temporarily invested prior to the payment of quarterly distributions, (2) the reduction in the asset base resulting from monthly mortgage payments received or mortgage dispositions, (3) variations in the cash flow attributable to the delinquency or default of Insured Mortgages, the timing of receipt of debentures, the interest rate on debentures and debenture redemptions, and (4) changes in the Partnership's operating expenses. As the Partnership continues to liquidate its mortgage investments and Unitholders receive distributions of return of capital and taxable gains, Unitholders should expect a reduction in earnings and distributions due to the decreasing mortgage base. Based upon the current level of interest rates, the trend in mortgage prepayments over the past year is

likely to continue. Such mortgage prepayments, if continued at the trend over the past year, will likely result in a termination and liquidation of the Partnership significantly earlier than the December 2009 stated termination date. Upon the termination and liquidation of the Partnership, distributions to Unitholders will be made in accordance with the terms of the Partnership Agreement. A final distribution will be based on the Unitholders' and the General Partner's pro-rata share of the Partnership's remaining net assets after deducting and setting aside amounts required to satisfy and discharge any existing Partnership obligations and expenses, as stated in the Partnership Agreement. Such distribution to Unitholders will be substantially less than the amount referenced in limited partners' equity in the Partnership's financial statements, since the Partnership's financial statements are prepared in accordance with GAAP and the distributions upon liquidation pursuant to the terms of the Partnership Agreement do not require the General Partner to contribute an amount equal to its General Partner's deficit to the Partnership.

Commencing in the first quarter of 2005, the General Partner will declare distributions of regular cash flow and mortgage proceeds, if any, once each quarter. The General Partner made the decision to declare distributions quarterly instead of monthly to reduce expenses associated with monthly declarations. The distributions are to be declared in March, June, September and December and to be paid after the end of each calendar quarter.

As of December 31, 2004, there were approximately 10,540 Unitholders.

The Partnership has no compensation plans or individual compensation arrangements under which equity securities of the Partnership are authorized for issuance.

#### ITEM 6. SELECTED FINANCIAL DATA

(Dollars in thousands, except per Unit amounts)

	For the Years Ended December 31,				
	2004	2003	2002	2001	2000
Income	\$ 2,312	\$ 5,080	\$ 6,443	\$ 8,526	\$ 9,979
Net gains on mortgage dispositions	2,055	1,498	1,851	1,785	428
Net earnings	3,801	5,573	7,138	8,969	8,866
Net earnings per Unit - Basic and diluted (1)	\$ 0.30	\$ 0.44	\$ 0.57	\$ 0.71	\$ 0.71
Distributions per Unit (1)(2)	\$ 3.855	\$ 0.895	\$ 2.755	\$ 1.91	\$ 1.61

	As of December 31,				
	2004	2003	2002	2001	2000
Total assets	\$ 16,802	\$ 69,048	\$ 78,238	\$ 98,070	\$ 118,621
Partners' equity	16,342	61,142	67,940	94,828	110,982

(1) Calculated based upon the weighted average number of Units outstanding.

(2) Includes distributions due the Unitholders for the Partnership's fiscal years ended December 31, 2004, 2003, 2002, 2001 and 2000 which were partially paid subsequent to year end. See Notes 8 and 9 of the Notes to Financial Statements (included in Item 8 hereof) for additional information.

The selected income statement data presented above for the years ended December 31, 2004, 2003, 2002, and the selected balance sheet data as of December 31, 2004 and 2003, are derived from, and are qualified by, reference to the Partnership's financial statements, which are included elsewhere in this Annual Report on Form 10-K. The selected income statement data for the years ended December 31, 2001 and 2000, and the selected balance sheet data as of December 31, 2002, 2001 and 2000 are derived from audited financial statements not included as part of this Annual Report on Form 10-K. This data should be read in conjunction with the financial statements and the notes thereto.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The Partnership's business consists of holding government insured mortgage investments primarily on multifamily housing properties and debentures issued by HUD, and distributing the payments of principal and interest on such investments to the holders of its depositary units of limited partnership interests ( Unitholders ). CRIIMI, Inc., a wholly-owned subsidiary of CRIIMI MAE Inc. ( CRIIMI MAE ), is the General Partner (the General Partner ) for the Partnership and holds a partnership interest of 3.9%. The Partnership's primary source of revenue and cash is the payment of mortgage interest and principal from its Insured Mortgages and the payment of debenture interest.

As the Partnership's mortgage investments continue to paydown and/or are liquidated and Unitholders receive distributions of return of capital and taxable gains, Unitholders should expect a reduction in earnings and distributions due to the decreasing mortgage base. The magnitude of the decrease will depend upon the size of the Insured Mortgages which are prepaid, sold or assigned for insurance proceeds.

Mortgage Investments

As of December 31, 2004, the Partnership had investments in 8 Insured Mortgages and one debenture with an aggregate amortized cost of approximately \$15.9 million, an aggregate face value of approximately \$16.0 million and an aggregate fair value of approximately \$16.0 million, as compared to December 31, 2003, when the Partnership had investments in 15 Insured Mortgages and five debentures with an aggregate amortized cost of approximately \$51.5 million, an aggregate face value of approximately \$51.6 million and an aggregate fair value of approximately \$52.4 million.

During the 2004, three Insured Mortgages were sold, three Insured Mortgages prepaid, five debentures were redeemed and one debenture was issued as assignment proceeds for one mortgage. The net aggregate amortized cost and aggregate face value of these assets was approximately \$35.4 million as of December 31, 2003.

The Partnership's investment in Insured Mortgages is comprised of participation certificates evidencing a 100% undivided beneficial interest in government insured multifamily mortgages issued or sold pursuant to the Federal Housing Administration Programs (FHA) programs (FHA-Insured Certificates) and mortgage-backed securities guaranteed by the Government National Mortgage Association (GNMA) (GNMA Mortgage-Backed Securities). The mortgages underlying the FHA-Insured Certificates and GNMA Mortgage-Backed Securities are non-recourse first liens on multifamily residential developments or retirement homes.

The following is a discussion of the types of the Partnership's mortgage investments:

**GNMA Mortgage-Backed Securities and FHA-Insured Certificates**



Listed below is the Partnership's aggregate investment in GNMA Mortgage-Backed Securities and FHA-Insured Certificates:

	2004	December 31,	2003
<b>Acquired Mortgages:</b>			
Number of			
GNMA Mortgage-Backed Securities		1	1
FHA-Insured Certificates (2) and (3)		7	9
Amortized Cost	\$	14,154,205	\$ 19,053,403
Face Value		14,260,814	19,122,101
Fair Value		14,299,980	19,264,433
<b>Originated Mortgages:</b>			
Number of			
GNMA Mortgage-Backed Securities (4)			1
FHA-Insured Certificates (1)			1
Amortized Cost	\$		\$ 15,803,978
Face Value			15,803,977
Fair Value			15,882,997

(1) In May 2004, the mortgage on Waterford Green Apartments was prepaid. The Partnership received net proceeds of approximately \$6.6 million and recognized a gain of approximately \$942,000 for the year ended December 31, 2004. A distribution of approximately \$0.455 per Unit related to the prepayment of this mortgage was declared in May and a distribution of approximately \$0.07 per Unit for additional proceeds received related to the Partnership's participation interest in this mortgage was declared in June. Both distributions were paid to Unitholders in August 2004.

(2) In May 2004, the mortgage on Northwood Place was prepaid. The Partnership received net proceeds of approximately \$4.3 million and recognized a loss of approximately \$51,000 for the year ended December 31, 2004. A distribution of approximately \$0.345 per Unit related to the prepayment of this mortgage was declared in June and paid to Unitholders in August 2004.

(3) In June 2004, the mortgage on Stafford Towers was prepaid. The Partnership received net proceeds of approximately \$303,000 and recognized a loss of approximately \$21,000 for the year ended December 31, 2004. A distribution of approximately \$0.02 per Unit related to the prepayment of this mortgage was declared in July and paid to Unitholders in November 2004.

(4) In July 2004, the GNMA security secured by the mortgage on Oak Forest Apartments II was sold with the consent of the Advisor. The Partnership received net proceeds of approximately \$10.6 million and recognized a gain of approximately \$553,000 for the year ended December 31, 2004. A distribution of approximately \$0.84 per Unit related to the sale of this GNMA security was declared in July and paid to Unitholders in November 2004.

As of March 1, 2005, all of the fully insured GNMA Mortgage-Backed Securities and FHA-Insured Certificates are current with respect to the payment of principal and interest.

#### FHA-Insured Loans

Listed below is the Partnership's aggregate investment in FHA-Insured Loans:

	2004	December 31,	2003
<b>Acquired Loans:</b>			
Number of Loans (1)			1
Amortized Cost	\$	\$	1,436,670
Face Value			1,701,956
Fair Value			1,701,956
<b>Originated Loans:</b>			
Number of Loans (2)			2
Amortized Cost	\$	\$	9,191,407
Face Value			8,950,266
Fair Value			9,576,785

(1) In January 2004, HUD transferred assignment proceeds to the Partnership in the form of a 5.75% debenture, with a face value of approximately \$3.5 million, in exchange for the mortgage on Kaynorth Apartments. Since the mortgage on Kaynorth Apartments was beneficially owned 50% by the Partnership and 50% by American Insured Mortgage Investors ( AIM 84 ), approximately \$1.7 million of the debenture face value was due to AIM 84. See further discussion below.

(2) In February 2004, the mortgages on Cobblestone Apartments and The Plantation were sold with the consent of the Advisor. The Partnership received aggregate net proceeds of approximately \$9.6 million and recognized aggregate gains of approximately \$386,000 for the year ended December 31, 2004. The aggregate distribution of approximately \$0.76 per Unit related to the sale of these two mortgages was declared in February 2004 and paid to Unitholders in May 2004.

During 2004, the Partnership disposed of all of its remaining investments in fully insured FHA-Insured Loans.

In addition to base interest payments under FHA Insured Loans that were Originated Insured Mortgages, the Partnership was entitled to additional interest based on a percentage of the net cash flow from the underlying development (referred to as Participations. ) During the years ended December 31, 2004, 2003 and 2002, the Partnership received \$0, \$0, and \$8,396, respectively, from the Participations. These amounts are included in mortgage investment income on the Statements of Income and Comprehensive Income of the financial statements (included in Item 8 hereof).

Investments in debentures and due to affiliate

In January 2004, HUD issued a 5.75% debenture to the Partnership in exchange for the mortgage on Kaynorth Apartments. The face value of the debenture was approximately \$3.5 million and pays interest semi-annually on January 1 and July 1. The Partnership recognized a gain of approximately \$246,000 for the year ended December 31, 2004 related to this assignment. This mortgage was beneficially owned 50% by the Partnership and 50% by AIM 84. In February 2004, AIM 84 sold its 50% interest in this debenture and the Partnership subsequently transferred the cash proceeds of approximately \$1.8 million to AIM 84. The fair value and face value of 50% of this debenture was approximately \$1.7 million as of December 31, 2004. The fair value of this debenture was included in Investment in debenture on the Partnership's balance sheet as of December 31, 2004.

**Results of Operations**

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### 2004 compared to 2003

Net earnings decreased by approximately \$1.8 million, or 32%, for 2004 as compared to 2003, primarily due to a decrease in mortgage investment income, of approximately \$2.8 million, or 57%, resulting from the reduction in the mortgage base, partially offset by an increase in net gains on mortgage dispositions of approximately \$557,000, and a decrease in total expenses of approximately \$439,000, or 44%. The mortgage base decreased as a result of 7 mortgage dispositions with an aggregate principal balance of approximately \$31.1 million, representing an approximate 68% decrease in the aggregate principal balance of the total mortgage portfolio since December 2003. See further discussion above in [GNMA Mortgage-Backed Securities and FHA-Insured Certificates](#) and [FHA-Insured Loans](#) for more information on the mortgage dispositions.

Interest and other income decreased by approximately \$11,000, or 5%, for 2004 as compared to 2003, primarily due to the timing and amount of the investment of mortgage proceeds prior to the distribution to Unitholders.

Asset management fees decreased by approximately \$343,000, or 56%, for 2004 as compared to 2003, primarily due to the reduction in the mortgage base discussed above.

General and administrative expenses decreased by approximately \$96,000, or 25%, for 2004 as compared to 2003, primarily due to the decrease in the mortgage base.

Gains on mortgage dispositions increased by approximately \$618,000 for 2004 as compared to 2003. Gains were recognized on one mortgage prepayment, three mortgage sales and one mortgage assignment in 2004, as discussed above, compared to gains recognized on seven mortgage prepayments and six mortgage assignments in 2003. Losses were recognized on two mortgage prepayments in 2004, as discussed above. A loss was recognized on one mortgage prepayment in 2003.

### 2003 compared to 2002

Net earnings decreased by approximately \$1.6 million, or 22%, for 2003 as compared to 2002, primarily due to an approximate \$1.3 million, or 21%, decrease in mortgage investment income resulting from the reduction in the mortgage base. The mortgage base decreased as a result of 14 mortgage dispositions with an aggregate principal balance of approximately \$19 million, representing an approximate 21% decrease in the aggregate principal balance of the total mortgage portfolio since December 2002.

Interest and other income decreased by approximately \$41,000 for 2003 as compared to 2002, primarily due to the timing and amount of the investment of mortgage proceeds prior to the distribution to Unitholders.

Asset management fees decreased by approximately \$133,000, or 18%, for 2003 as compared to 2002, primarily due to the reduction in the mortgage base discussed above.



General and administrative expenses decreased by approximately \$18,000 for 2003 as compared to 2002, primarily due to the decrease in the mortgage base.

Gains on mortgage dispositions decreased by approximately \$351,000 for 2003 as compared to 2002. Gains were recognized on seven mortgage prepayments and six mortgage assignments in 2003, as discussed above, compared to gains recognized on six mortgage prepayments and four mortgage assignments in 2002. A loss was recognized on one mortgage prepayment in 2003, as discussed above. A loss was recognized on one mortgage prepayment in 2002.

### **Liquidity and Capital Resources**

The Partnership's operating cash receipts, derived from payments of principal and interest on Insured Mortgages plus cash receipts from interest on debentures and short-term investments, are the Partnership's principal sources of cash flows, and were sufficient for the years ended December 31, 2004, 2003 and 2002 to meet operating expense requirements. The Partnership anticipates its cash flows will be sufficient to meet operating expense requirements for 2005.

The basis for paying distributions to Unitholders is net proceeds from mortgage dispositions, if any, and cash flow from operations, which includes regular interest income and principal from Insured Mortgages. Although the Partnership's Insured Mortgages pay a fixed monthly mortgage payment, the cash distributions paid to the Unitholders will vary during each quarter due to (1) the fluctuating yields in the short-term money market in which the monthly mortgage payment receipts are temporarily invested prior to the payment of quarterly distributions, (2) the reduction in the asset base resulting from monthly mortgage payments received or mortgage dispositions, (3) variations in the cash flow attributable to the delinquency or default of Insured Mortgages, the timing of receipt of debentures, the interest rate on debentures and debenture redemptions, and (4) changes in the Partnership's operating expenses. As the Partnership continues to liquidate its mortgage investments and Unitholders receive distributions of return of capital and taxable gains, Unitholders should expect a reduction in earnings and distributions due to the decreasing mortgage base. Based upon the current level of interest rates, the trend in mortgage prepayments over the past year is likely to continue. Such mortgage prepayments, if continued at the trend over the past year, will likely result in a termination and liquidation of the Partnership significantly earlier than the December 2009 stated termination date. Upon the termination and liquidation of the Partnership, distributions to Unitholders will be made in accordance with the terms of the Partnership Agreement. A final distribution will be based on the Unitholders and the General Partner's pro-rata share of the Partnership's remaining net assets after deducting and setting aside amounts required to satisfy and discharge any existing Partnership obligations and expenses, as stated in the Partnership Agreement. Such distribution to Unitholders will be substantially less than the amount referenced in limited partners' equity in the Partnership's financial statements, since the Partnership's financial statements are prepared in accordance with GAAP and the distributions upon liquidation pursuant to the terms of the Partnership Agreement do not require the General Partner to contribute an amount equal to its General Partner's deficit to the Partnership.

Since the Partnership is obligated to distribute the proceeds of mortgage prepayments, sales and insurance on Insured Mortgages (as defined in the Partnership Agreement) to its Unitholders, the size of the Partnership's portfolio will continue to decrease. The magnitude of the decrease will depend upon the size of the Insured Mortgages which are prepaid, sold or assigned for insurance proceeds.



Contractual Obligations

The following is a summary of the Partnership's contractual obligations as of December 31, 2004:

(Dollars in thousands)

	Total	2005	Payments due by period		2008-2009	Thereafter
			2006-2007			
Asset Management Fee (1)	\$ 728	\$ 146	\$ 291	\$ 291	\$	\$

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(1) The fee paid by the Partnership to the Advisor for services performed under the Advisory Agreements (the Asset Management Fee), is equal to 0.95% of the Partnership's Total Invested Assets (as defined in the Partnership Agreement.) The Asset Management Fee declines as the mortgage base declines.

Cash flow - 2004 compared to 2003

Net cash provided by operating activities decreased by approximately \$1.9 million in 2004 compared to 2003 primarily due to a reduction in earnings as a result of the reduction in mortgage base, as previously discussed.

Net cash provided by investing activities increased by approximately \$21.9 million in 2004 compared to 2003, primarily due to an increase in net proceeds received from mortgage sales, mortgage prepayments and redemption of debentures.

Net cash used in financing activities increased by approximately \$31.7 million in 2004 compared to 2003 due to an increase in the amount of distributions paid to partners in 2004 compared to 2003. The increase in distributions is the result of higher proceeds from mortgage sales and prepayments in 2004, as discussed above.

**Cash flow - 2003 compared to 2002**

Net cash provided by operating activities decreased by approximately \$2.0 million in 2003 compared to 2002 primarily due to a decrease in the receipt of interest previously accrued on mortgages awaiting assignment from HUD under the Section 221 program and a reduction in mortgage investment income.

Net cash provided by investing activities decreased by approximately \$10.6 million in 2003 compared to 2002, primarily due to decreases in net proceeds received from mortgage assignments, mortgage prepayments and redemption of debentures.

Net cash used in financing activities decreased by approximately \$7.4 million in 2003 compared to 2002 due to a reduction in the amount of distributions paid to partners in 2003 compared to 2002. The decrease in distributions is the result of lower proceeds from mortgage assignments and prepayments in 2003, as discussed above.

**Critical Accounting Policies**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Partnership continually evaluates the estimates used to prepare the financial statements, and updates those estimates as necessary. In general, management's estimates are based on historical experience, on information from third parties, and other various assumptions that are believed to be reasonable under the facts and circumstances. Actual results could differ materially from those estimates.

Management considers an accounting estimate to be critical if: