



INTERSTATE GENERAL COMPANY, L.P.

Audited Financial Statements for the Years Ended December 31, 2005 and 2004

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INTERSTATE GENERAL COMPANY, LP
AUDITED FINANCIAL STATEMENTS
FOR THE YEARS ENDED
DECEMBER 31, 2005 AND 2004

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Independent Auditor's Report

To the Partners

Interstate General Company, LP
Middleburg, Virginia

We have audited the accompanying Consolidated Balance Sheets of **Interstate General Company, LP** (a Delaware limited partnership), **Interstate Waste Technologies, Inc.** and **Caribe Waste Technologies, Inc.** (collectively, the "Company") as of December 31, 2005 and 2004, and the related Consolidated Statements of Loss, Changes in Partners' Capital and Cash Flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As noted in Footnote 14, the Company is transitioning its' business into developing waste to energy projects. These projects require significant amounts of capital and government approvals. To date, the Company has not finalized negotiations with the public utility on the power purchase agreement. Also, the Company's immediate cash flow is contingent upon the sale of approximately 68 acres of land under the purchase agreement as noted in Footnote 13. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 14. Furthermore, as discussed in Note 3, certain waste technology costs have been capitalized with recovery dependent upon future revenues from the construction and operation of a waste disposal plant. Realization of the carrying amount of these assets is dependent on the success of the Company's future operations and its ability to raise capital for the project. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.



ARONSON & COMPANY
Rockville, Maryland
October 3, 2006

INTERSTATE GENERAL COMPANY, LP
CONSOLIDATED STATEMENTS OF LOSS
(In thousands, except per unit amounts)

	YEARS ENDED DECEMBER 31,	
	2005	2004
Revenues		
Land sales	\$ 1,671	\$ 4,128
Gain on Brandywine land sales	1,225	0
Interest income	240	59
Gain on land remediation transfer	199	0
Other income	17	5
Total revenues	3,352	4,192
Expenses		
Cost of land sales	798	3,213
General and administrative	1,910	2,035
Interest expense	910	671
Depreciation and amortization	176	229
Wetlands expense	5	685
Waste project expense	106	125
Total expenses	3,905	6,958
Net loss	\$ (553)	\$ (2,766)
Net Loss		
General Partners	\$ (6)	\$ (28)
Limited Partners	(547)	(2,738)
	\$ (553)	\$ (2,766)

The accompanying notes are an integral part of these consolidated financial statements.

INTERSTATE GENERAL COMPANY, LP
CONSOLIDATED BALANCE SHEETS
(In thousands)

ASSETS

	DECEMBER 31,	
	2005	2004
Cash and Cash Equivalents		
Unrestricted	\$ 18	\$ 9
Restricted	651	207
	<u>669</u>	<u>216</u>
Assets Related to Waste Technology Projects		
Deferred costs	7,017	6,372
Property, plant and equipment less accumulated depreciation of \$248 and \$240 as of December 31, 2005 and 2004, respectively	147	154
	<u>7,164</u>	<u>6,526</u>
Assets Related to Land Development		
Land and development costs - St. Charles, Maryland	7,498	8,388
Accounts receivable and other assets	16	118
Note receivable IBC - sale of SCA	1,768	3,827
	<u>9,282</u>	<u>12,333</u>
Receivables and Other Assets		
Receivables, deposits and prepaid expenses	74	250
Property, plant and equipment, less accumulated depreciation of \$149 and \$140 as of December 31, 2005 and 2004, respectively	30	28
	<u>104</u>	<u>278</u>
Total Assets	<u>\$ 17,219</u>	<u>\$ 19,353</u>

The accompanying notes are an integral part of these consolidated financial statements.

INTERSTATE GENERAL COMPANY, LP
CONSOLIDATED BALANCE SHEETS

(In thousands)

LIABILITIES AND PARTNERS' CAPITAL

	DECEMBER 31,	
	2005	2004
Liabilities Related to Waste Technology Projects		
Accounts payable and accrued liabilities	\$ 1,038	\$ 751
Mortgage	146	155
	1,184	906
Liabilities Related to Land Development		
Wetlands remediation and accrued penalties	9	607
Road reimbursement accrual	150	150
Accounts payable, accrued liabilities and other liabilities	647	505
Deferred revenue from sale of partnership interest to affiliate	3,161	4,386
Loans payable land development	7,938	8,146
	11,905	13,794
Liabilities Related to Discontinued Operations		
Accounts payable and accrued liabilities	-	2
Reserve for completing discontinued operations	-	43
	-	45
Other Liabilities		
Accounts payable and accrued liabilities	1,291	1,215
Due to managing general partner, Interstate General Management Corporation ("IGMC")	76	77
	1,367	1,292
Total Liabilities	14,456	16,037
Commitments and Contingencies		
Partners' Capital		
General partners' capital	3,918	3,924
Limited partners' capital; 2,104 Class A Units issued and outstanding as of December 31, 2005 and 2004	(1,155)	(608)
Total partner's capital	2,763	3,316
Total Liabilities and Partners' Capital	\$ 17,219	\$ 19,353

The accompanying notes are an integral part of these consolidated financial statements.

INTERSTATE GENERAL COMPANY, LP
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' CAPITAL
YEARS ENDED DECEMBER 31, 2005 and 2004
(In thousands)

	General Partners' Capital	Limited Partners' Capital	Total
BALANCES, December 31, 2003	\$ 3,952	\$ 2,130	\$ 6,082
Net Loss	(28)	(2,738)	(2,766)
BALANCES, December 31, 2004	\$ 3,924	\$ (608)	\$ 3,316
Net Loss	(6)	(547)	(553)
BALANCES, December 31, 2005	<u>\$ 3,918</u>	<u>\$ (1,155)</u>	<u>\$ 2,763</u>

The accompanying notes are an integral part of these consolidated financial statements.

INTERSTATE GENERAL COMPANY, LP
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	YEARS ENDED DECEMBER 31,	
	2005	2004
Cash Flows from Operating Activities		
Net loss	\$ (553)	\$ (2,766)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Decrease (increase) in operating assets:		
Depreciation and amortization	176	229
Land and development costs – St. Charles, Maryland	434	13,027
Gain on land remediation transfer	(199)	-
Deferred costs	(645)	(656)
Restricted cash	(444)	(60)
Accounts receivable and other assets	109	367
Note receivable – Sale of SCA	2,059	(3,827)
Increase/(decrease) in operating liabilities:		
Accounts payable, accrued expenses and other liabilities	518	(128)
Deposit on land sale contract	-	(250)
Deferred revenue from sale of partnership interest to affiliate	(1,225)	4,386
Net cash provided by operating activities	230	10,322
Cash Flows from Financing Activities		
Cash proceeds from debt financing	2,469	12,348
Payment of debt	(2,688)	(22,574)
Payment of loan fees	(2)	(207)
Net cash used in financing activities	(221)	(10,433)
Net Change in Cash and Cash Equivalents	9	(111)
Cash and Cash Equivalents, Beginning of Year	9	120
Cash and Cash Equivalents, End of Year	\$ 18	\$ 9
Supplemental Disclosures:		
Interest paid	\$ 901	\$ 1,576
Income taxes paid	\$ 0	\$ 0
Non-cash investing and financing transactions:		
Reduction of note receivable for overhead expenses paid by affiliate (including interest)	\$ 1,143	\$ 1,625

The accompanying notes are an integral part of these consolidated financial statements.

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

(1) BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Interstate General Company, LP ("IGC", "the Company") was formed as a Delaware limited partnership in September 1986. Directly and through predecessors, the Company has been engaged in business since 1957. IGC's headquarters are located in Middleburg, Virginia. IGC traded publicly as a master limited partnership from February 1987 until December 28, 2004 on the American and Pacific Stock Exchanges. The Company's units were delisted in December 2004. Interstate Business Corporation and Interstate General Management Corporation are the General Partners of the Company. IBC holds a .6667% general partner interest and IGMC holds a .3333% general partner interest, IGMC is the Managing General Partner of IGC.

Historically, the Company has been engaged in two primary lines of business. First, the Company develops residential and commercial land. Second, through its affiliates, Interstate Waste Technologies ("IWT") and Caribe Waste Technologies ("CWT"), the Company is engaged in the development of waste-recycling projects that use an environmentally superior technology.

IGC owns the following assets: Land zoned commercial in St. Charles, Maryland. On October 11, 2004, the Company sold land under development in Brandywine, Maryland to IBC. In addition, all of the outstanding shares of stock of Interstate Waste Technologies ("IWT") and Caribe Waste Technologies ("CWT"), excluding shares issued in 1998 as incentive compensation to four key employees, are held in the IWT/CWT Trust ("the Trust") for the benefit of IGC's unit holders.

IGC's business plan since 1998 has been to sell its real estate assets to fund the start-up and success of IWT/CWT. In December, 2005 the Company's management and Board elected to recapitalize IWT/CWT with all of the assets of IGC (see footnote 14). The Company is currently liquidating the real estate assets to fund the waste-recycling projects.

(A) Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of IGC and its majority-owned and controlled partnerships, affiliates, and subsidiaries, after eliminating all inter-company transactions. All of the entities included in the consolidated financial statements are hereinafter referred to collectively as the "Company" or "IGC". The consolidated group includes IGC, American Family Homes, LLC ("AFH"), St. Charles Operating Company, LLC ("SCO"), IWT, CWT, and various inactive entities.

(B) Sales and Profit Recognition:

Sales revenues and profits from land sales activities are recognized at settlement and only when sufficient down payments have been obtained, possession and other attributes of ownership have been transferred to the buyer, and the Company has no significant continuing involvement, as stipulated under Financial Accounting Standards Board ("FASB") Statement No. 66, "Accounting for Sales of Real Estate."

(C) Profit recognition on Land Sales to Affiliates:

Profits on sale transactions with related parties are not recognized until the affiliate has sold the asset to outside parties as stipulated under FASB Statement No. 66 (Accounting for Sales of Real Estate).

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

(D) Cash and Cash Equivalents:

Cash and cash equivalents include cash on hand, unrestricted deposits with financial institutions, and short-term investments with original maturities of three months or less. During the year the Company maintained cash accounts that exceeded federally insured limits. Management does not believe that this results in any significant credit risk.

The Company classifies the following as restricted cash: remediation, tax, and site escrow accounts on deposit with lenders, funds in escrow for final subdivision work, and amounts received from lenders on development draw requests for payment of certified invoices.

(E) Deferred Waste Project Costs

The Company capitalizes the direct costs of procuring waste-recycling projects after achieving specific project-related milestones, and when management believes the costs are probable of being realized. All other project development costs are expensed as incurred.

For competitive procurements, costs of preparation and submission of the bid are expensed. When a competitive procurement is won, all subsequent costs through financial close and commencement of construction are capitalized, including contract negotiation as well as permitting and engineering costs.

Financial close refers to the date the Company receives all proceeds and commitments necessary to pay for the financing, development, design, construction, and start-up of the facility from the parties providing the financing.

For projects that are not subject to competitive procurements, the costs of obtaining each project are expensed until such time as certain project-related milestones are achieved. These milestones will vary from project to project depending upon the political jurisdictions involved. The costs are capitalized when management believes it has obtained sufficient assurances from the contracting jurisdictions that the project is more likely than not to proceed. At such a point, all subsequent costs through financial close and commencement of construction are capitalized, including contract negotiation as well as permitting and engineering costs.

To date, there has not been a financial close on any of the Company's waste-recycling projects.

All capitalized costs are evaluated for impairment at each reporting period. If the Company no longer believes the prospects of developing a project are probable, capitalized costs relating to that project are written off.

At December 31, 2005 and 2004, cost of approximately \$7,017,000 and \$6,372,000, respectively, have been capitalized relating to the waste-recycling project in Puerto Rico. The recovery is dependent upon future revenues from the operation of the waste-recycling plant.

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

(F) Accounts Receivable and Concentrations of Credit Risk

Accounts receivable are stated as the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectibility of specific customer accounts: customer credit worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. At December 31, 2005 and 2004, no allowance was considered necessary.

(G) Land Development:

Land Development costs consist of land owned and under development which are stated at the lower of accumulated cost or net realizable value. Interest costs incurred are capitalized only during the development period. The Company capitalized interest of \$708,000 for the year ended December 31, 2004. No interest was capitalized for the year ended December 31, 2005.

(H) Impairment of Long-Lived Assets:

The Company reviews land and development costs and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. An asset is considered impaired if its carrying amount exceeds the future net undiscounted cash flows that the asset is expected to generate. If such asset is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset, if any, exceeds its fair value.

(I) Financing and Related Loan Fees:

Financing and loan fees are amortized over the term of the loans using the straight-line method. Amortization of these fees is expensed over the life of the loan. Loan extension fees, if applicable, are amortized as an expense over the extension period.

For the year ended December 31, 2004, the Company incurred \$206,003 in financing fees for the First Bank and Trust Company of Illinois debt. In addition, the Company incurred loan extension fees on Washington Savings Bank debt. These extensions fees totaled \$1,300 and \$1,000 for the year ended December 31, 2005 and 2004, respectively.

For the year ended December 31, 2005, the Company incurred \$1,350 in loan extension fees for the M&T Bank debt. These costs are being amortized as an expense over the six-month extension period.

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

(J) Income Taxes

IGC and its controlled partnerships are not subject to U.S. taxes because they are organized as partnerships. Accordingly, these financial statements do not contain any provision for Federal or state income taxes relating to activities that are conducted through entities organized as partnerships.

IWT and CWT are organized as Delaware and Puerto Rico corporations respectively, and as a result, are subject to corporate income taxes.

All Federal and state income tax liabilities and/or tax benefits of IGC and its controlled partnerships are passed through to the individual partners in accordance with the Partnership Agreements and the Internal Revenue Code. While IWT and CWT are subject to Federal and state income taxes, respectively, neither has current income and each has a net operating loss carry-forward available as a deduction against future income.

(K) Depreciation and Amortization

Property, plant and equipment are recorded at cost. Buildings are depreciated over 35 to 40 years using the straight-line method. Furniture, fixtures and equipment are depreciated over four to seven years using the straight-line method. Deferred expenses are amortized over the period of estimated benefit using the straight-line method.

(L) Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" during 1996. The Company has elected to continue to measure compensation costs using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and therefore the adoption of this Statement did not have any effect on the financial results of the Company (see Note 8). Compensation expense, related to Unit options issued to directors and employees, is recognized at the time the options are granted in an amount equal to the excess of the currently calculated trading value of the Units over the option exercise price.

Compensation expense related to Unit Appreciation Rights ("Rights") is recognized quarterly on a cumulative basis since the issuance of the Rights is based on changes in Unit prices compared to the "strike" price of the Rights.

(M) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

(2) DISCONTINUED OPERATIONS

Effective November 13, 2000, IGC's Board of Directors adopted a plan to wind down and cease American Family Homes, LLC's ("AFH") operations following completion of the 30 homes then under construction. At December 31, 2000, the Company estimated that it would incur a loss of approximately \$700,000 as a result of closing down AFH. The estimate included projected costs to complete the remaining homes, as well as operating costs during that period, along with remaining lease costs the Company was obligated to pay. Through December 31, 2005, \$657,000 was incurred to close-out AFH. The remaining accrual of approximately \$43K was reversed at December 31, 2005 and is reflected in the other income on the consolidated statement of loss. The Company will no longer report the segment as discontinued operations. The Company does not expect any future expenses.

(3) INVESTMENT IN WASTE TECHNOLOGY PROJECTS

In 1990, IGC formed IWT to develop innovative solutions for the disposal of municipal waste and to pursue waste-recycling contracts with municipalities and government entities, as well as industrial and commercial waste generators.

In 1996, a second affiliate, CWT, was formed in Puerto Rico. CWT was established to perform waste-recycling projects in the Caribbean.

IWT/CWT's business plan is to develop and own waste-recycling projects using an environmentally superior technology licensed from Thermoselect S.A., a Swiss company. IWT/CWT has the right to develop projects using the Thermoselect technology in North and South America and for selected other projects worldwide. Typically, IWT/CWT and its alliance members offer to finance, build, own, and operate a plant for 25 or 30 years. Current alliance members include the technology provider, Thermoselect, the designer, HDR, the contractor, H. B. Zachary, and the operator, a subsidiary of Veolia Environment, one of the world's most experienced waste plant operators.

A description of the various IWT/CWT development activities follows:

Puerto Rico

In December 1998, CWT entered into a Host Community and Sponsor Agreement with the Municipality of Caguas, Puerto Rico. The agreement described the basis on which CWT would enter into a contract to develop and own a Thermoselect facility to process waste from the metropolitan San Juan, Puerto Rico area. On February 28, 2002 the Municipality of Caguas signed an extension to the Host Community Agreement. On April 4, 2003, Caguas filed a petition with the Solid Waste Management Authority to approve the project. On January 15, 2004, the Municipality of San Juan signed a Letter of Intent with the Company to become a project sponsor and to negotiate project sponsor and waste processing agreements. On March 8, 2004, the Puerto Rico Electric Power Authority confirmed that it would negotiate a power purchase agreement with CWT as required by the Public Utility Regulatory Policies Act.

CWT has reached agreement with Caguas, its sponsoring municipality, on a waste processing agreement. The agreement provides that Caguas shall deliver an agreed amount of waste for 30 years and pay a processing fee per ton which escalates over the 30-year term. Signature of the agreement is expected soon. This will be the model contract used in negotiations with other municipalities. A number of meetings have been held among the private sponsor, government officials and the government's

INTERSTATE GENERAL COMPANY LP
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YEARS ENDED DECEMBER 31, 2005 AND 2004

electric utility to conclude a power purchase agreement. Management believes that an acceptable agreement will be reached shortly.

(4) DEBT

As of December 31, 2005, assets with a book value of approximately \$7,622,000 were encumbered by approximately \$8,084,000 of recourse debt. The significant terms of IGC's recourse debt financing are shown below. The debt is collateralized primarily by land and land improvements. Other outstanding debt that matured in 2006 or was paid off is shown in Note 13.

The following paragraphs summarize the indebtedness of the Company for its land development loans for land in St. Charles, Maryland:

First Bank and Trust Company of Illinois ("FB&T")

In September 2004, FB&T provided a real estate loan with a principal amount of \$7.740 million in the form of repayment to the previous lender, Collateral Mortgage Capital LLC. At closing, the lender required payment of a \$132,000 loan origination fee. The loan term is 18 months and the interest rate is prime plus 4.5%, with a floor of 8.5%. The loan provides an interest and tax reserve account totaling \$1,060,000, from which interest and taxes will be advanced by the lender on a monthly basis, to pay these specific items over the term of the loan. As land sales occur, the lender requires that an exit fee (additional interest) ranging from one to two percent be paid with each principal repayment.

The loan is secured by a first deed of trust on all of the St. Charles land except for a few small parcels and open spaces. The borrower on the loan is IGC. IBC is the guarantor. Additional collateral was posted by IBC in the form of pledged stock. The stock had a value at the time of closing of approximately \$3.5 million. In addition, IGC and IBC must maintain an aggregate net worth of \$40 million and liquidity of \$4 million, inclusive of the stock pledge under the loan, each as determined by the lender. The loan requires that the pledged stock value exceed \$3.5 million.

In December, 2005, the interest and tax reserve was depleted. The lender allowed the Company to use land sale proceeds to replenish this reserve account in the approximate amount of \$547,000. As of December 31, 2005, the reserve account balance is approximately \$532,000. This reserve account has been accounted for in the accompanying financial statements as part of the restricted cash and cash equivalents balance shown on the consolidated balance sheet.

The loan balance at December 31, 2005 and 2004 was approximately \$7,738,000 and \$7,946,000, respectively. The loan matured on March 23, 2006 and was refinanced with Mercantile Southern Maryland Bank.

Mercantile Southern Maryland Bank ("Mercantile")

Subsequent to year end, the FB&T loan matured and was refinanced through Mercantile. The new loan totals \$7.950 million and the interest rate is at prime. Monthly interest payments are paid automatically from an interest reserve account that was established with the lender shortly after closing.

The loan is secured by land in St. Charles, Maryland known as Lots 1, 2, 3, 4, 5 and II at Towne Center South and Parcel F-9. The loan is also secured by an assignment of the land sales agreement

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

contract between IGC and the contract purchaser of Towne Center South lots 1-5, as described in Note 14. The loan is formally guaranteed by St. Charles Operating Company, LLC, the land owner, Wilson Securities Corporation, and personally by both James J. Wilson and J. Michael Wilson. The loan matures March, 23, 2007.

Washington Savings Bank (“WSB”)

In May 2003, the Company borrowed \$200,000 from the WSB for operating cash and preliminary development funds. The loan is secured by a first deed of trust on a 3/4-acre parcel located in St. Charles, Maryland, known as D4. The loan is guaranteed by IBC and WSC, an IBC affiliate. Monthly interest payments are required at 10.5%.

The loan balance at December 31, 2005 and 2004 was \$200,000 for both years. Subsequent to the year-end, Parcel D4 was sold for \$350,000 and the debt was repaid.

M&T Bank (“M&T”)

In May 1990, the Company borrowed approximately \$227,000 from M&T for an office building located in Malvern, Pennsylvania. The mortgage loan required monthly principal and interest payments of approximately \$1,818.

The loan balance at December 31, 2005 and 2004 was approximately \$146,000 and \$155,000, respectively.

Subsequent to year end, the building was sold for \$330,000 and the remaining principal balance of approximately \$146,000 was repaid. The Company entered a leaseback agreement with the new owner for a 1-year term with 2 additional 1-year options. Sale-leaseback agreements are treated as single financing transactions and the profit on the sale of approximately \$160,000 will be deferred and amortized over the life of the lease as an adjustment to the monthly rental, as stipulated in FASB No. 28 “Accounting for Sales with Leasebacks”.

Loan interest costs incurred during 2005 and 2004 were accounted for as follows (in thousands):

	2005	2004
Expensed	\$ 910	\$ 671
Capitalized	-	708
	\$ 910	\$ 1,379

(5) LEGAL PROCEEDINGS

Wetlands litigation was commenced by the United States Government in 1996 against the Company, its affiliates, SCA, and James J. Wilson. In November 1999, the Company pled guilty to a single violation of the CWA, and the Company and its affiliate, SCA, entered into a consent decree whereby the civil complaint by the government against them for alleged violations of the CWA was dismissed. Pursuant to the Consent Decree, the Company and SCA paid a civil penalty of \$1,360,000, placed \$40,000 in escrow to pay for certain remediation costs in the Dorchester neighborhood of St.

INTERSTATE GENERAL COMPANY LP
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Charles (referred to as "Dorchester and Parcel Q"), and agreed to complete, within 24 months, a remediation plan covering certain land in Towne Center South and in Parcel L, another location in St. Charles.

Following the entry of the Consent Decree in 1999, remediation pursuant to an agreed plan began in 2000 in conjunction with the development of the Company's Towne Center South property. In March 2001, the Company and SCA sought to set aside the Company's criminal conviction and to vacate the Consent Decree entered in 1999. Work was suspended when the Company filed its motion seeking to vacate the Consent Decree. On June 12, 2001, the District Court denied defendants' requests. The Court subsequently stayed the time limits for carrying out the Consent Decree. Under the stay, time limits were suspended for a period not to exceed 15 months from a final judicial determination of the matters on appeal. Pending the stay, the Company was prohibited from the development or sale of any parcel at Towne Center South other than one 30-acre parcel. On July 2, 2002, the United States Court of Appeals for the Fourth Circuit affirmed the decision of the District Court that has now become final, allowing the Company to proceed with the sale or development of approximately 80 acres of commercial land in St. Charles' Towne Center South. The Company was obligated to complete the previously ordered restoration by January 2, 2004. The status of this obligation is addressed in the following paragraphs.

In July 2003, the Company entered into a contract for the required work at Towne Center South and Parcel L, a one-acre parcel of land in St. Charles. Work commenced in late July. The contract was guaranteed by IBC, the Company's general partner. The contract provided for cash payments plus the transfer to the contractor of a three-acre parcel at Towne Center South. As of this filing, the contractor has completed the work, been transferred a three-acre parcel of land, and is due a cash payment of approximately \$41,000. This obligation is included in the accompanying financial statements under the liabilities related to land development/accounts payable.

The remediation was not completed by January 2, 2004, making the Company liable for fines of \$1,000 per day for the first 30 days of non-compliance, \$2,000 per day for days 31 through 60, and \$3,000 per day thereafter plus other possible penalties. The Company accrued fines of approximately \$492,000 through July 14, 2004 and penalties of approximately \$14,000. The Government took the position that the fines continued to run until September, 2004 when an escrow agreement was signed and the Company deposited \$100,000 in escrow to pay the cost of certain reseeding and planting of vegetation called for by the Consent Decree. The estimated difference in the penalties and interest between July 2004 and September 2004 was not accrued by the Company. The Company and the Government subsequently agreed to a compromise whereby SCO, the owner of Town Center South, granted a conservation easement in four small parcels of land totaling two acres to the Conservancy for Charles County, Inc., and paid for the installation of a chain link fence extending some 6,000 feet on the conservation easement parcel adjacent to the developable property at the Town Center South site. The cost of the fence was approximately \$125,000. The book basis of the two acres of land granted was \$182,000 prior to recordation of the easement. The net effect of the land write-off, cost of fencing, and accrued penalty offset of approximately \$199,000 is reflected in the accompanying financial statements under gain on land remediation transfer. In addition, IBC agreed to pay the additional cost, if any, of replacement plantings and seeding for the next three growing seasons to ensure 85% survival and 85% coverage as required by the Consent Decree. In consideration of the foregoing, the Government agreed to request that the Court terminate the Consent Decree, including waiving the assessed penalty. On March 6, 2006, the Court granted a joint motion of the parties to this effect.

INTERSTATE GENERAL COMPANY LP
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

The following table reflects the calculation used to arrive at the gain reflected in these financial statements.

	Approximate Amounts
Remediation penalty	\$506,000
Less: cost of fencing	(125,000)
Less: land basis	<u>(182,000)</u>
Gain on transfer of land	\$199,000

The Company is also involved from time to time in other miscellaneous legal matters that arise in the normal course of business. In Management's opinion, none of the actions is of such a degree whereby there would be a material adverse impact on the financial condition or results of operations of the Company.

(6) OPERATING LEASES

The Company leases office facilities under two long-term operating leases that expire in 2007 and 2010. The leases require minimum annual rental payments plus additional amounts based upon future increases in property taxes, building operating expenses and adjustments to the Consumer Price Index.

The lease expiring in 2007 contains one three-year renewal option. The lease expiring in 2010 contains one remaining five-year renewal option. The Company exercised the first five-year renewal on July 24, 2002.

The following is a schedule of future minimum rental payments required under the leases described above as of December 31, 2005:

<u>Year Ending December 31,</u>	<u>Operating Leases</u>
2006	\$ 60,000
2007	49,300
2008	14,100
2009	14,100
2010	<u>9,400</u>
Total minimum lease payments	<u>\$ 146,900</u>

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(7) RELATED PARTY TRANSACTIONS

Certain officers, directors, and a general partner of the Company, IBC, have ownership interests in various entities that conducted business with IGC during the last two years. The financial impact of the related party transactions on the accompanying consolidated financial statements are reflected below:

INCOME STATEMENT IMPACT (In Thousands):	Year Ended December 31,	
	2005	2004
<u>Interest Income</u>		
IBC, general partner of IGC	(A1) \$ 238	\$ 52
	<u>\$ 238</u>	<u>\$ 52</u>
<u>General and Administrative Expense</u>		
IBC, general partner of IGC for miscellaneous	(A2) \$ 4	\$ 4
Smallwood Village Associates, LP ("SVA"), affiliate of IBC, for rent	(A3) 16	15
American Rental Management Company ("ARMC"), subsidiary of ACPT, for support and other services	(A4) -	1
IBC, consulting fee	(A5) (40)	(7)
Equus Gaming Company, LP ("Equus"), affiliate of IBC, consulting fee	(A6) (278)	(219)
ARMC, subsidiary of ACPT, consulting fee	(A7) (200)	(200)
	<u>\$ (498)</u>	<u>\$ (406)</u>
<u>Interest Expense</u>		
IBC, general partner of IGC	(A8) \$ 31	\$ 89
	<u>\$ 31</u>	<u>\$ 89</u>

BALANCE SHEET IMPACT (In Thousands):	Balance	
	December 31, 2005	December 31, 2004
<u>Other Assets</u>		
Receivables:		
IBC, note receivable, sale of SCA partnership interest	(A1) \$ 1,768	\$ 3,827
Brandywine Investment Associates, LP ("BIA"), miscellaneous receivables	(A10) -	100
ARMC receivables, miscellaneous	(A4) 1	-
	<u>\$ 1,769</u>	<u>\$ 3,927</u>
<u>Other Liabilities</u>		
Advances, IBC, general partner of IGC	(A8) \$ -	\$ -
Accounts payable to IBC for miscellaneous	(A2) -	4
Accounts payable to SVA for rent	(A3) -	26
Advances, IGMC, IGC's managing general partner	(A9) 76	77
Deferred profit-sale of SCA partnership	(A11) 3,161	4,386
	<u>\$ 3,237</u>	<u>\$ 4,493</u>

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(A) Transactions with related parties are as follows:

- (1) In October 2004, the Company sold its partnership interest in SCA to IBC. The purchase price was \$5.4 million. IBC provided a \$1.2M deposit in the form of a credit to the working capital agreement and IGC took a note receivable for the balance of \$4.2 million, ("Note Receivable - Sale of SCA Partnership"). Interest is charged at prime plus 1% and accrues until paid. Interest charged through December 31, 2005 and 2004 totaled approximately \$238,000 and \$52,000 respectively.

For the years ending December 31, 2005 and 2004, IGC collected repayments and applied cash and credits against the working capital advances from IBC of approximately \$2,297,000 and \$1,625,000, respectively. These amounts include payments of accrued interest and the initial deposit noted above.

The note receivable balance at December 31, 2005 and 2004 is approximately \$1,768,000 and \$3,827,000, respectively.

- (2) IGC incurs shared expenses with IBC for office supplies and services. For the year ended December 31, 2005, IGC has incurred approximately \$4,000 of expenses. For the same period in 2004, the amount of expenses totaled approximately \$4,000. The balances owed from and due to IBC at December 31, 2005 for these expenses were used to reduce or increase the advances under the Working Capital Support Agreement.
- (3) IGC rents office space from SVA, an affiliate of IBC, at prevailing market rental rates. The balance owed as of December 31, 2005 and 2004 was approximately \$0 and \$26,000, respectively. On December 31, 2005, IBC agreed to apply the \$42,000 in rents due SVA from IGC as advances under the IBC-IGC Working Capital Support Agreement.
- (4) ARMC, an affiliate of ACPT, provides IGC with miscellaneous photocopy, postage, and delivery services on a cost reimbursement basis. These services totaled approximately \$220 and \$650 for the years ended December 31, 2005 and 2004, respectively.
- IGC incurred costs during 2003 relating to a change of address and phone number. The costs associated with these changes are being offset against future amounts billed by ARMC. As of December 31, 2005, IGC holds a credit balance of approximately \$750.
- (5) IGC provides IBC on a monthly basis, miscellaneous accounting and real estate support services. The salary and benefits related to these services is allocated to IBC on a monthly basis, based on the percentage of time spent.

As part of the Company's Working Capital Support Agreement with IBC, any amounts due at the end of each quarter are used to reduce advances under the agreement. For the years ended December 31, 2005 and 2004, IBC was charged \$40,000 and \$7,000, respectively. All amounts for both years were applied against the agreement.

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- (6) James J. Wilson provides consulting services on a monthly basis to Equus. The salary and benefits related to these services is allocated to Equus on a quarterly basis, based on the percentage of time Mr. Wilson spends on Equus matters.

As part of the Company's Working Capital Support Agreement with IBC, any amounts due at the end of each quarter are used to reduce advances under the agreement. For the years ended December 31, 2005 and 2004, Equus was charged \$278,000 and \$219,000, respectively. All amounts for both years were assumed by IBC and applied against the agreement.

- (7) In October 1998, James J. Wilson entered into a consulting agreement with ARMC, a subsidiary of ACPT, providing for an annual consulting fee of \$500,000 per year for a two-year period, then \$200,000 per year for an eight-year period. Mr. Wilson's consulting fee is paid directly to IGC, which in turn, pays Mr. Wilson, crediting the amount against IGC's salary obligation to Mr. Wilson.

- (8) Historically, the Company has had various forms of working capital support agreements with IBC. The most recent agreement, dated September 1, 2002, is an Amended and Restated Working Capital Support Agreement, whereby loans are made to IGC in the form of promissory notes. Interest is charged at prime plus 1% and accrues until paid.

The agreement states that IGC shall repay to IBC, 1) the balance of funds available from waste projects, after deducting reasonable reserves for operating needs, or 2) proceeds from real estate sales, provided there are sufficient funds available, and subject to the discretion of the IGC Board of Directors.

Effective December 31, 2004 IBC and IGC agreed to a First Amendment to the Amended and Restated Working Capital Support Agreement whereby an offset provision was added allowing IBC to offset any working capital advances made to IGC against the Note Receivable – Sale of SCA Partnership interest balance owed to IGC. Offsets are made on the last day of each calendar quarter. Therefore, there was no Working Capital Support Agreement balance due at December 31, 2005 and 2004.

- (9) The Company advances funds to IGMC, its managing general partner, to pay for miscellaneous expenses such as annual filing fees.
- (10) The Company advanced \$110,000 to the SCA partnership for loan closing costs associated with the refinancing of the M & T Bank loan. The Company collected approximately \$10,000 by December 31, 2004 and the remaining balance of \$100,000 was collected in February, 2005.
- (11) The Company accrued a deferred profit of approximately \$4.4 million from its sale of the SCA partnership and Brandywine project investment. Revenue will be recognized as land sales occur to unrelated third parties at the Brandywine project, which was previously owned by the Company, and sold to IBC, a related party. During 2005, the Company recognized revenue of approximately \$1,225,000. No revenue was recognized during 2004.

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(8) OPTIONS, APPRECIATION RIGHTS, AND WARRANTS

IGC maintains Unit incentive plans for directors (the "Directors' Plan") and employees (the "Employees' Plan"). These plans were amended in 1994 and 1995 to allow for the issuance of Unit Appreciation Rights and other incentive awards.

The Directors' Plan is for directors of the managing general partner who are not officers or employees of the Company or of any General Partner or affiliate of the Company. The Directors' Plan was amended, restated, and adopted by the Company's Board of Directors during 2002.

The Employees' Plan is for employees of IGC (some of whom may now be current employees of ACPT), including employees who are Directors of any general partner of IGC or of any affiliate of IGC. The Employees' Plan expired on September 22, 1997, and the remaining reserved IGC units will now be issued to individual employees as needed.

Under the terms of the plans, directors and employees may be granted options, incentive rights, or other Unit-based awards as determined by a committee of the directors of the managing general partner, which excludes directors who are eligible to participate in that particular plan ("Committee".)

There has been no activity under the Directors' Plan for the years ended December 31, 2005 and 2004.

As of December 31, 2005, there are 8,452 and 11,824 IGC Class A Units available for issuance under both the Directors' Plan and former Employees' Plan, respectively. These units are held by the Company's transfer agent.

Options

As of December 31, 2002, all recorded option contracts were fulfilled.

Appreciation Rights

Under the terms of the above plans, directors and employees may be granted "Unit Appreciation Rights" which entitle the holder to receive, upon vesting, an amount payable in cash, Class A Units of the Company, other property, or some combination thereof, as determined by the Committee. The amount received upon exercise on or after January 20, 1995, is based on the excess of the fair market value of the Company's Units on the exercise date, plus, for rights granted prior to 1995, 50% of the fair market value of Equus Units on the exercise date, over the base price of the Unit Appreciation Rights specified in the individual rights agreements or individual employment agreements. Fair market value is defined in each individual rights agreement but is generally the average of the closing prices of Units on the principal exchange on which they are traded for the 20 trading days beginning ten trading days before the exercise date and ending on the ninth day after the exercise date. No adjustment was made for Unit Appreciation Rights exercised prior to January 20, 1995, since prior to this date, the Company's market price still reflected the value of its interest in Equus, which was spun off at that time. The number of stock appreciation rights outstanding, that were exercisable, but not exercised prior to October 19, 1998, was reduced as a result of a one (1) for five (5) reverse unit split. The number of stock appreciation rights outstanding after the reverse split was 21,300. These rights were granted to some of the Company's prior employees, who are now employees of ACPT, a non-combined affiliate.

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The following chart summarizes activity of appreciation rights during 2004 and 2005.

	<u>Number of Rights</u>	<u>Weighted Average Exercise Price</u>	<u>Vesting Percentage</u>	<u>Expiration Date</u>
Outstanding at January 1, 2004:				
Granted - May 15, 1994	11,300	\$ 3.71	100%	May 15, 2004
Granted - August 13, 1997	10,000	\$ 2.90	80%	August 13, 2007
	<u>21,300</u>			
Activity during 2004:				
Grants	-	\$ -	---	---
Cancellation - May 15, 2004	(11,300)	\$ 3.71	---	---
	<u>(11,300)</u>			
Outstanding at December 31, 2004:				
Granted - August 13, 1997	10,000	\$ 2.90	100%	August 13, 2007
Activity during 2005:				
Grants	-	\$ -	---	---
Forfeitures/Cancellations	-	\$ -	---	---
	<u>-</u>			
Outstanding at December 31, 2005:				
Granted - August 13, 1997	10,000	\$ 2.90	100%	August 13, 2007
Total	<u><u>10,000</u></u>			

Warrants

As of September 30, 2003, all warrants to purchase IGC units were either fulfilled or have expired.

(9) RETIREMENT AND PROFIT SHARING PLANS

IGC established a retirement plan (the "Retirement Plan") effective January 1, 1988 for non-union employees of IGC. In 1992, union employees were added to the plan. Employees are eligible to participate in the Retirement Plan when they meet eligibility requirements based on months of service. IGC's contributions to the Retirement Plan for eligible employees was equal to 5.7% of basic salaries and wages for 2005 and 2004 that were not in excess of the U.S. Social Security taxable wage base, plus 11.4% of salaries that exceeded the U.S. Social Security taxable wage base. Employees' salaries in excess of \$210,000 and \$205,000 for 2005 and 2004, respectively were excluded from the calculation of contributions. Additional contributions to the Retirement Plan can be made pursuant to the Profit Sharing Plan based on net income of the Company.

Contributions to the Retirement Plan were approximately \$70,000 and \$73,000 for the years ended December 31, 2005 and 2004, respectively. No additional contributions were made as a profit sharing contribution for 2005 or 2004.

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(10) INCOME TAXES

The consolidated financial statements of the Company include the accounts of IGC and its majority-owned and controlled partnerships, affiliates, and subsidiaries, after eliminating all inter-company transactions. IGC and its majority-controlled partnerships ("the partnerships") are treated as partnerships under applicable provisions of the tax code as described below. IWT and CWT are organized as C corporations. Their tax treatment is discussed below.

Entities Subject to Partnership Taxation Provisions

IGC is a partnership and accordingly is not subject to U.S. taxes. These financial statements do not contain any provision for Federal or state income taxes for 2005 or 2004 relating to IGC or its consolidated partnerships. All Federal and state income tax liability and/or tax benefits are passed through to the individual partners in accordance with the Partnership Agreement and the Internal Revenue Code.

IGC had been grand-fathered through 1997 as a non-tax paying public partnership. Such grand-fathering was based on guidelines outlined in the Omnibus Budget Reconciliation Act of 1987 allowing publicly traded partnerships existing as of December 17, 1987 not to be taxed as corporations as long as a substantial new line of business is not added. Beginning in 1998, however, IGC could be taxed as a corporation unless at least 90% of IGC's gross income is derived from qualifying "passive type" sources such as interest, dividends, and real property income. If IGC is not in compliance with the 90% test in any given taxable year, it will be taxed as a corporation at statutory corporate rates and those taxes could be substantial.

Entities Subject to Corporate Taxation Provisions

At December 31, 2005 IWT has net operating loss carry-forwards of approximately \$9,936,000, which are available to offset future taxable income through 2025, with various expirations, starting in 2011.

CWT is a Puerto Rico corporation subject to Puerto Rican income taxes. At December 31, 2005 CWT has net operating loss carry-forwards of approximately \$3,208,000, which are available to offset future taxable income through 2011, with various expirations.

Deferred income taxes arise primarily from net operating tax losses. The Company's deferred tax assets at December 31, 2005 and 2004 consist of:

	2005	2004
Deferred tax asset, net operating loss carry-forward	4,402,000	4,242,000
Valuation allowance	(4,402,000)	(4,242,000)
Net deferred tax asset	\$ -	\$ -

The Company provides a valuation allowance account for deferred tax assets that will most likely only be realized as the result of operations of waste-recycling projects that will be conducted via IWT and

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CWT. Until such time as contracts are signed and the Company proceeds to financial close for a project, the Company will provide an off-setting valuation allowance for the tax benefit relating to such operations.

(11) DELISTING OF IGC PARTNERSHIP UNITS

The Company's units were delisted by the American Stock Exchange and the Pacific Stock Exchange in late 2004 and early 2005, respectively, and are no longer traded on either exchange. Shortly thereafter, the Company filed a Form 15 with the Securities and Exchange Commission certifying to the suspension of its' duty to file reports with the SEC under relevant sections of the Securities Exchange Act of 1934.

(12) SALE OF ST. CHARLES ASSOCIATES LP IN OCTOBER 2004

In October 2004, the Company entered into an agreement with its affiliate, IBC, to sell the Company's interest in St. Charles Associates, LP ("SCA"), the general partner of BIA. BIA owns land under development in Brandywine, Maryland.

The sale price was \$5.4 million, plus 50 percent of IBC's general partner share of SCA's remaining cash. At closing, IGC received payment of \$1.2 million (included in the foregoing selling price) from IBC in the form of a credit against working capital advances previously made by IBC to IGC. The Company took a note receivable for the balance due at the time of sale of \$4.2 million. The note earns interest at prime plus 1%. Collections under the note are due as cash flow is available from the Brandywine project. As of December 31, 2005 and 2004, the balance of the note including interest is \$1,768,000 and \$3,827,000, respectively.

In return, the Company was released from more than \$7 million of indebtedness to Mercantile Mortgage Corporation. The proceeds of the transaction repaid to the Company about \$2.8 million previously advanced by the Company to SCA/BIA. The Company has no continuing obligation to advance funds to SCA or BIA. Future development costs for Brandywine, not funded under the development loan, are the obligation of IBC.

Sales revenues and profits from transactions with related parties are not recognized until settlement occurs with outside parties as stipulated under FASB No. 66 "Accounting for Sales of Real Estate". Therefore, the Company recorded a deferred profit of approximately \$4,386,000 at the time of the sale. As of December 31, 2005 the company recognized revenue of approximately \$1,225,000. No revenue was recognized during 2004.

(13) COMMITMENTS AND CONTINGENCIES

The Company has the following commitments and contingencies:

Real Estate Sale Agreement:

On July 21, 2005, the Company entered a sale agreement with an affiliate of a national real estate investment trust to sell approximately 68 acres of land in Towne Center South for \$16,000,000. The agreement called for due diligence period expiration on September 21, 2005 with an estimated (original) sale closing date of September 30, 2005. The agreement allows the purchaser to extend the closing date

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up to two times, each such extension not to exceed 30 days each. If the purchaser elects to extend the closing date, the purchase price at closing is increased by \$200,000 and the purchaser shall pay the Company a \$75,000 non-refundable extension fee for each 30 day extension. The \$75,000 shall be applied to the purchase price at closing.

In addition, the purchaser posted a \$500,000 earnest money deposit with the designated escrow agent. The purchase agreement requires certain approvals by the Charles County Government which the purchaser will seek at its sole cost and expense.

On September 19, 2005, the purchase agreement was amended to extend the due diligence period, require a cash deposit of \$25,000, increase the earnest money deposit by \$150,000, and outline specific development approvals and agreements upon which the agreement is contingent upon, among other things. This amendment included a provision for extension of the closing date up to six times in order to satisfy development conditions, each such extension not to exceed 30 days each.

The purchase agreement was amended on November 29, 2005 and December 9, 2005 to extend the due diligence period, increase the purchase price, confirm deposits and payments, increase the earnest money deposit, and incorporate certain matters related to development approvals and title matters.

Subsequent to year end on January 31, 2006, the agreement was amended to extend the due diligence period, extend the closing date, increase the purchase price, increase the earnest money deposit, and further clarify the development approval contingencies.

The purchaser exited the due diligence study period on March 14, 2006. The purchaser paid a \$300,000 nonrefundable deposit and a \$75,000 non-refundable extension fee and the purchase price increased to \$16,800,000 on that date. The purchaser could elect to extend closing for nine, 30-day periods each, by paying the \$75,000 non-refundable extension fee per month, to be credited against the purchase price at closing. The last 30-day extension under the agreement is October 10, 2006 with a final closing date of November 10, 2006. The purchase price on November 10, 2006 will be \$18,400,000.

The purchaser has received most of the required development approvals from Charles County, including a master plan amendment and site development plan approvals. The purchaser awaits approval on its developer rights agreement with the County. The agreement was held open for public comment until October 16, 2006. The County Commissioners can then approve the agreement. The Company and the purchaser await the County's approval.

Debt:

Historically, the Company has had various forms of Working Capital Support Agreements with IBC. The most recent agreement, dated September 1, 2002, is an Amended and Restated Working Capital Support Agreement, whereby loans are made to IGC and represented by promissory notes. Interest is charged at prime plus 1% and accrues until paid. Payments are first applied to unpaid interest and then to principal. IGC is to repay to IBC from 1) the balance of funds available from waste projects after deducting reasonable reserves for operating needs, or 2) proceeds from real estate sales, provided there are sufficient funds available, and subject to the discretion of IGC's Board of Directors.

Effective December 2004, IGC and IBC agreed that any amounts and balances that IGC owes to IBC will be offset against the note receivable balance due to IGC from IBC, from the sale of the SCA partnership. At December 31, 2005 and 2004, IGC owed IBC approximately \$1,143,000 and \$425,000,

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respectively for working capital advances. These amounts were offset against the note receivable on the last day of each year, respectively.

Guarantees:

The Company is guarantor of five (5) surety bonds amounting to approximately \$940,000 for land development completion and homebuilding warranties. In addition, the Company is still contingently liable on eight (8) surety bonds amounting to approximately \$977,000 related to certain land improvements in St. Charles, Maryland for properties that were transferred to ACPT in 1998 as part of the Distribution (see footnote 1). As part of this transfer, ACPT assumed responsibility for the bonds and their related liability. The Company does not expect these bonds to be called or to incur any liability relating to their release.

Legal:

In 2000, the owners of a parcel of land located in Charles County sued the Company and one of its officers in the Circuit Court for Charles County, Maryland (“Langley v. St. Charles Associates, et al”). The Circuit Court entered judgment in favor of the Company and its officer, and the landowners appealed that judgment to the Maryland Court of Special Appeals. While the appeal was pending, the parties entered into a final settlement agreement resolving all claims raised in the litigation. The owners therefore dismissed their appeal with prejudice on June 3, 2004.

Notice of Tax Penalty Assessment:

The Company received notice in February, 2006 of an imposition of fine by the Internal Revenue Service ("IRS") for failing to timely file its 2003 Form 1065 and failure to file electronically the associated Schedule K-1's. The Company filed a response with the IRS shortly thereafter seeking an abatement of the full penalty. On October 12, 2006, the IRS issued a letter to the Company stating it had removed the full failure to e-file and late filing penalties charged.

Virgin Islands Waste to Energy Project:

The government of the U.S. Virgin Islands conducted a competitive procurement and selected CWT in late 2000 as the preferred bidder to negotiate contracts for a two-line Thermoselect plant. Agreement with the government was reached on a waste-recycling contract in the summer of 2001, subject to satisfactory agreement with the Territory's electric utility for the purchase of power and possibly water. The utility took the position that CWT must be certified as a "qualifying facility" under Virgin Islands law before further negotiations could take place. CWT filed for certification with the Public Service Commission on December 4, 2001. An evidentiary hearing took place on March 18, 2002, and a ruling was issued on July 1, 2002, granting CWT certification. The utility appealed this administrative ruling in court. On September 23, 2003, the utility informed CWT that it was terminating contract negotiations and would issue an RFP for its power purchase requirements. In response, CWT informed the utility that it was required by law to purchase electricity from a "qualifying facility," and that it intended to pursue its legal remedies unless the utility complied. The utility refused. CWT filed a damages action in federal court. As of December 31, 2005 CWT remains in litigation with the electric utility. The delay caused by the electric utility will cause the Waste Management Authority to rebid the project.

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(14) SUBSEQUENT EVENTS

IGC's business plan since 1998 has been to sell its real estate assets to fund the start-up and success of IWT/CWT. IGC is no longer a publicly traded company. It was de-listed by the AMEX and PCX in December 2004. The Board and management have studied how to accomplish IGC's goal of successfully launching IWT/CWT in the most efficient, cost-effective manner.

In December 2005, the Company's management and Board elected to recapitalize IWT/CWT by a transfer, assignment and conveyance of all the assets and liabilities of IGC to IWT effective January 1, 2006. The Board and management concluded that it was in the unitholders' best interest to recapitalize IWT/CWT by combining IGC's assets and liabilities with IWT and terminate the IGC partnership. When complete, the transfer will reduce the administrative costs of IGC and strengthen IWT/CWT's financial qualifications to enable them to better compete for existing and new projects.

IWT is a Delaware corporation. CWT is a Puerto Rico corporation. IGC unitholders' interest is currently held by a Trust.

By a news release dated January 28, 2006, the Company announced to its unitholders that it has taken longer than management and the Company's Board of Directors expected to transition IWT/CWT from a development to an operating company. Early challenges with the technology and other factors delayed IWT/CWT project implementation. Therefore, the above recapitalization was implemented.

There is no assurance IWT/CWT will be successful. However, the Company believes there is a reasonable probability that the Puerto Rico project will go forward and that IWT/CWT will win additional projects. The Company believes there has been a positive change in the marketplace toward advanced conversion technologies and away from incinerators and landfills.