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Phone: 631-979-3141 | Fax: 631-979-3996

636 Veterans Memorial Highway | Hauppauge, NY 11788

[www.rosscompanycpa.com](http://www.rosscompanycpa.com) | [info@rosscompanycpa.com](mailto:info@rosscompanycpa.com)

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## VALUATION REPORT

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# Valuation of a General & Limited Partnership Interest in The Paul Jones Family Partnership, L.P. *(A New York Limited Partnership)*

Huntington, New York

*As of December 4, 2003*

Report Dated

September 14, 2004

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## **TABLE OF CONTENTS**

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*Important Notices*

*Section 1: Valuation Summary*

*Section 2: The Valuation Assignment*

*Section 3: The U.S. Economic Outlook*

*Section 4: The Industry Outlook*

*Section 5: Valuation Findings*

*Appendices*

*Appendix A: Professional Qualifications*

*Appendix B: Valuation Data*

*Appendix C: Certification and Conditions*

# Valuation Report For The Paul Jones Family Partnership, L.P.

## Detailed Table of Contents

<b>TABLE OF CONTENTS .....</b>	<b>2</b>
DETAILED TABLE OF CONTENTS .....	3
INDEX OF CHARTS AND TABLES .....	4
<b>IMPORTANT NOTICES .....</b>	<b>5</b>
COPYRIGHT .....	5
LIMITED COPYRIGHT LICENSE .....	5
TERMS AND CONDITIONS .....	5
<b>SECTION 1: VALUATION SUMMARY .....</b>	<b>6</b>
OWNERSHIP .....	7
THE VALUE OF A 1% GENERAL PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	7
THE VALUE OF A MINORITY INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	7
VALUATION ASSIGNMENT TERMS AND CONDITIONS .....	8
<b>SECTION 2: THE VALUATION ASSIGNMENT .....</b>	<b>9</b>
DESCRIPTION OF THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	9
OWNERSHIP .....	10
BUSINESS PURPOSE .....	10
<b>SECTION 3: THE U.S ECONOMIC OUTLOOK .....</b>	<b>11</b>
GENERAL OVERVIEW .....	11
ASSUMPTIONS AND THEIR IMPLICATIONS FOR THE FORECAST .....	12
<i>Fiscal Policy</i> .....	12
<i>The Presidential Election and Economic Performance</i> .....	13
<i>Monetary Policy</i> .....	13
<i>U.S. Population Characteristics</i> .....	14
<i>Commodity Prices</i> .....	15
<i>The Gross Domestic Product, the S&amp;P 500 and the Inflation Outlook</i> .....	16
<i>The Interest Rate Outlook</i> .....	18
<i>The Global Economy</i> .....	18
<i>The State of the Economy from the Business Owner Perspective</i> .....	19
<i>The State of the Consumer</i> .....	20
<i>The State of Capital Spending</i> .....	21
SUMMARY .....	22
<b>SECTION 4: COMMERCIAL REAL ESTATE OUTLOOK .....</b>	<b>23</b>
EMERGING TRENDS IN REAL ESTATE .....	23
STURDY PERFORMANCE CONTINUES .....	23
<i>Facing Facts</i> .....	24
<i>A Postponement Effect</i> .....	24
THE ECONOMY: CONCERN ABOUT JOB GROWTH .....	25
<i>Got a Job?</i> .....	25
<i>Overseas Outsourcing—A Thorny Issue</i> .....	25
<i>What Will Drive the Economy?</i> .....	26
<i>Interest Rates—A Slow Go</i> .....	27
<i>The Housing Market and Consumer Credit—Keep Your Fingers Crossed</i> .....	27
<i>Ample Dollars: Capital Pulls Back, Not Out</i> .....	28
<i>A “Ton” of Vacant Office Space</i> .....	29
INTENSIFYING UNEASE OVER AN UNCERTAIN WORLD .....	30
<i>Wavering Confidence</i> .....	30
<i>Terror Redux</i> .....	30
<b>SECTION 5: VALUATION ANALYSIS .....</b>	<b>32</b>
NET ASSET VALUE .....	32
THE VALUE OF 1 SHARE OF GENERAL AND LIMITED PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	32
THE VALUE OF AN ECONOMIC INTEREST .....	33
<i>Price-to-NAV Analysis</i> .....	38
THE LIQUIDITY DISCOUNT .....	38
THE VALUE OF A 1% GENERAL PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	42
THE VALUE OF A 1% LIMITED PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P. ....	43
<b>APPENDIX A: PROFESSIONAL QUALIFICATIONS .....</b>	<b>44</b>
<b>APPENDIX B: VALUATION DATA .....</b>	<b>45</b>
<b>APPENDIX C: CERTIFICATION AND CONDITIONS .....</b>	<b>47</b>
APPRAISAL CERTIFICATION .....	47
STATEMENT OF CONTINGENT AND LIMITING CONDITIONS .....	48

# Valuation Report For The Paul Jones Family Partnership, L.P.

## Index of Charts and Tables

TABLE 1-1: OWNERSHIP INTERESTS AS OF DECEMBER 4, 2003 .....	7
TABLE 1-2: VALUATION OF 1% GENERAL PARTNERSHIP INTEREST AS OF DECEMBER 4, 2003 .....	7
TABLE 1-3: VALUATION OF 1% LIMITED PARTNERSHIP INTEREST AS OF DECEMBER 04, 2003 .....	7
TABLE 2-1: OWNERSHIP INTERESTS AS OF DECEMBER 04, 2003 .....	10
TABLE 5-1: NET ASSET VALUE AS OF DECEMBER 12, 2003 .....	32
TABLE 5-2: EQUATION VARIABLES .....	33
TABLE 5-3: GUIDELINE PUBLICLY TRADED REAL ESTATE PARTNERSHIPS AS OF APRIL/MAY 2003 .....	35
TABLE 5-4: PRICE-TO-NAV FOR SELECTED CLOSED-END FREQUENTLY TRADED REAL ESTATE FUNDS .....	36
TABLE 5-5: BUILD-UP OF PRICE-TO-NAV .....	38
TABLE 5-6: REPRESENTATIVE STUDIES THAT ATTEMPT TO MEASURE THE LIQUIDITY DISCOUNT .....	39
TABLE 5-7: VALUATION OF 1% GENERAL PARTNERSHIP INTEREST AS OF DECEMBER 4, 2003 .....	42
TABLE 5-8: VALUATION OF 1% LIMITED PARTNERSHIP INTEREST AS OF DECEMBER 04, 2003 .....	43
TABLE B-1: PRICE-TO-NAV FOR SELECTED CLOSED-END FREQUENTLY TRADED REAL ESTATE FUNDS .....	45
TABLE B-2: LEVERAGE AND SIZE DISCOUNT .....	45

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## IMPORTANT NOTICES

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### Terms and Conditions

The business valuation result contained in this report is subject to the Appraisal Certification, and Statement of Contingent and Limiting Conditions. Appendix C of this report contains these documents.

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## SECTION 1: VALUATION SUMMARY

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The Paul Jones Family Partnership, L.P. is a limited partnership under the provisions of the laws of the State of New York. The appraisal of 32.00% general partnership interest & 25.23% limited partnership interest is being conducted for estate tax filing purposes. The valuation date is December 4, 2003. There is a difference in the date of the property appraisals, December 12, 2003, and the date of death for Mr. Jones, which was December 4, 2003. For my review of the factors impacting the real estate and limited partnership valuations, this difference in dates has no material effect on the value of the partnership interests.

The principal office of the Company is located in Huntington, New York. The business of the Company is to own, maintain, manage, invest, buy or sell and otherwise operate the Company's assets, which shall initially include certain commercial real properties located at 15 Northern Boulevard, 16 Northern Boulevard, and 17 Northern Boulevard Bayside Queens County New York. A description of the properties is presented below.

**I. 15 Northern Boulevard:** A 19,200+/- square-foot block front site situated on the north side of Northern Boulevard, between 203<sup>rd</sup> and 204<sup>th</sup> Streets. The site is improved by a two story Wendy's fast-food restaurant constructed in 1990 and onsite parking. The property contains 5,070+/- square feet of gross building area. The property is net, net leased for a remaining term of 20+/- years with renewal options for an additional 20 years. The building is considered to be in generally good condition. The appraised market value is \$2,600,000.

**II. 16 Northern Boulevard:** A 14,000+/- square-foot block front site situated on the north side of Northern Boulevard, between 204<sup>th</sup> and 205<sup>th</sup> Streets. It is improved with a one-story, 13,500+/- square-foot commercial building, constructed circa 1960, occupied by Auto Barn, Inc., an automobile accessory store, under a 30-year lease with a remaining term of 18+/- years, with renewal options of an additional 20 years. The building is considered to be in average condition. The appraised market value is \$3,200,000.

**III. 17 Northern Boulevard:** A 16,150+/- square-foot block front site situated on the north side of Northern Boulevard, between 205<sup>th</sup> and 206<sup>th</sup> Streets. It is improved with a one-story, 5,970+/- square-foot showroom and garage building and a one-story, detached, frame office building containing 1,100 square feet that were constructed circa 1959. The entire property is occupied by Nassau Honda under a six-year net lease that is now in the second option period, with a total of approximately two years remaining on the lease. The buildings are considered to be in average condition. The appraised market value is \$2,000,000.

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**Ownership**

The general partner of The Paul Jones Family Partnership, L.P. is Paul Jones Corp.; the limited partner is Paul Jones. Ownership interests as of the valuation date are shown below:

**Table 1-1: Ownership Interests as of December 4, 2003**

Source: Ross & Company CPA, PLLC

	<b>Ownership Interest</b>		<b>Value of Interest</b>		<b>Total Value of Jones Estate Interest</b>
General	32.00	\$	75,411	\$	2,413,141
Limited	25.23	\$	47,754	\$	1,204,823
<b>Total</b>				\$	<b>3,617,964</b>

**THE VALUE OF A 1% GENERAL PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P.**

The value of a 1% general partnership interest in The Paul Jones Family Partnership, L.P. is \$75,411 as shown in the table below.

**Table 1-2: Valuation of 1% General Partnership Interest as of December 4, 2003**

Source: Ross & Company CPA, PLLC

<b>Value of 1 Percent General Partnership Interest in The Paul Jones Family Partnership, L.P.</b>	
1) Value of 1 General Partnership Share	\$ 94,263
2) Discount Due to Marketability	20.00%
3) Marketability Discount Adjustment (Row 1 x Row 2)	\$ 18,853
4) Value of 1% General Partnership Interest Discounted for Marketability (Row 1 - Row 3)	\$ 75,411

**THE VALUE OF A MINORITY INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P.**

The value of a 1% limited partnership interest in The Paul Jones Family Partnership, L.P. is \$47,754 as shown in the table below.

**Table 1-3: Valuation of 1% Limited Partnership Interest as of December 04, 2003**

Source: Ross & Company CPA, PLLC

<b>Value of a 1 Percent Limited Partnership Interest in The Paul Jones Family Partnership, L.P.</b>	
1) Value of 1 Limited Partnership Share	\$ 66,324
2) Base Discount Due to Marketability	20.00%
3) Increase in Discount Due to Transfer Restrictions	10.00%
4) Total Discount (1 - Row 2) x (1 - Row 3)	1 - (0.80 x 0.90) 28.00%
5) Marketability Discount Adjustment (Row 1 x Row 4)	\$ 18,571
6) Value of 1% Limited Partnership Interest Discounted for Liquidity (Row 1 - Row 5)	\$ 47,754

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**Valuation Assignment Terms and Conditions**

Ross Valuation is independent of The Paul Jones Family Partnership, L.P. and related organizations, and neither Ross Valuation nor I have any financial interest in the securities subject to appraisal. Our fee for this valuation is in no way influenced by the result of our valuation conclusion. This valuation report is prepared solely for the purpose stated herein.

The remaining sections and appendices further describe the analyses performed and the conclusions reached during this valuation. The attached certification, limitation of liability, statement of contingent and limited conditions, and my qualifications are integral parts of this valuation opinion.



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Ross & Company CPA, PLLC

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Date

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## SECTION 2: THE VALUATION ASSIGNMENT

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### Description of The Paul Jones Family Partnership, L.P.

The Paul Jones Family Partnership, L.P. is limited under the provisions of the laws of the State of New York. The appraisal of a 32% general partnership and 25.23% limited partnership interest is being conducted for estate tax filing purposes. The valuation date is December 4, 2003. The principal office of the Company is located in Huntington, New York. The business of the Company is to own, maintain, manage, invest, buy or sell and otherwise operate the Company's assets, which shall initially include certain commercial real properties located at 15 Northern Boulevard, 16 Northern Boulevard, and 17 Northern Boulevard Bayside Queens County New York. A description of the properties is presented below.

**I. 15 Northern Boulevard:** A 19,200+/- square-foot block front site situated on the north side of Northern Boulevard, between 203<sup>rd</sup> and 204<sup>th</sup> Streets. The site is improved by a two story Wendy's fast-food restaurant constructed in 1990 and onsite parking. The property contains 5,070+/- square feet of gross building area. The property is net, net leased for a remaining term of 20+/- years with renewal options for an additional 20 years. The building is considered to be in generally good condition. The appraised market value is \$2,600,000.

**II. 16 Northern Boulevard:** A 14,000+/- square-foot block front site situated on the north side of Northern Boulevard, between 204<sup>th</sup> and 205<sup>th</sup> Streets. It is improved with a one-story, 13,500+/- square-foot commercial building, constructed circa 1960, occupied by Auto Barn, Inc., an automobile accessory store, under a 30-year lease with a remaining term of 18+/- years, with renewal options of an additional 20 years. The building is considered to be in average condition. The appraised market value is \$3,200,000.

**III. 17 Northern Boulevard:** A 16,150+/- square-foot block front site situated on the north side of Northern Boulevard, between 205<sup>th</sup> and 206<sup>th</sup> Streets. It is improved with a one-story, 5,970+/- square-foot showroom and garage building and a one-story, detached, frame office building containing 1,100 square feet that were constructed circa 1959. The entire property is occupied by Nassau Honda under a six-year net lease that is now in the second option period, with a total of approximately two years remaining on the lease. The buildings are considered to be in average condition. The appraised market value is \$2,000,000.

## Valuation Report For The Paul Jones Family Partnership, L.P.

### OWNERSHIP

The general partner of The Paul Jones Family Partnership, L.P. is Paul Jones Corp. The limited partner is Paul Jones. Ownership interests as of the valuation date are shown below.

Table 2-1: Ownership Interests as of December 04, 2003

Source: Ross & Company CPA, PLLC

	Ownership Interest	Value of Interest	Total Value of Jones Estate Interest
General	32.00	\$ 75,411	\$ 2,413,141
Limited	25.23	\$ 47,754	\$ 1,204,823
Total			\$ 3,617,964

### BUSINESS PURPOSE

The purpose of the Partnership is as indicated in Section 1.4 of the Agreement.

### PARTNERSHIP PURPOSE:

(a). to invest in, engage in, manage and participate in, such enterprises, business activities and transaction of whatsoever kind or nature, for the benefit and best interests of the partners, and in connection therewith, to purchase, acquire, hold, exchange and manage stocks, bonds, commodities, real property, interest in other partnership and investments of every kind, nature or description and to hold, invest and reinvest its funds, and in connection therewith to hold part or all of its funds in cash, and to purchase or otherwise dispose of real and personal property, mortgage notes, partnership interest and other property and to exercise, as owner or hold or any such items, and, in general, to conduct the business of the partnership, as the General Partner may determine in his sole discretion;

(b). to enter, perform and carry out contracts or take action of any kind necessary to, in connection with , or incidental to, the accomplishment of the foregoing purposes, and in connection therewith the Partnership is empowered and authorized:

(i) to raise and provide such funds as may be necessary to achieve the purposes and objectives of the Partnership and to borrow funds, execute and issue mortgage notes and other evidences of indebtedness and secure the same by mortgage, deed of trust, pledge or other lien;

(ii) to enter into, perform and carry out contracts, and engage in other activities, which may be necessary and proper for the protection and benefit of the partnership and the accomplishment of its purposes and objectives.

(iii) from time to time to do any one or more of the things and acts set forth herein.

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## SECTION 3: THE U.S ECONOMIC OUTLOOK<sup>1</sup>

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### General Overview

Although the economy in 2003 got off to a somewhat slow start, recent reports show rapid growth. In particular, the preliminary report on GDP in the 3<sup>rd</sup> quarter revealed real growth at an annual rate of 8.2 percent! With low interest rates in place and fiscal stimulus from both tax cuts and spending, we anticipate a continuation of growth. In 2002, the real Gross Domestic Product (GDP) in the U.S. economy grew at an annual rate of 2.4 percent. We expect growth of 3.0 percent in 2003, followed by a significant pick-up in 2004, with GDP growing at 4.0 percent. In 2005 and 2006, growth will continue at annual rates of about 3.5 percent. For the rest of the decade, GDP grows around 3.1 percent annually. In the 2010-2015 period, the average annual growth rate for GDP falls to 2.7 percent, largely the consequence of the slowing rate of labor force growth.

In 2002, consumer spending, residential construction, and government spending represented the principal areas of strength in the economy. In 2003, consumer spending, residential construction and defense spending continue to pull the economy forward. In addition, nonresidential investment growth has resumed, as had export growth. In the coming years, we anticipate balanced growth. In 2004, nonresidential investment and exports will lead growth.

In our 2004 forecast, consumer spending grows at 3.9 percent, more rapidly than its growth of 3.1 percent in 2003. Tax cuts, the introduction of a Medicare drug benefit, and increased employment all contribute to growth in disposable income. We anticipate significant growth (7.1 percent) for investment in producers' durable equipment and software in 2004, followed by growth of 6.7 percent in 2005. Growth will rebound for nonresidential structures (around 8 percent per year in the next two years), spurred by low interest rates and meaningful growth in the economy. Residential construction will remain near the current high levels, but will decline slightly in 2004 and 2005.

The Inforum long-term forecast projects low inflation, at rates somewhat lower than the rates of the last ten years. As measured by the Personal Consumption Expenditures (PCE) deflator, we expect inflation to average 1.4 percent annually over the 12 year forecast horizon. Short-term interest rates are at their lowest levels in more than 40 years. With a resumption of growth in the economy, but low inflation, we expect the short term rate to rise slowly. However, significant federal budget deficits will exert upward pressure on interest rates.

The unemployment rate in 2002 was 5.8. In 2003, we expect it will average around 6.1 percent, and then fall to 5.6 percent in 2004 as the economy experiences robust growth. Table 1 below shows selected macroeconomic indicators for the outlook.

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<sup>1</sup> Inforum Semi-Annual Industry Forecast, Winter 2003-2004 Copyright IERF, Inc.

## Valuation Report For The Paul Jones Family Partnership, L.P.

**Table 3-1: Summary of Long-Term Macroeconomic Outlook**  
**Source: Winter 2003-4 Inforum Industry Forecast**

	Average Annual Growth Rates, percent					
	89-03	00-03	03-04	04-05	05-10	10-15
Gross Domestic Product	2.8	1.9	4.0	3.5	3.2	2.8
GDP Deflator	2.1	1.7	1.8	0.7	1.1	1.8
Labor productivity	1.8	2.7	1.9	1.9	2.0	2.0
Civilian Labor Force	1.2	0.9	1.5	1.5	1.1	0.7
		Average Level, percent				
Unemployment rate	5.6	4.8	5.9	5.7	5.4	5.0
Treasury bills, 3-month	5.3	3.6	1.4	1.5	3.1	3.7

Inforum's forecast for the U.S. economy is made as part of its long-term international forecasts of major trading partners. We expect annual U.S. export growth will average 7.2 percent over the next three years. The dollar has experienced significant depreciation against most major currencies in 2003. In contrast to our June 2003 assumptions, we anticipate further weakening of the dollar over the next three years. A falling exchange rate of the dollar is advantageous for U.S. exports. The falling dollar also curbs import growth somewhat, although the improving domestic economy in our U.S. forecast increases imports. The reduction in import growth is sufficient to reduce real net exports after 2005. By 2015, it is half of the level in 2003. The current dollar trade balance improves as well. However, this improvement is largely offset by changes in net factor income, so there is little improvement in the current account deficit.

### **Assumptions and Their Implications for the Forecast**

#### **Fiscal Policy**

This forecast incorporates the tax changes included in the Jobs and Growth Tax Relief Reconciliation Act of 2003. This act accelerates previously enacted tax reductions for individuals. It also reduces taxes on dividends and capital gains. The 2003 tax act also has implications for corporate taxes. The provision for growth incentives for business, on bonus depreciation and expensing some investment, decreases revenue through 2005, but increases it thereafter. Another provision shifts some 2003 corporate estimated tax payments to 2004. We used CBO estimates of the impact on revenue to modify the model's corporate income tax rate.

To project federal spending, we rely on projections from other sources, or on behavioral or "accounting" relationships. Outlays for unemployment insurance rely on the number of people unemployed and an assumption about the real, yearly transfer per unemployed person. Our forecast includes the changes in unemployment benefits for 2003 and 2004 from recent legislation. Federal interest payments depend on interest rates and the Federal debt. Medicare and Social Security outlay projections are guided by the respective trust fund reports, as shares of nominal GDP.

We do, however, make explicit assumptions about federal and state and local purchases of goods and services, including labor compensation and employment. Table 3-2 shows a summary of historical data and projections for these categories. Employment growth in all government sectors is assumed to be slower than labor force growth. We assume

## Valuation Report For The Paul Jones Family Partnership, L.P.

an increase in growth in federal defense purchases especially within the 2003-07 period. Although our assumption increases defense spending, we expect growth that is less rapid than the nearly 10 percent growth during 2003. We expect a modest slowdown in the growth of non-defense consumption and investment expenditures.

During 2003, as a consequence of the slowdown in state and local revenue receipts, there has been little growth in state and local consumption expenditures, although some growth occurred in investment spending in the 3<sup>rd</sup> quarter. For the remainder of the forecast, state and local government spending grows less rapidly than it did during the last decade. During the nineties, state and local spending grew a bit more rapidly than GDP. Over the forecast horizon, we assume that S&L spending will grow more slowly than GDP.

**Table 3-2: Assumptions about Real Government Purchases and Employment Growth**  
**Source: Winter 2003-4 Inforum Industry Forecast**

	2002	Growth Rates					
		89-03	00-03	03-04	04-05	05-10	10-15
Consumption and Gross investment (1996\$, Bil)	1719	1.9	3.6	2.3	1.3	1.9	2.0
Federal defense	400	-0.1	7.7	3.6	0.7	0.8	1.4
Federal non-defense	215	2.8	3.7	2.5	2.1	2.0	1.8
State & local	1103	2.8	2.2	1.8	1.4	2.3	2.3
Employment (Jobs, Thou)							
Federal defense	683	-3.3	0.3	1.8	-1.0	-1.0	0.0
Federal non-defense	1142	0.6	-0.6	0.7	0.7	0.6	0.6
S&L education	9980	2.0	1.9	0.9	1.5	1.3	1.2
S&L health	1050	-0.2	1.2	0.5	0.5	0.5	0.5
S&L other	6631	1.6	1.1	0.5	0.5	0.5	0.5

### The Presidential Election and Economic Performance

The U.S. presidential election will be the most contentious election in recent presidential history. From an economic perspective, a Kerry victory will result in the repeal of the dividend tax cut as well as a revamping of the 2003 tax cuts. If Bush loses, it will be the first time in recent memory that a president presiding over a significant economic expansion will have lost his bid for a second term. This forecast assumes that Bush wins by a slight margin and he continues his current policies into the second term.

### Monetary Policy

The federal funds rate has fallen from 6.4 percent in December 2000 to about 1 percent during the last few months. The rate cuts translated directly into reductions in short-term interest rates, such as the 3-month Treasury bill rate. This variable is endogenous to the model, responding to the deviation of real GDP from potential, expected inflation, the growth in the monetary base, and the demand for private investment and deficit financing. Implicitly, with this equation, we are assuming that the Federal Reserve continues to "lean against the wind," by raising short-term interest rates when the economy begins to exceed potential and lowering them when it starts to fall below potential. The Fed's action produced interest rates that were lower than our equations would have predicted. Consequently, we have reduced this equation's estimate in our

## Valuation Report For The Paul Jones Family Partnership, L.P.

2003 projection. This modifier is gradually relaxed to allow interest rates to rise as the economy recovers.

We also make assumptions about the rate of growth of the money supply, which we measure with M2, and the monetary base, which enters directly into the main interest rate equation. In this projection, we allow M2 to rise about 2 percent faster than the rate of growth of potential GDP. The gap between M2 growth and potential GDP growth provides the underlying trend in inflation expectations, which itself enters the interest rate equations. We also set the monetary base to grow slightly faster than potential GDP, with the aim of having the growth in the real monetary base remain roughly constant in the forecast.

### U.S. Population Characteristics

Our population forecast is based on the Census Bureau's projection for the size and age distribution of the U.S. population. We have relied upon the Census Bureau's projections made in January 2000. We used these projections to derive the model's forecast of population by age and sex by moving forward a preliminary Census estimate of the 2001 population. Overall, the population is projected to grow 0.8 percent annually from 2003 through 2015, down slightly from the 1 percent rate achieved in the fifteen years between 1985 and 2000.

The main population story is not the size of the overall population, but its age distribution. The leading edge of the Baby Boom generation turns 65 in 2011. The share of the population over age 64 rises from 12.6 percent in 2002 to 13.2 percent in 2010 and to 14.6 percent by 2015. In our model, the age distribution influences labor force growth, the growth in federal outlays, and the distribution of consumer spending.

The aging of the population reduces labor force growth. In the late nineties, the labor force grew at an annual rate of 1.5 percent per year. In the 2010-2015 period, labor force growth will slow to 0.7 percent per year. That slowdown in the labor force is largely responsible for the predicted slowdown in GDP growth during the last few years of the forecast. The slowdown in labor force growth is a direct result of the changing age composition of the underlying populations. The slowdown occurs in spite of stable or increasing participation rates in the underlying population groups, as shown in the table below. However, since participation rates are much lower for those 65 and over than those 20 through 64, the aggregate participation falls in the last years of the forecast.

Labor force data in the model has been updated to reflect BLS revisions that were released earlier this year.

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**Table 3-3: Assumptions behind the Civilian Labor Force Growth**  
**Source: Winter 2003-4 Inforum Industry Forecast**

	2000	85-00	00-03	03-08	08-15
Working Age Population	212	1.0	1.1	1.1	0.9
Teenagers 16-19 yrs.	16	0.4	0.6	1.6	-0.7
Men, 20-64	80	1.0	1.2	1.0	0.6
Women, 20-64	82	1.0	1.2	1.0	0.6
Men, 65-84	13	1.4	0.7	1.4	3.0
Women, 65-84	20	1.2	0.4	1.2	2.5
Civilian Labor Force (mil)	143	1.4	0.9	1.3	0.8
Teenagers 16-19 yrs	8	0.3	-2.4	1.8	-0.4
Men, 20-64	70	1.1	1.2	1.2	0.7
Women, 20-64	60	1.8	1.2	1.2	0.7
Men, 65-84	2	2.3	1.5	1.9	3.5
Women, 65-84	2	3.0	2.8	2.8	4.3
Labor Force Participation Rates, Percent					
Teenagers, 16-19	52	-0.1	-3.0	0.1	0.2
Men, 20-64	87	0.2	0.0	0.2	0.1
Women, 20-64	74	0.8	0.0	0.2	0.1
Men, 65-84	19	0.9	0.7	0.5	0.6
Women, 65-84	9	1.8	2.4	1.6	1.8
Total, 16-84	67	0.4	-0.2	0.3	-0.1

Beyond the labor force effects, the aging population has implications for the federal government budget. Federal outlays are heavily influenced by Medicare and Social Security payments, where eligibility is linked to age. In this forecast, Medicare and Social Security outlays rise from 34.5 percent of federal spending in 2001 to 41 percent in 2015, and account for 8.2 percent of GDP by 2015. The payments were 6.6 percent of GDP in 2001.

**Commodity Prices**

Our projection contains a few assumptions about key commodity/sectoral prices, which are exogenous to the model. The major prices we set are:

- ç The producer price for Agriculture, forestry, and fishery products is set to grow 0.5 percentage points slower than the consumption deflator.
- ç The producer price for Crude petroleum is set in dollars per barrel through 2004. For the remainder of the forecast, oil prices grow 0.25 percentage points faster than GNP deflator.
- ç The producer price for natural gas at the wellhead is set through 2004, and then mimics the movements in the crude oil price from 2005 through 2015.

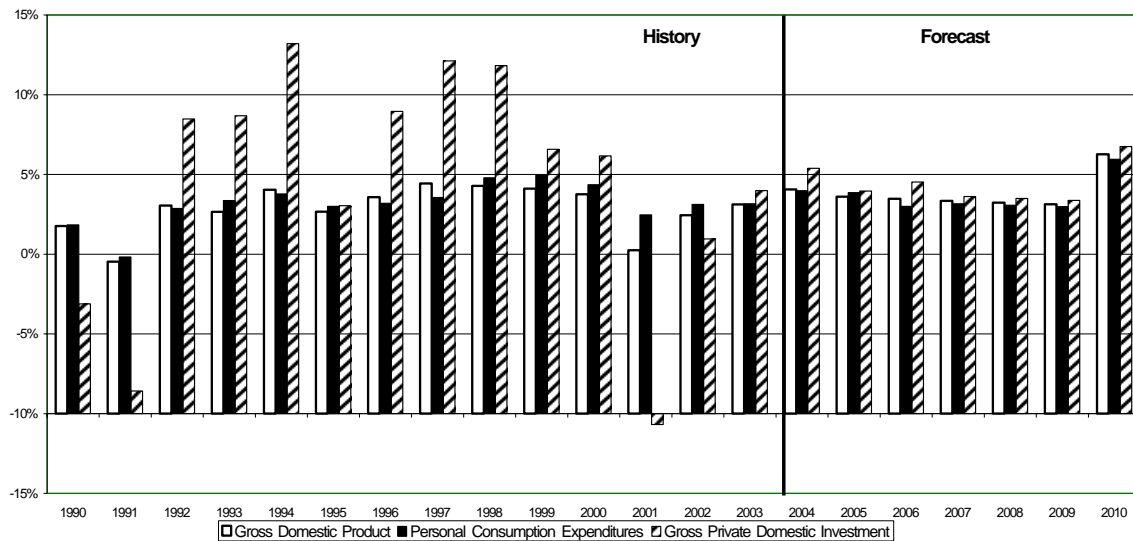
## Valuation Report For The Paul Jones Family Partnership, L.P.

- ç Inforum continues to follow its approach of treating the prices of Computers and Semiconductors and electronic components as unchanging over time. We are, in effect, modeling nominal spending for these goods.

### The Gross Domestic Product, the S&P 500 and the Inflation Outlook

The annual percentage changes in constant dollar GDP, personal consumption and gross private domestic investment over the history from 1990 to 2003, and the forecast from 2004 through 2010 are shown in Chart 3-4.

**Chart 3-4: GDP, Personal Consumption, and Gross Private Domestic Investment**  
Source: Winter 2003-4 Inforum Industry Forecast



A continued economic recovery means that real GDP will continue to expand led by growth in real consumer spending and investment in new plant and equipment. Real GDP is expected to rise by 4.0 percent in 2004 and 3.6 percent in 2005. GDP growth averages 3.4 percent during 2004-10.

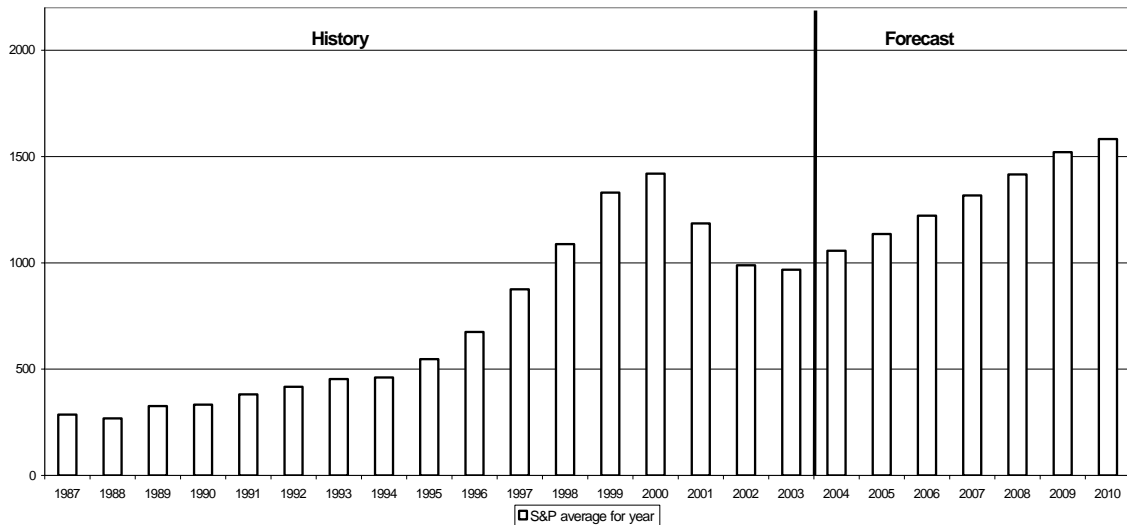
Among the broad components of GDP, consumer-spending growth is slightly less than GDP growth over the forecast horizon. This slight moderation of PCE contrasts with the last five years in which PCE outpaced GDP by 1 percent per year. Residential structures also grew more rapidly than GDP, but will decline slightly in the coming five years. We expect a recovery in investment in non-residential structures, with annual growth that is 3 percent faster than GDP growth during the next five years. During the boom of the late nineties, spending on producers' durable equipment (PDE) and software soared. By 2002, it had fallen by 8 percent from its peak in 2000. Investment in PDE has grown in 2003 and will pick up in 2004 and 2005. During the forecast period, PDE growth, on average, exceeds GDP growth by 1.2 percent.

The economy picked up steam during the second half of 2003, and growth momentum into 2004 and beyond should be very positive for firm earnings and stock values. However, fear of rising rates and unexpected terrorist activity has caused investors to

## Valuation Report For The Paul Jones Family Partnership, L.P.

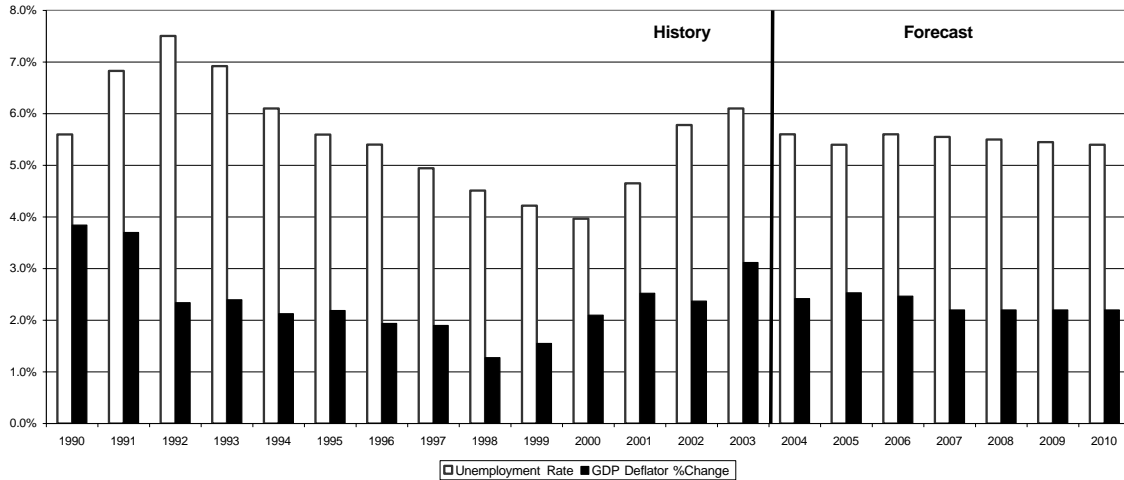
build in a high risk premium into stocks. Thus, despite good economic fundamentals, a combination of rising interest rates and expectations of higher inflation will likely place a drag on equity values moving forward. The performance of U.S. stocks, as measured by the S&P 500 Index, is shown in Chart 3-5.

**Chart 3-5: The S & P 500 Index: Stock prices rise after a tough 2002**  
**Source: Winter 2003-4 Inforum Industry Forecast**



Overall, the forecast projects inflation, measured by the GDP deflator, to grow at a little over two percent over the forecast period. Moderate growth, coupled with low inflation, produces reasonably low interest rates. Rates on 3-month Treasury bills move upward to three percent over the forecast period. All of this occurs within an economy where the unemployment rate trends below 6%, but remains above 5%, over the forecast horizon as shown in Chart 3-6.

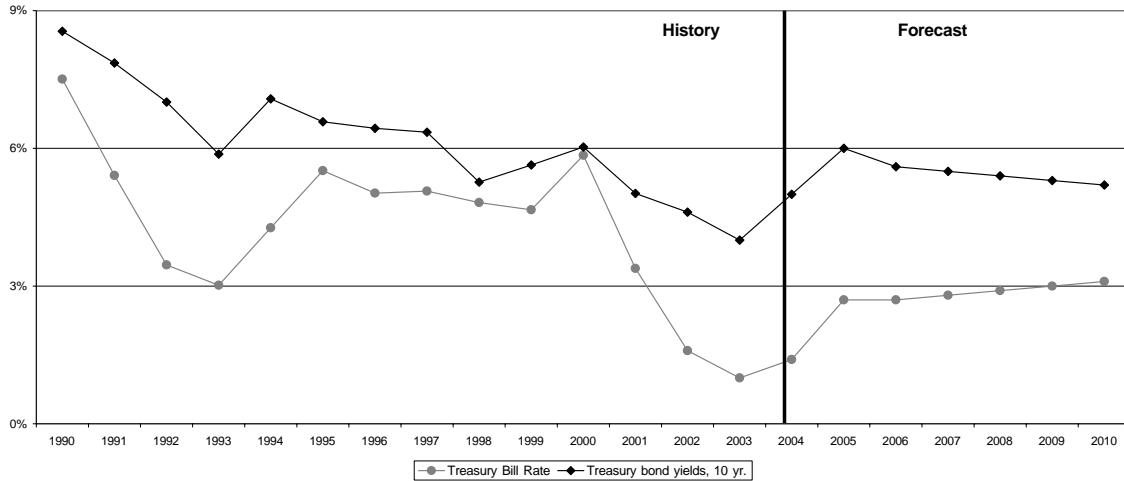
**Chart 3-6: Inflation and the Unemployment Rate: Both indicators improve over the forecast**  
**Source: Winter 2003-4 Inforum Industry Forecast**



**The Interest Rate Outlook**

Chart 3-7 shows the expected course of short and long-term interest rates.

**Chart 3-7: Interest Rates: A slight rise as the economy improves**  
**Source: Winter 2003-4 Inforum Industry Forecast**



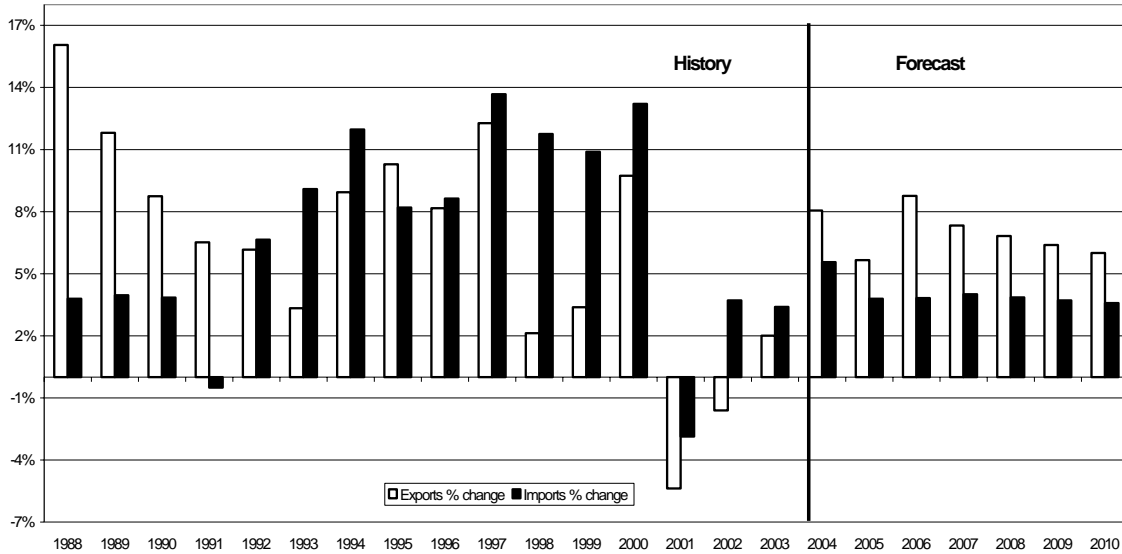
As the economy expands, both long and short-term rates are expected to increase. This is due to a greater overall demand for credit and the Fed tightening monetary policy to moderate any inflationary pressure that may emerge as a result of sustained economic activity. Although energy price increase have been substantial, the overall price level is not likely to follow suit. The major reason for this is that we expect continued improvements in labor productivity thereby moderating the increase in unit labor costs.

**The Global Economy**

Over the forecast, exports are expected to outpace imports as shown in Chart 3-8 below

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**Chart 3-8: Growth in Exports and Imports**  
**Source: Winter 2003-4 Inforum Industry Forecast**



Despite strong export growth, the U.S. will continue to run a trade deficit, although we expect it to narrow over time. While imports are much larger than exports, hence, resulting in a perpetual trade deficit, a large percentage of the non-oil imports are from foreign subsidiaries of U.S. firms. When looked at this way, the trade deficit becomes less troubling since it represents intra-company transfers rather than a dependency on an unaffiliated foreign supplier.

One key set of assumptions common to all countries is the exchange rate outlook. We make our exchange rate assumptions by considering other forecasts of exchange rates, and the relative trade and inflation positions of the countries. In the last two years, the dollar has fallen relative to the Canadian dollar, the euro, the won, and the yen. Our forecasts assume further decline over the next three years. In 2005, we introduce an appreciation of the Chinese Yuan relative to the dollar. The table below summarizes these assumptions.

**Table 3-9: Exchange Rate Assumptions (Foreign currency per US dollar)**  
**Source: Winter 2003-4 Inforum Industry Forecast**

	1997	2000	2002	2003	2004	2005	2010	2015
Canadian Dollar	1.38	1.49	1.57	1.40	1.26	1.20	1.13	1.13
Mexican Peso	7.92	9.46	9.66	10.82	10.82	10.82	11.30	11.94
Euro	0.89	1.08	1.06	0.89	0.80	0.76	0.71	0.68
British Pound	0.61	0.66	0.67	0.62	0.56	0.53	0.49	0.47
Chinese Yuan	8.32	8.28	8.28	8.28	8.28	7.45	6.71	6.71
Japanese Yen	121	108	125	116	104	99	93	93
S. Korean Won	954	1131	1250	1183	1088	1045	964	916

**The State of the Economy from the Business Owner Perspective**

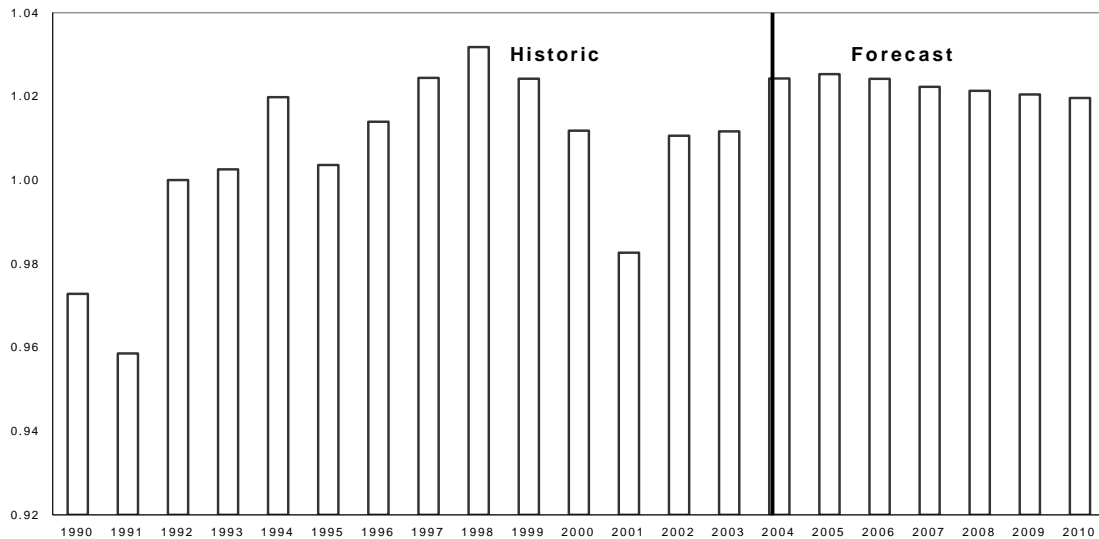
The Economy Performance Index shown in Chart 3-10 is calculated by starting with 1.0 and then adding the percentage growth of real economic growth and finally subtracting the percentage increase in inflation. When the value is 1, then economic growth is being

## Valuation Report For The Paul Jones Family Partnership, L.P.

matched by growth in inflation. When inflation exceeds real economic growth, the index is less than 1.

From this perspective, the 1996 to 2000 years were great, as real economic growth soared in a time of low inflation. The performance of the economy over the forecast period is also robust and compares favorably to the 1990s.

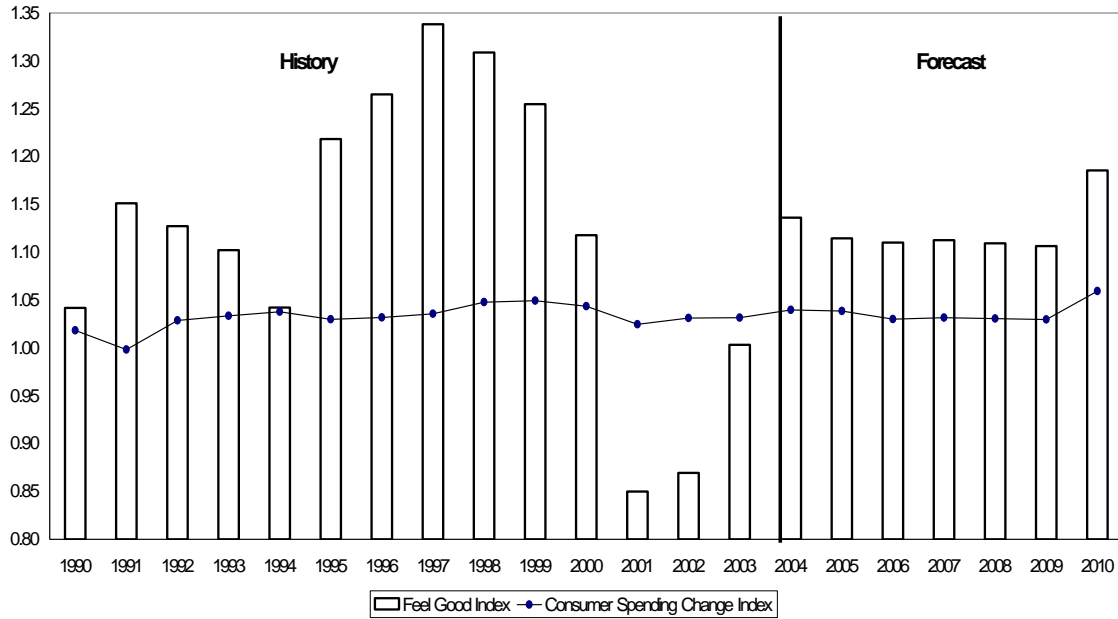
**Chart 3-10: Economy Performance Index: The future looks bright**  
**Source: Winter 2003-4 Inforum Industry Forecast**



### The State of the Consumer

The Feel Good Index, shown in Chart 3-11, combines the change in disposable income with a wealth effect (the change in the stock market as measured by the S&P 500 Index). When we plug the Inforum forecast values into the Feel Good Index, we see a bounce back to values greater than 1.0 in 2003, after a very tough 2001 and 2002. Over the remaining forecast years, the Feel Good Index stays in the 1.10 range, which, while respectable, is nevertheless lower than most years in the 1990s.

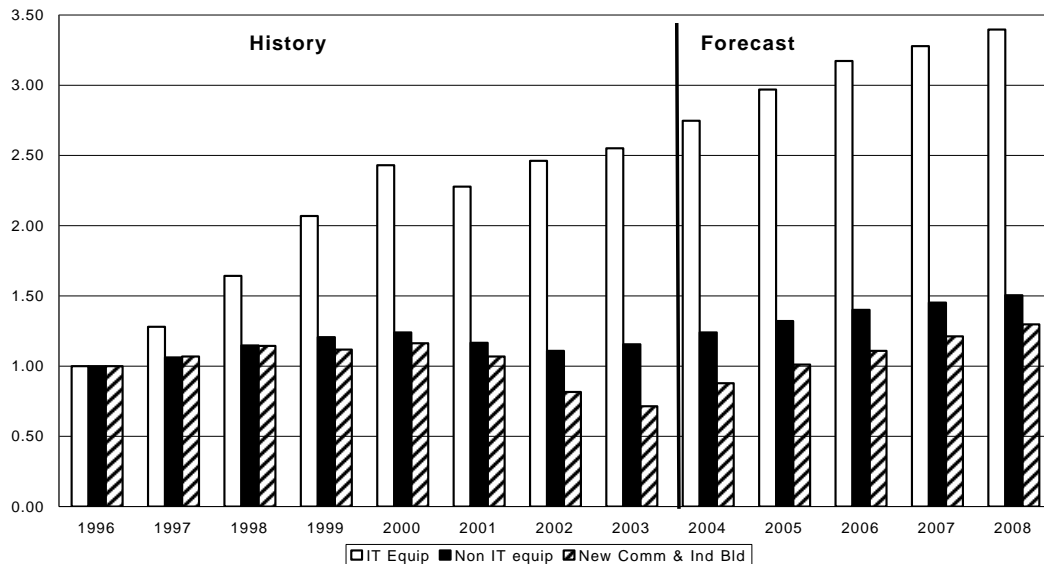
**Chart 3-11: Feel Good Index: Bouncing Back After Big Drop**  
**Source: Winter 2003-4 Inforum Industry Forecast**



### The State of Capital Spending

Capital spending is the key to future economic growth. Expected economic growth will stimulate capital spending in the first instance as shown in Chart 3-12. This new capital will provide the production base for additional economic growth, continuation in productivity expansion, and rising profits.

**Chart 3-12: Capital Spending Indexes 1996=1**  
**Source: Winter 2003-4 Inforum Industry Forecast**



According to the Inforum forecast, investment in information technology (IT) equipment will experience strong growth over the forecast horizon. New developments in the IT

## **Valuation Report For The Paul Jones Family Partnership, L.P.**

world and technological obsolescence of the installed IT capital base will set the stage for robust growth. Investment in non-IT equipment will also expand, although not as rapidly as investment in IT. Commercial and industrial buildings are expected to increase in line with the overall economy.

### **SUMMARY**

The U.S. and global economy will continue to expand. While global terrorism will remain a central concern, and the terror risk premium that is currently reflected in prices of financial assets can not be underestimated, the long-term technology trends are indeed promising. Fear of rising inflation brought on by a sharp increase in oil and energy prices, is not likely to bring on large unexpected increases in inflation any time soon. The long-term outlook for economic growth and job creation remains quite positive.

The overall U.S. economic outlook should have a modestly positive impact on the value of the Paul Jones Family Partnership, L.P. over the next few years. A balanced economic outlook with modest growth, low inflation, low unemployment, and moderate interest rates presents an environment conducive to meeting the financing needs of businesses of all sizes.

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## SECTION 4: COMMERCIAL REAL ESTATE OUTLOOK <sup>2</sup>

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### Emerging Trends in Real Estate

To be sure, sustained improvement of commercial real estate markets isn't likely until 2005 or later, and a shallow, but protracted downturn promises to stress some investors in the meantime. Even as the overall economy signals modest growth, punctuated by a presidential election year of inevitable pump priming, real estate performance in 2004 could continue to erode, especially for office investors. "The worst is behind, but recovery isn't imminent."

For 2004, the moods of *Emerging Trends* interviewees range from "cautiously pessimistic" to "at best, less sanguine." Cheerleaders rightly tout the industry's "resilience": real estate has delivered positive returns through an entire cycle, surpassing stock and bond performance for the last decade. But optimists must temper their hopes of surfing the cyclical bottom unscathed—despite Alan Greenspan's largesse and investors' lingering doubts about Wall Street alternatives. America's economy hasn't shown enough potency to inspire confidence or deflect uncertainty. Where are the job generators? Will corporations continue to outsource jobs to overseas locations? How do we factor in the nation's looming deficits and perilous entanglements in Iraq, Israel, and Korea?

### Sturdy Performance Continues

In the near term, annualized core real estate returns will be quite acceptable—surprisingly good in fact—remaining in the mid to high single-digits for portfolios concentrated in well-leased, cash-cow apartment, retail, and warehouse holdings. Results will be better—in the low teens—for core investors who have strategically used cheap debt to leverage up rent revenues locked in from recent market peaks. But lower-quality office properties suffering high vacancies will likely register value write downs—"as much as 25 percent"—and dwindling cash flows. Tenants in all property sectors have substantial bargaining power, and will trade up for quality space at favorable rents.

Overall, returns continue to belie those "stinky" market fundamentals: the near-record vacancies, falling rents (plummeting in some office markets), hefty renewed concessions, mounting property taxes, and inflated operating expenses. The only property sector that hasn't deteriorated is retail—kept afloat by consumers flush with added buying power from refinanced mortgages and federal tax cuts. Grocery-anchored retail, fortress malls, and power centers have fared particularly well, as America's passion for shopping continues unabated—for now.

For the most part, real estate investors, property companies, developers, and lenders are effectively adapting to this changing market, and a majority of *Emerging Trends* respondents are expecting that the profitability of their firm will be good to excellent in 2004.

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<sup>2</sup> Adapted from "Emerging Trends in Real Estate: 2004" by The Urban Land Institute and PricewaterhouseCoopers LLP, October 2003.

## Facing Facts

At some point, reality sinks in. The heady elixir of seemingly low-as-you-can-go interest rates and ample inflows of capital, steering away from turbulent stock market, can't camouflage property markets indefinitely—or offset declining revenues. Some fallout is inevitable, and investors will need to refocus on replacement cost and exit risk, not just current returns based on transient cash flows.

Challenges loom. In a general economic recovery, property values could actually drop if interest rates surge before job growth can boost leasing activity. Office markets always lag economic rebounds by as much as 12 to 18 months, and that could mean big trouble in the current environment. Especially vulnerable are borrowers holding floating-rate debt; they'll get whipsawed if interest rates rise and net operating incomes drop further—or even stagger. “A lot of guys are just hanging on.” There's no doubt that office performance is headed for a rough stretch. The survivors will be buildings with minimal tenant rollover and strong credit rosters to sustain rent levels above market-rate declines.

Warehouses and apartments both suffer from uncharacteristically high, though still manageable, vacancies. But these sectors usually rebound more quickly in economic turnarounds and are less exposed than office. For hotels, the key will be businesses' willingness to loosen their travel-budget purse strings. Absent a surge in corporate profits and a decline in CFO nickel-and-dime accounting, that's a questionable prospect.

Most developers, meanwhile, have been forced uncomfortably to the sidelines. “We're back to the early 1990s.” Although investors are relieved that recent construction has remained in relative check and lenders appear to have been disciplined, “considerable overcapacity still exists in the markets. That's another way of saying we're overbuilt.” Right now, “this country doesn't need anything new for a while.” Surprisingly, the one unrestrained sector has been apartments—lusty construction activity has continued even in the face of slackened demand. But investors continue to pay premiums for multifamily, expecting favorable demographics to propel future leasing and rent growth.

## A Postponement Effect

Of longer-term concern is the consequence of declining capitalization rates propping up returns during an extended market trough. The “unprecedented” anomaly of high prices and outsized returns in an otherwise troubled market could rob investors of any robust upside when properties move closer to supply/demand balance in 2006 and 2007. “Current returns may be borrowing from future gains, making the next cycle very lackluster,” says a noted REIT stock manager.

“It's a postponement effect,” adds a leading researcher. Instead of a more typical sharp decline during the cyclical nadir, markets will clear “in a slow painful adjustment.”

“Pricing hasn't corrected as you'd expect. Buyers have already anticipated a recovery in their cap rates, getting ahead of current fundamentals. Future returns will focus mostly on property cash flows—you won't see much appreciation. No spikes like there were in the last cycle.”

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As markets bump along toward an anemic recovery, 2004 will be a transition year. Cash flows will key performance. Returns will be income driven. “It will all be about keeping up cash returns.” Buildings with solid tenant rent rolls will be fine. Properties hobbled by declining cash flows will struggle unless interest rates stay low. The bifurcation between “have” (tenants) and “have not” properties will become more apparent. Downside risk clearly outweighs upside potential until the economy reignites—and that means substantial job growth. “You may wait a long time.” Expect moderate returns, with more distress and a few horror stories. Real estate will continue to attract investors, but bad-news headlines may dim some of its “safe haven” luster.

“It’s hard to have much near-term conviction.”

### **The Economy: Concern About Job Growth**

The dream for 2003—that the economy would rebound before crummy real estate fundamentals could take their toll on investors—has been painfully slow to materialize. The industry’s fortunes are inextricably tied to recovery. “Real estate is the tail of the dog. In the early 1990s, we were a drag on the economy; this time it’s dragging us.”

*Emerging Trends* interviewees are guardedly hopeful about steady economic improvement in 2004. Nearly 90 percent expect “low to medium growth.” Last year, close to 85 percent correctly predicted “no to low growth.” While concern over a possible double-dip recession is negligible, none of our more than 200 survey respondents predict high growth for the year ahead.

### **Got a Job?**

Economic expansion without significant employment gains is interviewees’ leading concern. “Job growth will be the key to 2004. Period.” If corporations expand their U.S. workforces, vacant office buildings will begin to fill. Expanded production and distribution will benefit warehouses, and increased business travel will buoy hotels. More wage earners—cashing bigger paychecks—will rent more apartments and spend more in malls. That hasn’t been happening.

Low interest rates and a flood of capital from investors fleeing the equities’ tech wreck bought time for the property markets, but any recent up-ticks in economic performance and corporate earnings have come mostly through productivity gains—at the expense of jobs. “Corporations have become very good at doing more with less.” Since early 2001, when the recession began, the United States has lost more jobs than at any time since the Great Depression. Payroll jobs continued to be shed well into 2003, more than 18 months into supposed recovery, and pay raises have been puny—only slightly ahead of inflation and well below averages in the 1990s. “Companies have learned to be lean,” says an interviewee, who works in a global money management firm. “It takes an act of Congress to get new people in the door.”

### **Overseas Outsourcing—A Thorny Issue**

The jobless recovery has roots in technology advances and competitive pressures from globalization. Blue-collar jobs have been bleeding offshore for decades, going to countries where local hires earn a pittance compared with what U.S. factory workers earn. This leakage continues apace—more than 2 million U.S. manufacturing jobs have

## Valuation Report For The Paul Jones Family Partnership, L.P.

been eliminated or moved overseas in the past two years alone. Since the early 1990s, data processing and call centers have also been successfully shifted to English speaking countries like Ireland and the Philippines.

Now the trend is moving up the worker food chain, as knowledge-based tasks are transferred to lower-cost overseas sites as well. Analyst, research, accounting, and other white collar office jobs are ticketed to countries like India and China, which feature highly educated and motivated workforces earning fractions of comparable U.S. wages and benefits. "It was one thing to move a back office to the suburbs or send a call center to Sioux Falls—it's quite another to move an accounting operation to Bangalore."

Satellites, fiber optics, Web-based systems, and computing advances combine to make "a seamless operation" possible and highly desirable for company bottom lines. "The Indian government rolls out the red carpet: you can pay MBAs less than \$10,000 for work comparable to a U.S. job paying \$50,000. Despite some extra costs for travel, relocation, and equipment, overall expenses can be cut by two-thirds."

The impacts of global white-collar outsourcing are unsettling at the very least. High-tech has been America's recent edge, but now industry behemoths Microsoft and IBM plan to move increasing numbers of high-paying software design jobs to Asia and India. Microsoft's 5,000 planned new hires are welcome news, but 2,000 of them will be located outside the United States. In real estate, mortgage servicers have jumped on the outsourcing -to-India bandwagon. By some estimates, U.S. companies will send upwards of 3 million service jobs overseas by 2015. "Do the math," says one researcher. At 200 square feet per worker, "that's 600 million square feet of office worker space we won't need." Whatever the number, outsourcing means diminished growth in demand for office in the future.

If U.S. corporate profits improve on the back of more belt-tightening and global outsourcing, it may be good for shareholders and stock prices, but not for U.S. job creation. Not only will office expansions be constrained, but retail sales will suffer as well. Today, it's lower-paying service jobs that show the most growth; among corporate middle managers, unemployment is well above average. Little surprise that Wal-Mart is now the country's top employer instead of GM or IBM.

The potential real estate fallout isn't all bad. Demand for affordable housing will escalate. And warehouse properties shouldn't be affected as much—once goods get shipped to the United States they still need to be distributed. "That's the other side of the global economy," a researcher comments wryly.

A flare-up in India-Pakistan relations could stanch enthusiasm for relocating operations to the Indian subcontinent. "There is something to be said for stability." But lower-cost English-speaking alternatives abound worldwide.

### **What Will Drive the Economy?**

It might be extreme to call international outsourcing a "crisis" or "a deflationary nightmare" (our interviewees' words), but at minimum the trend underscores the country's growing struggle to find a new economic engine. "We need a saving grace, and can't assume we have a monopoly on creativity anymore." The big question: What will be the economy's new driver?

## Valuation Report For The Paul Jones Family Partnership, L.P.

“It’s hard to anticipate.” In the 1980s, insurance companies and brokerages morphed into financial service giants while Ma Bell’s breakup fueled the telecom industry. High-tech stoked the 1990s “and that turned out to be mostly b.s.” “Nobody seems to know what will turn the trick now—it will be something.”

Interviewees point to biotechnology and nanotechnology. Defense spending and homeland security offer more traditional, less cutting-edge wellsprings. But the tax-cutting wave and looming federal deficits limit government’s role in any jobs recovery. State and local governments, meanwhile, lay workers off or freeze payrolls.

The country’s advantages—wealth, strategic location, labor mobility, huge markets, stability, rule of law, and educated workforce, among many others—outweigh current concerns and doubts about employment generators and global competition. But clearly the solution isn’t more discount store salesclerks or airport security guards.

### **Interest Rates—A Slow Go**

Unquestionably, low interest rates have shielded both the economy and real estate markets: “They’re the difference between now and ten years ago,” when property markets were mired in depression. Despite weakened cash flows, borrowers have “been hanging on,” and delinquency and default rates have remained low. Low-cost debt on well-leased properties has boosted returns. Put another way, “low interest rates have covered up industry flaws and made up for some bad underwriting.”

Most interviewees expect and hope that rates will climb slowly in 2004, coaxed along by the Federal Reserve as the economy strengthens. “It’s an educated bet that the Fed won’t raise rates dramatically in an election year and will try to carefully manage the recovery.”

Stable or declining rates would mean only trouble at this point in the cycle—the economy isn’t gaining any traction. But if interest rates rise too quickly before supply/demand trends improve, floating-rate borrowers will suffer shortfalls and values could decline. “A 200-basis-point increase in interest rates pushes up cap rates while NOI [net operating income] doesn’t go anywhere,” observes a pension fund adviser. “That’s the biggest risk. The next 18 months are problematic.”

If interest rates ratchet up suddenly from some exogenous shock, “a lot of people could be cooked.” Concern mounts over the federal deficit and increased government borrowing, which normally exert upward pressure on rates. The country’s current accounts deficit and burgeoning expenses in Iraq cloud the outlook further.

“The smartest people don’t know where rates are headed.”

### **The Housing Market and Consumer Credit—Keep Your Fingers Crossed**

Although *Emerging Trends* doesn’t attempt to forecast single-family residential markets, it’s clear that decline in house prices would threaten the economy—upending consumer spending and knocking out a key driver in recovery. “It could be the biggest threat.” The American consumer has been overextended for years on credit card and mortgage debt, spending through the recession on the back of inflating home equity. Low interest rates

## Valuation Report For The Paul Jones Family Partnership, L.P.

have spurred a tsunami of homeowner refinancing that feeds consumer purchases at malls and car dealerships. Lower mortgage payments mean more cash to burn.

More important, low mortgage rates have enabled many first-time home purchases and trade-ups, strengthening home prices and property values. If housing demand drops because higher interest rates make mortgages less attractive and home values consequently ebb or fall, retail's recent run-up could be over. And if consumers stop spending, any rebound in corporate profits would hit the skids. Bad news for everyone. But realistically, if the housing market is not another bubble, it's at least due for a breather.

Multifamily owners see a silver lining in the prospect of higher mortgage rates: fewer homebuyers will mean more apartment renters. However, an improved business environment and resumption of job formation are more critical to feeding the renter pool.

### **Ample Dollars: Capital Pulls Back, Not Out**

Real estate's risk profile has improved over the past decade. Heightened regulatory scrutiny, greater transparency, more professional analysis, and public market oversight give investors increased confidence in their ability to assess holdings. Recent solid returns have reinforced perceptions that real estate yields can be sustained through entire cycles, including market troughs.

But interviewees are concerned about whether the recent surge of capital into the property markets and the ensuing cap rate compression reflect a more permanent shift in real estate's standing or a temporary cyclical phenomenon driven by equity outflows from the 2000–2002 bear market on Wall Street.

Coming out of the early-1990s debacle, cap rates shot up as investors factored more risk into the property sectors. During the late 1990s, as property markets returned to equilibrium, "cap rates stayed high when the risk premium should have been shrinking." With the risk profile declining, investors have been willing to take lower returns in stronger property types (apartments, warehouse, neighborhood shopping centers, and well-leased downtown office) with minimal leasing risk. "On balance, cap rates should stay lower for these stronger property types," says a researcher. In fact, cap rates actually trend near historical averages despite recent compression.

Private syndication activity and increased pension fund allocations support the view that capital flows are broadening, and the maturing CMBS and REIT sectors have secured real estate's position in the public markets. "Real estate will never be a rock-star asset class," says an interviewee, "but investors, particularly baby boomers, want the attractive yields real estate offers, and that will keep money flowing and cap rates down."

Most respondents believe an improving stock market will siphon capital from new property investments, and 2004 may prove the point. For the first time in four years, a majority of *Emerging Trends* respondents (52 percent) predict that stocks will outperform real estate and that investment potential for both private and public real estate will diminish.

"Real estate may turn out to be a flavor of the month if the stock market gets hot."

But more than 95 percent of the interviewees forecast that real estate will beat bond returns, and the persisting cap rate spread of over 400 basis points between real estate

## Valuation Report For The Paul Jones Family Partnership, L.P.

yields and ten-year Treasuries continues to offer real estate investors comfort with respect to risk-adjusted performance.

Still, as a pension fund adviser points out: “Investors are fickle. Real estate isn’t big enough to accept all the money that has wanted to come in lately. It’s an alternative investment category, not an asset class like stocks and bonds. If the stock market looks good, money will move out.”

Barring an unlikely rash of bad headlines and red ink, any pullback will be confined to momentum investors. Premium pricing will dissipate, and underwriting will become more discriminating. Office could suffer from weakening operations, and retail has been overheated. Other sectors should hold their own. “Real estate delivered on its promise—it stayed in positive territory and offered diversification. It’s done its job. We’ll cruise along.”

### **A “Ton” of Vacant Office Space**

Despite all the credible evidence of greater transparency and information flow in the real estate markets, most analysts admit a lack of certitude in calculating levels of current office vacancy. They use words like “massive,” “unprecedented,” “as bad as ten years ago or worse.” Brokerage firms put out their leasing reports, but the numbers don’t convince anyone. “We’re probably identifying 80 to 90 percent” of the vacancy, said one tenant representative. “But it’s very hard to pin down.”

Getting a handle on the extent of phantom (empty occupied) space, in addition to ample sublease vacancy, has been the primary conundrum. Corporate business units have held onto unused space, anticipating new hiring. Languishing cubes seem omnipresent. “Companies aren’t going out of their way to report subvacancy and shadow space.” Once they start expanding again, they won’t need to lease new space immediately.

Then there’s the totally vacant but still-leased space, which creeps off rent rolls. “The pain continues to shift from tenants to landlords” as this space burns off, depressing net operating incomes.

Most observers predict there won’t be any significant office leasing upswings until 2005, and rents won’t increase until markets show some signs of returning to equilibrium. How long that takes depends on how much vacant space is really out there, and the velocity of job growth. Rental rates in many markets have fallen to mid-1990s levels or lower—well below peaks of the late 1990s and in the range of mid-1980s rents in some markets. “When five- and seven-year leases come due, tenants should be able to sign sweet deals. Many will be able to trade up to higher-quality space for less. That spells big trouble for lower-quality office space, some of which was rescued from obsolescence by the tech-bubble leasing boom.

Perceptions of office-market health typically influence feelings about real estate’s overall investment potential. Skylines and towers showcase the property markets’ most visible calling cards—too many see-through floors and “For Rent” signs can chill investor appetites for properties in general. With soft tenant rosters and uncertainty about the depth of vacancies, there’s scant reason for near-term comfort.

### **Intensifying Unease over an Uncertain World**

Since the late 1990s, real estate's durability and resistance to a host of shocks and troubling undercurrents have impressed investors, drawing new adherents. Fallout from 9/11 dampened hotels and shook confidence in office towers, but overall impacts have been restrained. The Enron and WorldCom scandals in 2002 raised questions about credit tenancy, but were otherwise nonevents for property investors unless fallen companies were their tenants.

### **Wavering Confidence**

In general, the longer-term nature of mortgages and leases has helped insulate real estate investments from volatile shifts and damaging swings during choppy periods. Eventually, real estate reflects general economic conditions, but it typically lags behind both good and bad phases, smoothing out dips and humps along the way. Today's uncertainty about geopolitical risk, however, is gnawing away at confidence levels and economic underpinnings, raising concerns among interviewees about the strength of any real estate rebound. In addition to the global competitive forces pressuring the U.S. economy, a host of world conflicts test our security and well-being:

- ç Israeli/Palestinian turmoil spirals out of control, destabilizing the entire Middle East.
- ç Iraq looks like a sump for U.S. tax dollars as we attempt to establish social order in the face of terrorist resistance and local distrust. Afghanistan remains a hot spot, and next door, Islamic Pakistan retains nuclear weapons as its shaky government parries threats with nuclear neighbor India.
- ç North Korea's growing nuclear arsenal menaces Asian security, confounding Pentagon planners.

Countries from Africa through the Asian subcontinent, the Pacific, and South America represent potential breeding grounds for anti-Western terrorists, who seem able to strike anywhere at any time, but probably can't and won't.

"These world events are sidetracking us—creating uncertainty and putting drags on our economy," says an interviewee. "Decisions important to real estate are outside one's control. It's more difficult to assess risks and plan accordingly."

### **Terror Redux**

The domestic terror threat has been pushed toward the background. "Time has helped us come to terms. We've bounced back from the first one." But last year's overriding interviewee assumption holds firm: another disruptive strike will occur somewhere, sometime, and perhaps with considerable consequences. Only a marginal lowering of concern about terrorism's negative impact on real estate registers in this year's survey. Here are 9/11's lasting repercussions:

*Skyscraper Anxiety* Except for the very tallest buildings in major 24-hour markets like New York and Chicago, fears about occupying skyscrapers appear muted. But tenant skittishness has compromised the value of a handful of icon skyscrapers. "People are still worried about being on the 80th floor."

## Valuation Report For The Paul Jones Family Partnership, L.P.

*Dispersion* Major companies continue to disperse operations, both within major metropolitan areas and to geographically diverse locations. “All the big New York–based financial companies are moving operations outside the city. They’ll keep a headquarters presence and certain functions, but not everything in one central location. It’s too risky.” Memories of 9/11 only reinforce companies’ inclinations to seek lower-cost space outside premium office markets wherever possible, whether domestically or internationally.

*Insurance* As expected, the market has resolved most insurance cost–related issues stemming from the World Trade Center attack. Owners absorb added, but not dramatically higher, costs for most properties. But the federal government backstop sunsets at the end of 2005, which could revive the issue.

*Security and Safety Expenses* Wherever possible, building owners have shied away from shelling out for top-of-the line security systems, though installation of additional guards and cameras has increased costs modestly at some properties. More prominent buildings with Fortune 500 tenants in major markets typically maintain greater vigilance, employing not only typical rent-a-guard ID screening, but also expensive optical badge-reading turnstiles and/or metal detectors. Most tenants in most places are considerably more concerned about petty theft than a terrorist assault. They don’t want to go through the hassle of checkpoint screenings, let alone pay additional pass-through charges. Outside major markets or in more commodity-type buildings “it’s walk right in and get in the elevator, just like it’s always been.”

*Mall Vulnerability* Throughout the world, terrorists have historically targeted shopping districts, where they can wreak havoc anonymously and escape detection. Although the Oklahoma City and 9/11 attacks struck office buildings, interviewees continue to be more concerned about malls or other shopping centers. These properties are largely defenseless and the lasting damage to consumer psyches could be severe.

*Travel Woes* Terror alerts fray nerves. International flare-ups keep people closer to home. And tighter U.S. visa restrictions reduce foreign visitations. All spell less business for many hotel operators. First, the World Trade Center tragedy devastated occupancies and revenues; then foreboding over the war in Iraq delayed any recovery. Who knows what’s next? That’s the problem.

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## SECTION 5: VALUATION ANALYSIS

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### Net Asset Value

An initial step in analyzing the Company is to calculate its net asset value (NAV). The NAV of the Paul Jones Family Partnership, L.P. as reflected herein is the amount for which a controlling interest could liquidate the underlying assets and liabilities excluding transaction costs. The NAV of the Company is computed by adding the total market value of the Company's assets and subtracting from this amount any of its liabilities or debts. The market value of the Paul Jones's assets was based on appraisals by Real Estate Appraisal Associates, Inc. The appraised values as of December 12, 2003 are shown below.

**Table 5-1: Net Asset Value as of December 12, 2003**  
**Source: Ross & Company CPA, PLLC**

<b>The Paul Jones Family Partnership, L.P.</b>	<b>Market Value as December 4,</b>	
15 Northern Boulevard	\$	2,600,000
16 Northern Boulevard	\$	3,200,000
17 Northern Boulevard	\$	2,000,000
<b>Total Asset</b>	<b>\$</b>	<b>7,800,000</b>
<b>Liabilities</b>	<b>\$</b>	<b>273,512</b>
<b>Net Asset</b>	<b>\$</b>	<b>7,526,488</b>

The Paul Jones Family Partnership, L.P. has liabilities of \$273,512; therefore its NAV is \$7,526,488 as of December 12, 2003. There is a difference in the date of the appraisal, December 12, 2003, and the date of death, December 4, 2003. For my review of the factors impacting the real estate and limited partnership valuations, this difference in dates has no material effect on the value of the partnership interests. The pro rata 1% interest is therefore \$75,265.

### THE VALUE OF 1 SHARE OF GENERAL AND LIMITED PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P.

By definition, the NAV of the Paul Jones Family Partnership, L.P. is equal to the following identity:

$$NAV = P_g * S_g + P_l * S_l$$

where:

$P_g$  = Price of general partnership share

$S_g$  = Number of general partnership shares

## Valuation Report For The Paul Jones Family Partnership, L.P.

$P_l$  = Price of limited partnership share

$S_l$  = Number of limited partnership shares

We know that the value of  $P_l$  is less than the value of  $P_g$  because limited partners do not exercise control over the assets of the partnership. The discount applied to the limited partnership shares due to the lack of control is approximately 0.7036 and is discussed subsequently. Using this value and the known quantities of  $S_g$ ,  $S_l$ , and NAV we can solve the following simultaneous system for the values of the general and limited partnership shares:

$$NAV = P_g * S_g + P_l * S_l$$

$$P_l = 0.7036 * P_g$$

The result is shown in the following table:

**Table 5-2: Equation Variables**  
**Source: Ross & Company CPA, PLLC**

<i>Variable</i>	<i>Value</i>
<i>Net Asset Value, NAV</i>	<i>\$7,526,488</i>
<i>Number of General Partnership Shares, <math>S_g</math></i>	<i>32</i>
<i>Number of Limited Partnership Shares, <math>S_l</math></i>	<i>68</i>
<i>Value of General Partnership Share, <math>P_g</math></i>	<i>\$94,263</i>
<i>Value of Limited Partnership Share, <math>P_l</math></i>	<i>\$66,324</i>

### THE VALUE OF AN ECONOMIC INTEREST

The value of an economic interest in the Company is its fair market value. Revenue Ruling 59-60 defines fair market value as:

The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property----- As a generalization, the prices of stocks which are traded in volume in a free and active market by the informed persons best reflect the consensus of the investing public as to what the future holds for the corporations and industries...<sup>3</sup>

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<sup>3</sup> Revenue Ruling 59-60

## Valuation Report For The Paul Jones Family Partnership, L.P.

A minority interest in a publicly held limited real estate partnership interest is comparable to a privately held limited interest in The Paul Jones Family Partnership, L.P. for several reasons. Like a minority partner in limited real estate partnership, a member of the Paul Jones Family Partnership, L.P. cannot:

1. Influence the distribution of earnings,
2. Influence the reinvestment of earnings,
3. Sell the underlying assets,
4. Control or manage the activities of the entity.

The minority interest in The Paul Jones Family Partnership, L.P. and a publicly held limited real estate partnership differ primarily in the degree of assurance that an owner would have regarding the distribution of earnings and in the marketability of the interest. It is probable that the investor in the publicly held security would have greater assurance of the distribution of earnings due to the higher level of scrutiny. Additionally, the publicly held interests are traded on a secondary exchange, whereas no public market exists for a privately held interest in The Paul Jones Family Partnership, L.P.

An examination of publicly held limited partnerships was conducted to identify guideline entities that were similar to The Paul Jones Family Partnership, L.P. in terms of risk and return. The analysis included a review of over 260 publicly held real estate partnerships from the Partnership Profiles Minority Interest Discount Database. This database provides comprehensive financial information regarding publicly traded limited partnership interests from 1994 to 2003. From the partnerships in the database, a search was conducted for publicly held partnerships with the following attributes.

1. The partnerships owned and managed equity interests in commercial property,
2. The partnerships had not announced definitive plans to liquidate,
3. The partnerships generated a return between 5.5% and 10.4%.

Data was obtained from Partnership Profiles, Inc. (PPI), a company that provides financial and transaction data on publicly held limited partnerships and from the Partnership Profiles Minority Interest Discount Database. Selected data from each of the guideline partnerships is summarized in the table below.

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**Table 5-3: Guideline Publicly Traded Real Estate Partnerships as of April/May 2003**

**Source: Partnership Profiles Inc.**

Guideline Publicly Traded Real Estate Partnerships: Values as of April/May 2003						
Partnership Name	Price to NAV	Total NAV(\$)	Borrowings/NAV	Yield Based on NAV	Yield Based on Price	GCF/NAV
The Evelyn DiBenedetto FLP		\$ 7,800,000	3.81%	8.51%		9.18%
First Capital Income Properties XI	0.85811	\$ 11,760,446	0.00%	7.80%	9.10%	9.90%
Rancon Income Fund I	0.69863	\$ 5,312,575	0.00%	5.50%	7.80%	9.90%
Wells Real Estate Fund III-A	0.92105	\$ 14,923,333	0.00%	5.90%	6.40%	6.60%
Wells Real Estate Fund IV-A	0.83444	\$ 11,985,556	0.00%	6.60%	7.90%	7.90%
Wells Real Estate Fund IX-A	0.93258	\$ 27,062,515	0.00%	9.70%	10.40%	10.20%
Wells Real Estate Fund VI-A	0.83241	\$ 19,720,403	0.00%	5.10%	6.10%	7.90%
Wells Real Estate Fund VIII-A	0.91534	\$ 25,677,162	0.00%	10.40%	11.30%	9.50%
Average for Publicly Traded Partnerships	0.85608	\$ 16,634,570	0.00%	7.29%	8.43%	8.84%

The guideline funds are closed-end real estate partnerships where the shares of the partnership are fixed. Hence, the purchase of shares by a new investor requires that an existing owner or owners sell an equivalent number of shares. In contrast, when shares of an open-end mutual fund are purchased, the fund creates new shares, which are sold to the investor at the share's net asset value. The number of open-end mutual fund shares outstanding increase by the amount of new shares created. Alternatively, when an investor desires to sell his/her position in the open-end fund, the shares are sold back to the fund at their net asset value. The shares outstanding of the open-end mutual fund are then reduced by the number of shares redeemed. In the case of open-end funds, the purchase and sale price is the fund's net asset value or NAV. Net asset value is defined as the market value of the assets less the value of liabilities divided by the number of fund shares outstanding. The upshot is that the share price of closed-end funds can sell at a discount or premium to their net asset value. Discounts emerge when the demand for the fund shares diminishes relative to supply of shares outstanding. Premiums emerge when the reverse develops.

Price-to-NAV ratios of the guideline limited partnerships were closely grouped and ranged from 0.8324 to 0.9326:1, with an outlier at .6986:1. The average price discount from NAV is about 14% (.8561:1) as of April/May 2003. Since the valuation date is December 04, 2003, Ross Valuation updated the average price-to-NAV ratio to make it consistent with the market conditions at the valuation date. We have done this by reviewing the extent to which the price to NAV ratios of four closed-end real estate funds have changed between April-May and December, 2003. The price-to-NAV of the funds chosen reflect the various market factors that influence both prices and NAVs and therefore we believe they offer appropriate guidance as to how the price to NAV ratios for the far less frequently traded guideline publicly traded limited real estate partnerships might change between April/May and the valuation date. Our assumption is that the average price to NAV for the sample of limited partnerships would experience the same magnitude of change as that experienced by the average price to NAV of the more

**Valuation Report For The Paul Jones Family Partnership, L.P.**

frequently traded closed-end real estate funds. The selected closed-end real estate funds used to update the average price to NAV of the publicly traded real estate partnerships are shown below.

**Table 5-4: Price-to-NAV for Selected Closed-End Frequently Traded Real Estate Funds**  
**Source: Yahoo! Finance and SEC Filings**

	AIM Select Real Estate	SSB Real Estate Fund	Scudder Real Estate Fund	AEW Real Estate Fund	Average
Start Date	5/31/2002	7/31/2002	10/31/2002	11/30/2002	Across Row
Date	Price/NAV	Price/NAV	Price/NAV	Price/NAV	Price/NAV
4/30/2003	0.96357	0.86169	0.91454	0.90483	0.91116
5/31/2003	1.01085	0.84306	0.95222	0.93772	0.93596
6/30/2003	0.87793	0.85388	0.86713	0.96711	0.89151
7/31/2003	0.90409	0.82110	0.89103	0.82707	0.86082
8/31/2003	0.90812	0.83014	0.91492	0.84153	0.87368
9/30/2003	0.92891	0.83155	0.96212	0.85367	0.89406
10/31/2003	0.96579	0.87347	0.96387	0.89184	0.92374
11/30/2003	0.99329	0.83853	1.00175	0.91209	0.93641
12/31/2003	0.88278	0.87958	0.88656	0.86142	0.87759
Decrease from May to December 2003					-0.0624

The results indicate that average price-to-NAV has decreased between April-May and December 2003 by approximately 6.24% or a factor of 0.9376 (1 minus .0624). We would expect this relationship to hold for the average price-to-NAV of the guideline real estate partnerships. Therefore, at the valuation date, the average price to NAV for the guideline partnerships would have been 0.8027 (0.8561 \*0.9376).

Each publicly registered partnership was further analyzed by examining the partnership's annual reports filed with the Securities and Exchange Commission. The following sections summarize the guideline partnerships' formation and holdings.

**First Capital Income Properties XI** (the "Partnership") is a limited partnership organized in 1985 under the Uniform Limited Partnership Act of the State of Illinois. The Partnership was formed to invest primarily in existing commercial income-producing real estate, such as shopping centers, warehouses and office buildings, and, to a lesser extent, in other types of commercial, income-producing real estate.

**Rancon Income Fund I** (the "Partnership") Rancon Income Fund I, a California Limited Partnership, (the Partnership) was organized in accordance with the provisions of the California Revised Limited Partnership Act for the purpose of acquiring, operating and disposing of existing income producing commercial, industrial and residential real estate properties. The General Partner of the Partnership is Rancon Income Partners I (General Partner). The Partnership was organized in 1986 and completed its public offering of partnership units (Units) in April 1989. As of December 31, 2003 and 2002, there were 12,966 and 13,279 Units outstanding, respectively.

**Wells Real Estate Fund III, LP** (the "Partnership") is a Georgia public limited partnership with Leo F. Wells, III and Wells Capital, Inc. (Wells Capital), a Georgia corporation, serving as its General Partners (the General Partners). The Partnership was formed on July 31, 1988 for the purpose of acquiring, developing, constructing,

## Valuation Report For The Paul Jones Family Partnership, L.P.

owning, operating, improving, leasing, and managing income-producing commercial properties for investment purposes. The Partnership has two classes of limited partnership interests, Class A and Class B Units. The limited partners may vote to, among other things, (a) amend the partnership agreement, subject to certain limitations; (b) change the business purpose or investment objectives of the Partnership; and (c) add or remove a general partner. A majority vote on any of the above-described matters will bind the Partnership without the concurrence of the General Partners. Each limited partner unit has equal voting rights regardless of class.

**Wells Real Estate Fund IV, LP** (the "Partnership") is a Georgia public limited partnership with Leo F. Wells, III and Wells Partners, L.P. (Wells Partners), a Georgia non-public limited partnership, serving as the General Partners. The Partnership was formed on October 25, 1990, for the purpose of acquiring, developing, constructing, owning, operating, improving, leasing and otherwise managing income-producing commercial properties for investment purposes. The Partnership has two classes of limited partnership interests, Class A and Class B units. Limited partners may vote to, among other things, (a) amend the partnership agreement, subject to certain limitations, (b) change the business purpose or investment objectives of the Partnership, and (c) add or remove a general partner. A majority vote on any of the above described matters will bind the Partnership without the concurrence of the general partners. Each limited partner unit has equal voting rights, regardless of class.

**Wells Real Estate Fund IX, L.P.** (the "Partnership") is a Georgia public limited partnership with Leo F. Wells, III and Wells Partners, L.P. ("Wells Partners"), a Georgia nonpublic limited partnership, serving as General Partners. The Partnership was formed on August 15, 1994, for the purpose of acquiring, developing, constructing, owning, operating, improving, leasing, and otherwise managing income producing commercial properties for investment purposes. The Partnership has two classes of limited partnership interests, Class A and Class B Units. Limited partners shall have the right to change their prior elections to have some or all of their units treated as Class A or Class B Units one time during each quarterly accounting period. Limited partners may vote to, among other things, (a) amend the partnership agreement, subject to certain limitations, (b) change the business purpose or investment objectives of the Partnership, and (c) add or remove a general partner. A majority vote on any of the above described matters will bind the Partnership, without the concurrence of the general partners. Each limited partnership unit has equal voting rights, regardless of class.

**Wells Real Estate Fund VI, L.P.** (the "Partnership") is a Georgia public limited partnership having Leo F. Wells, III and Wells Partners, L.P. ("Wells Partners"), a Georgia non-public limited partnership, as General Partners. The Partnership was formed on December 1, 1992, for the purpose of acquiring, developing, constructing, owning, operating, improving, leasing and otherwise managing for investment purposes income-producing commercial or industrial properties. The Partnership has two classes of limited partnership interests, Class A and Class B Units. Limited Partners have the right to change their prior elections to have some or all of their units treated as Class A Units or Class B Units one time during each quarterly accounting period. Limited Partners may vote to, among other things, (a) amend the partnership agreement, subject to certain limitations, (b) change the business purpose or investment objectives of the Partnership, and (c) add or remove a general partner. A majority vote on any of the

## Valuation Report For The Paul Jones Family Partnership, L.P.

above described matters will bind the Partnership, without the concurrence of the general partners. Each limited partnership unit has equal voting rights, regardless of class.

**Wells Real Estate Fund VIII, L.P.** (the "Partnership") is a Georgia public limited partnership with Leo Wells III and Wells Partners, L.P. ("Wells Partners"), a Georgia nonpublic limited partnership, serving as the General Partners. The Partnership was formed on August 15, 1994, for the purpose of acquiring, developing, owning, operating, improving, leasing, and otherwise managing income-producing commercial properties for investment purposes. The Partnership has two classes of limited partnership interests, Class A and Class B Units. Limited partners have the right to change their prior elections to have some or all of their units treated as Class A Units or Class B Units one time during each quarterly accounting period. Limited partners may vote to, among other things, (a) amend the partnership agreement, subject to certain limitations, (b) change the business purpose or investment objectives of the Partnership, and (c) add or remove a general partner. A majority vote on any of the above described matters will bind the Partnership, without the concurrence of the General Partners. Each limited partnership unit has equal voting rights, regardless of class.

### Price-to-NAV Analysis

To select an appropriate price-to-NAV ratio, The Paul Jones Family Partnership, L.P.'s investment characteristics were compared to the guideline partnerships.

- ☐ The Paul Jones Family Partnership, L.P. is considerably smaller than the guideline entities and was less diversified owning only three properties. This suggests a lower price-to-NAV ratio than the average of 0.8561: 1.
- ☐ The Paul Jones Family Partnership, L.P. consists of both assets and liabilities, whereas the guideline partnerships have no liabilities. This suggests a lower price-to-NAV ratio than the average of 0.8561: 1.

Based on these factors, we have included an additional discount of 12.34%; the derivation of this adjustment is covered in Appendix B. The calculation of the price-to-NAV ratio for The Paul Jones Family Partnership, L.P. is shown in the table below.

**Table 5-5: Build-up of Price-to-NAV**  
**Source: Ross & Company CPA, PLLC**

1) Average of Guideline Partnerships	0.8561
2) Update Factor	0.9376
3) Baseline Discount (Row 1 * Row 2)	0.8027
4) Discount Due to Leverage & Size	0.8766
<b>5) Final Price to NAV (Row 3*Row 4)</b>	<b>0.7036</b>

### THE LIQUIDITY DISCOUNT

Before calculating the final value of a minority interest in The Paul Jones Family Partnership, L.P., we need to develop an appropriate discount to reflect the fact that an economic interest in The Paul Jones Family Partnership, L.P. can not be easily sold or

## Valuation Report For The Paul Jones Family Partnership, L.P.

converted into cash. This discount is referred to as the liquidity or marketability discount. A discussion of how this discount was arrived at follows.

The liquidity discount reduces the ownership value to reflect the fact that the ownership interest cannot be easily sold. Any potential buyer of the ownership value faces the risk that he/she cannot sell the ownership interest in a timely way because there are a limited number of potential buyers. This is to be contrasted to shares of stock that trade on the New York Stock Exchange for example. These shares can be readily purchased and sold and, except for rare cases, the price received will reflect the fair market value of these shares. Thus, the liquidity discount reflects the additional risk that the buyer faces because he/she may not be able to receive a price that would be obtained if ownership interest in The Paul Jones Family Partnership, L.P. were sold in a highly liquid market.

Although much has been written on the liquidity discount and several organizations have routinely attempted to measure it, the values traditionally reported are far too high. The reason is that what is reported as a marketability or liquidity discount is really a private company discount. This private company discount reflects a number of factors that are not related to lack of liquidity. The differences between private firm valuations and those of public peers can occur because of differing cash flow growth prospects, timing of cash flows and differing ratios of debt to equity. The result is that reported discounts for marketability are too high and private company valuations that use them are too low. Table 5-6 offers evidence of the variation in private company discounts.

**Table 5-6: Representative Studies That Attempt to Measure the Liquidity Discount**  
**Source: Ross & Company CPA, PLLC**

<i>Author(s)</i>	<i>Peer Review</i>	<i>Discount</i>	<i>Reported Dispersion</i>	<i>Type of Study</i>
<i>William Silber</i>	Yes	35%	<i>14% for large creditworthy companies; 50% for small firms with negative earnings</i>	<i>Restricted stock study</i>
<i>M. Hertzal and Richard Smith</i>	Yes	<i>Not Reported</i>	<i>.2 % - 43.7 %</i>	<i>Private Equity Study</i>
<i>John Emory</i>	Yes	47%	<i>Not Reported</i>	<i>Pre-IPO Study</i>
<i>John Koeplin et.al.</i>	Yes	20.39%	<i>Depending on the multiple used, discount varied from 0% based on sales revenue to 28.26% using the ratio of Enterprise Value to EBIT</i>	<i>Identified all acquisitions of private firms from 1984 to 1998</i>
<i>Willamette Associates</i>	No	40.1%	<i>Wide dispersion from a premium to a maximum discount of 99%</i>	<i>Pre-IPO Study</i>

Two of the two major studies that valuation experts often reference when developing a marketability discount were reviewed in a recent article in the Business Valuation Review by Dr. Stanley J. Feldman. The author concludes the following:

Recent research seems to suggest that the size of the marketability discount is in the neighborhood of 13.5% and more recent work has suggested it is as low as 7.23%. The regression models of Silber, and Hertzal and Smith have provided both the intellectual and empirical basis for these conclusions. These models were initially developed to study the determinants of the marketability discount. It has been suggested that they should now be used as a basis for

## Valuation Report For The Paul Jones Family Partnership, L.P.

forecasting the marketability discount. This paper demonstrates that these models should not be used for this purpose because the forecast errors are likely to be large. Moreover, based on the structure of these models and their prediction errors, it is not possible to state with any certainty that a 13.5% marketability discount is statistically different than a discount of say 25%.<sup>4</sup>

Feldman's analysis indicates that the range within which the "true" marketability discount lies is quite wide, although the range is a function of a number of critical factors including firm size, and the level of interest rates at the valuation date. While the focus of Feldman's article is on the research of Silber and Hertz and Smith, the analysis is equally applicable to the studies conducted by Emory and Willamette Associates.

The Willamette results are the best known and as can be seen are generally consistent with those reported by other researchers. The problem with Willamette's results is that their data is proprietary and Willamette has not disclosed this information for peer review and analysis by academic researchers. This is an important qualification. This creates the potential that the empirical work presented may simply be fraught with errors. The peer review process, while it does not completely remove this possibility, nevertheless, minimizes the potential for drawing incorrect conclusions due to errors related to measurement, research design, and statistical method. It is particularly important to utilize peer-reviewed research when one is valuing a private asset since many of the issues that arise have been addressed by finance scholars and for which there is a well-developed academic literature.

Based on Ross & Company's review of this research, we believe that a starting point for developing an appropriate marketability discount is the 20% average discount published in the Koeplin study. This conclusion is based on two factors. First, their research controls for capital structure differences. Second, selection of the private company's public company peer was dictated by whether they were in the same four- digit SIC industry. In addition, the 20% starting point appears to be consistent with other academic research.

In a study by Sanger and McConnell<sup>5</sup> that measured the increase in share return occurring when a stock is listed on an exchange. The hypothesis is that improved liquidity emerges by exchange listing since the shares are now available to a larger group of investors. This results in permanent increase in the share price, which reflects the incremental return to increased marketability. Alternatively, one would also expect the stock price to fall if shares were delisted. Their research first focuses on firms that were traded on the OTC, prior to the existence of the NASDAQ. The researchers wanted to estimate the size of the average incremental return that occurs when an OTC stock was listed on an exchange during the pre-NASDAQ period. Their results indicate that

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<sup>4</sup> Stanley J. Feldman, *A Note on Using Regression Models to Predict the Marketability Discount*, **Business Valuation Review**, September, 2002, p.145.

<sup>5</sup> Gary C. Sanger and John J. McConnell, *Stock Exchange Listings, Firm Value, and Security Market Efficiency: The Impact of NASDAQ*, **The Journal of Financial and Quantitative Analysis**, Volume 21, Issue 1 (March, 1986), pp. 1-25.

## Valuation Report For The Paul Jones Family Partnership, L.P.

during the pre-NASDAQ period, the incremental return due to increased liquidity was 25.68%. This translates into a discount of approximately 20%<sup>6</sup>, interestingly about what Koeplin reports using a completely different research methodology, different sample, and covering a different time frame. Moreover, Koeplin's research measured marketability discount for controlled transactions, which presumably would be subject to greater marketability discount due to large size than a minority interest, which is what is being measured in the Sanger and McConnell study.

Edelman and Baker<sup>7</sup> extend the work of Sanger and McConnell by examining the market behavior of common stocks transferring from the NASDAQ stock market to the New York Stock Exchange. With some caveats, their results suggest that low volume (low liquidity) NASDAQ stocks seem to increase in price when they switch to the New York Stock Exchange, while high volume (high liquidity) NASDAQ stocks that switch do not. In fact the results indicate these stocks actually decline in price subsequent to the switch. This suggests that the incremental return of 25.86% reported by Sanger and McConnell might in fact be a good deal higher for relatively low volume OTC stocks. Although not statistically significant, Edelman and Baker report that low volume NASDAQ stocks that move to the New York Stock Exchange generally earn average incremental returns of 6.3%. While recognizing that this incremental return may result from more than just marketability, it does, nevertheless, suggest that low liquidity stocks that switch to a larger and better known exchange are likely to register permanent price gains. Based on these results, we conclude the following about the size of marketability discounts.

- Ç Research seems to suggest that a base marketability discount should not exceed 20%.
- Ç Increments above this 20% base should reflect unique characteristics of the interests being valued. For example, one would expect that firms whose shares were restricted in terms of the number and types of owners would be subject to an additional discount. S corporations, in contrast to their C counterparts, are characterized by these limitations, and therefore one would expect shares of S corporations to carry a greater marketability discount than shares of equivalent C corporations.
- Ç Based on the Edelman study, one can think of S shares being analogous to low volume C shares that move from a less to a more liquid exchange. S shares have relatively lower trade volume than like C shares because restrictions limit the market for them and therefore they are less liquid than their C counterparts. The incremental 6.27% Edelman reports that emerges when low volume NASDAQ stocks switch to the New York Stock Exchange translates into a discount of about 6%. Edelman points out that a percentage of this incremental return is unrelated to improvements in marketability but related to signaling-investor's expectations that the firm has better prospects than initially thought prior to the exchange move. This means that the pure liquidity effect, which we

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<sup>6</sup> Assume that the share price before switch was \$100. After the switch the price is \$125.68. If the switch were reversed, the price would decline from a \$125.68 to \$100 or a discount of approximately 20% ( $25.68/125.68 = 20.4\%$ ).

<sup>7</sup> Richard B. Edelman and H. Kent Baker, *The Impact of Company Pre-Listing Attributes on the Market Reaction to NYSE Listings*, **The Financial Review**, Vol. 28 No. 3, August, 1993, pp. 431-448.

## Valuation Report For The Paul Jones Family Partnership, L.P.

are attempting to measure, is lower than 6.27%. Edelman states, but does not show, that signaling is the more dominant attribute. We conclude that the incremental return to liquidity is about 3.14%, or about half of the reported 6.27%. This translates to an incremental discount of 3%. Because S shares are less marketable than low volume C shares used in the Edelman study, we conclude that the incremental discount for these is an additional 2% for a total discount of 5%.

- ç Discounts for lack of marketability in excess of the additional 5% already noted are based on incremental restrictions on the sale of shares that need to be valued. As a general rule the partnership provisions in Subchapter K of the Internal Revenue Code adopt an entity approach in dealing with the tax consequences when partnership interests are transferred. This is also true for LLCs taxed as partnerships. The transferred interest is treated like corporate stock and is considered to be a separate intangible asset rather than an undivided tenancy-in-common interest in partnership assets. LLCs are not subject to the same restrictions that S corporations are, and hence are more liquid, but LLCs that are effectively limited partnerships, like The Paul Jones Family Partnership, L.P. do have restrictions on transferability of economic interests that limit their marketability in a way that is similar to the limitations on S corporation shares.

### THE VALUE OF A 1% GENERAL PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P.

The value of a general partnership interest in The Paul Jones Family Partnership, L.P. is calculated in the table below.

**Table 5-7: Valuation of 1% General Partnership Interest as of December 4, 2003**

**Source: Ross & Company CPA, PLLC**

<b>Value of 1 Percent General Partnership Interest in The Paul Jones Family Partnership, L.P.</b>	
1) Value of 1 General Partnership Share	\$ 94,263
2) Discount Due to Marketability	20.00%
3) Marketability Discount Adjustment (Row 1 x Row 2)	\$ 18,853
4) Value of 1% General Partnership Interest Discounted for Marketability (Row 1 - Row 3)	\$ 75,411

**Valuation Report For The Paul Jones Family Partnership, L.P.**

**THE VALUE OF A 1% LIMITED PARTNERSHIP INTEREST IN THE PAUL JONES FAMILY PARTNERSHIP, L.P.**

The value of a 1% limited partnership interest in The Paul Jones Family Partnership, L.P. is calculated in the table below.

**Table 5-8: Valuation of 1% Limited Partnership Interest as of December 04, 2003**

**Source: Ross & Company CPA, PLLC**

<b>Value of a 1 Percent Limited Partnership Interest in The Paul Jones Family Partnership, L.P.</b>	
1) Value of 1 Limited Partnership Share	\$ 66,324
2) Base Discount Due to Marketability	20.00%
3) Increase in Discount Due to Transfer Restrictions	10.00%
4) Total Discount (1 - Row 2) x (1 - Row 3)	1 - (0.80 x 0.90) 28.00%
5) Marketability Discount Adjustment (Row 1 x Row 4)	\$ 18,571
6) Value of 1% Limited Partnership Interest Discounted for Liquidity (Row 1 - Row 5)	\$ 47,754

Since the limited partnership data used to convert the net asset value to the price of an economic interest was based on price-to-NAV of minority interests, no further discount for lack of control is needed. To the extent that a general partner's interest in the partnership carries with it rights, beyond simply managing the partnership, then such an interest is more valuable than a minority interest in the partnership.

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## APPENDIX A: PROFESSIONAL QUALIFICATIONS

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### Glen A. Ross, CPA, CVA

Mr. Ross graduated from Long Island University -CW Post Campus in 1992 with a Bachelor of Science Degree. He received his CPA designation -New York State licensure in 1998 and received his Certified Valuation Analyst (CVA) designation in 2003.

Mr. Ross is a member of the New York State Society of Certified Public Accountants, the National Conference of Certified Public Accounting Practitioners and the National Association of Certified Valuation Analysts.

Mr. Ross has worked for the CPA firm of Ross & Ross, CPA since 1992 and became a Partner of said firm in 1998. In 2005, the firm changed names to Ross & Company CPA, PLLC. He has been Treasurer of a local non-profit company since 1993, which helps to educate underprivileged youths. In 1999, Mr. Ross founded an online interactive advertising company. He acted as President and CEO of the company until it was sold in 2001. Also since 2001, Mr. Ross has been a member of the Executive Advisory Board of AccountStreet. This company provides specialized services to the accounting industry and CPAs.

In 2003 and 2004 Mr. Ross lectured on business valuations. His course, Understanding & Using Business Valuations, is approved for both CPE and CLE credit.

Mr. Ross has specialized knowledge and experience in the following industries and areas:

- Valuations of various entities and professional licenses including litigation support services.
- Forensic accounting in the determination of fraud and true economic value.
- Vast experience in taxation, tax planning and management advisory services for small, closely held businesses, new start-ups and going concern entities.
- Financial statement presentation and support.
- Computer consulting and integrated systems analysis.

Mr. Ross has worked on many major projects over the years including, but not limited to:

- Conducted and/or assisted in approximately 75 valuation engagements consisting of: Matrimonial disputes of closely held businesses, valuations of professional licenses, valuations of closely held businesses for estate taxes, gifting, buy/sell agreements and ESOPs.
- Mr. Ross was a Beta tester for "ValueSource Pro 2003" from John Wiley & Sons. This program is the leading valuation and financial analysis software in the country.
- Mr. Ross has prepared and/or analyzed financial statement projections and related analysis for start-up organizations and/or going concern entities.
- Mr. Ross has performed and/or assisted in certified audits for closely held businesses since 1991, totaling in excess of 80 audits.

## APPENDIX B: VALUATION DATA

**Table B-1: Price-to-NAV for Selected Closed-end Frequently Traded Real Estate Funds**

Source: Yahoo! Finance and SEC Filings

	AIM Select Real Estate	SSB Real Estate Fund	Scudder Real Estate Fund	AEW Real Estate Fund	Average
Start Date	5/31/2002	7/31/2002	10/31/2002	11/30/2002	Across Row
Date	Price/NAV	Price/NAV	Price/NAV	Price/NAV	Price/NAV
4/30/2003	0.96357	0.86169	0.91454	0.90483	0.91116
5/31/2003	1.01085	0.84306	0.95222	0.93772	0.93596
6/30/2003	0.87793	0.85388	0.86713	0.96711	0.89151
7/31/2003	0.90409	0.82110	0.89103	0.82707	0.86082
8/31/2003	0.90812	0.83014	0.91492	0.84153	0.87368
9/30/2003	0.92891	0.83155	0.96212	0.85367	0.89406
10/31/2003	0.96579	0.87347	0.96387	0.89184	0.92374
11/30/2003	0.99329	0.83853	1.00175	0.91209	0.93641
12/31/2003	0.88278	0.87958	0.88656	0.86142	0.87759
Decrease from May to December 2003					-0.0624

The table above shows the monthly price-to-NAV ratio for the selected closed-end funds. Using this data, we are able to update the price-to-NAV ratios given by the guideline partnerships. The assumption here is that the average change in the price-to-NAV ratio for the closed-end funds is equal to the change in the same ratio for the guideline partnerships. The average percentage decrease is equal to (May 2003 – December 2003)/May 2003 or  $(0.93596 - 0.87759)/0.93596$ , which is equal to negative 0.0624.

**Table B-2: Leverage and Size Discount**

Source: Ross & Company CPA, PLLC

Case 1 - No Debt, No Size Premium		Case 2 - With Debt & Size Premium	
Risk Free Rate*	4.38%	Risk Free Rate	4.38%
Market Risk Premium	7.42%	MRP	7.42%
Beta	1	Beta	1
Debt/Equity	0	Debt/Equity	0.0363
Tax Rate	40.00%	Tax Rate	40.00%
Size Premium	0%	Size Premium	1.5%
Required Rate of Return	11.8000%	Required Rate of Return	13.4616%
Growth	0%	Growth	0%
Earnings	\$ 1.00	Earnings	\$ 1.00
Price	\$ 8.47	Price	\$ 7.43
<b>Discount</b>	<b>12.34%</b>		

\*As of December 4, 2003. Federal Reserve Board of Governors

The table above shows our analysis of the leverage and size discount for The Paul Jones Family Limited Partnership. Investors require a higher rate of return as compensation for the risk of holding an asset that has debt. Additionally, investors must also be compensated for the risk associated with the incremental size difference

## Valuation Report For The Paul Jones Family Partnership, L.P.

between the guideline partnerships and the Paul Jones Family Limited Partnership. To determine the appropriate discount, we assumed two scenarios - the first a partnership with no debt and no size difference and the second a partnership with debt and a size premium to reflect the fact that the Paul Jones Family Limited Partnership is smaller than the guideline partnerships. The resultant difference in the price of the securities is equal to the discount that should be applied in this case.

Mathematically, the first step is to determine the required rate of return. Using a variation of the Capital Asset Pricing Model (CAPM) and assuming beta equal to unity, the base case required rate of return is 11.8%. This value is substituted into the Gordon Shapiro constant growth model, where the growth rate is assumed to be zero and earnings per share is \$1.00. We repeated this process, except in the second round we assumed a debt to equity ratio of 0.0363 (which is equal to the ratio for the Paul Jones Family Limited Partnership) and a size premium of 1.5%. The percentage difference between the two rounds is equal to the discount that should be applied for leverage and size.

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## APPENDIX C: CERTIFICATION AND CONDITIONS

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### Appraisal Certification

We hereby certify the following statements regarding this business valuation:

- ☒ We have not personally inspected the assets, properties, or business interests encompassed by this appraisal.
- ☒ We have no present or prospective future interest in the assets, properties, or business interests that are the subject of this business valuation.
- ☒ We have no personal interest or bias with respect to the subject matter of this report or the parties involved.
- ☒ Our compensation for making the appraisal is in no way contingent upon the value reported or upon any predetermined value.
- ☒ To the best of our knowledge and belief, the statements of facts contained in this report, upon which the analyses, conclusions, and opinions expressed herein are based, are true and correct
- ☒ Our analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the Uniform Standards of Professional Appraisal Practice, as promulgated by The Appraisal Foundation, except where noted.
- ☒ Subject to certain limitations the reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the Code of Professional Ethics and the Standards of Professional Appraisal Practice of The Appraisal Institute, of the American Society of Appraisers, and of the other professional organizations, unless otherwise stated.
- ☒ We have performed a historical analysis of the business's financial statements. We assume that the financial and related information supplied by the firm's representative reflects the normal operation of the business. To the extent this is not an accurate representation, the analysis and conclusions drawn are not valid and shall not be represented in any context that implicitly or explicitly suggests that Ross Valuation and its representatives believe the business valuation to be accurate.

## Valuation Report For The Paul Jones Family Partnership, L.P.

### Statement of Contingent and Limiting Conditions

This appraisal is made subject to these general contingent and limiting conditions:

- Ç We assume no responsibility for the legal description or matters including legal or title considerations. Title to the subject assets, properties, or business interests is assumed to be good and marketable unless otherwise stated.
- Ç The subject assets, properties, or business interests are appraised free and clear of any or all liens or encumbrances unless otherwise stated.
- Ç We assume responsible ownership and competent management with respect to the subject assets, properties, or business interests
- Ç The information furnished by others is believed to be reliable. However, we issue no warranty or other form of assurance regarding its accuracy.
- Ç We assume no hidden or unapparent conditions regarding its accuracy.
- Ç We assume that there is full compliance with all applicable federal, state, and local regulations and laws unless the lack of compliance is stated, defined, and considered in the appraisal report.
- Ç We assume that all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any local, state, or national government, or private entity or organization have been or can be obtained or reviewed for any use on which the opinion contained in this report is based.
- Ç Unless otherwise stated in this report, we did not observe, and we have no knowledge of, the existence of hazardous materials with regard to the subject assets, properties, or business interests. However, we are not qualified to detect such substances. We assume no responsibility for such conditions or for any expertise required to discover them.
- Ç Possession of this report does not carry with it the right of publication. It may not be used for any purpose by any person other than the client whom it is addressed without our written consent and, in any event, only with proper written qualifications and only its entirety.
- Ç We, by reason of this opinion, are not required to furnish a complete valuation report, or to give testimony, or to be in attendance in court with reference to the assets, properties, or business interests in question unless arrangements have been previously made.
- Ç Neither all nor any part of the contents of this report shall be disseminated to the public through advertising, public relations, news, sales, or other media without our prior written consent and approval.
- Ç The analyses, opinions, and conclusions presented in this report apply to this engagement only and may not be used out of context presented herein. This report is valid only for the effective date(s) specified herein and only for the purpose(s) specified herein.