

# CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM

## AP Equity Properties, Ltd.

**\$10,000,000**

### **1,062,500 Units of Limited Partnership Interest**

AP Equity Properties, Ltd., a Texas Limited Partnership (the "Company"), pursuant to the terms and conditions set forth in this Confidential Private Placement Memorandum (the "Memorandum") hereby offers for sale (the "Offering") only to accredited, private investors up to \$10,000,000, a "maximum amount" of 1,062,500 units of the Company's Limited Partnership Interest. Each unit of Limited Partnership Interest is being sold for \$8.50. The minimum dollar amount necessary to close this Offering is \$100,000.

**An investment in the units of Limited Partnership Interest offered hereby involves a high degree of risk and is suitable only for persons who can bear the economic risk of an investment for an indefinite period of time and afford the total loss of their investment. See "Risk Factors" beginning on page five for a discussion of certain factors that should be considered by prospective investors.**

**The securities described herein have not been registered pursuant to the Securities Act of 1933, as amended, nor have they been registered under the securities act of any state. These securities are offered pursuant to an exemption from registration. These securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is unlawful.**

This is a confidential private placement memorandum of our business model, strategy and other proprietary information. Any duplication or transmission of the accompanying information without our prior express permission is strictly prohibited.

**November 2004**

The information contained in this private placement memorandum is not complete and its contents may differ from that of private placement memoranda designed to conform to the requirements applicable to registration statements under United States securities laws. The securities described herein are being offered only to "accredited investors," as that term is defined by Regulation D under the Securities Act of 1933, as amended, and the rules and regulations thereunder, who directly or through their advisors, have the expert knowledge to evaluate information and data relating to the energy technology industry and whose potential investment is sufficiently large to justify the

utilization by them of the access being granted them to other information. Prospective investors will be granted access to all reasonably available, relevant data concerning us and are urged to request whatever documents or material they believe will be useful in making their investment decisions. It is assumed that potential investors will base their investment decisions on their own analysis of all information they deem to be relevant. The information presented herein is deemed ~~to be confidential~~ ~~because the business is not guaranteed~~ by have not been registered, none of the securities may be resold, transferred or otherwise disposed of unless the transaction effecting such disposition is registered under the Securities Act of 1933, as amended, or an exemption therefrom is available. Purchase of such securities entails a high degree of risk and the resale or other transfer thereof will be subject to restrictions. No public market exists with respect to any of our securities. We cannot assure you that any such market will develop. Investors should be aware that they may be required to bear the risks of this investment for an indefinite period. Each investor must sign an investment representation consistent with the foregoing.

The securities offered here by have not been and will not be approved or disapproved by the Securities and Exchange Commission or by any state securities commission or other regulatory authority, nor will the Securities and Exchange Commission or any such agency pass upon the merits of this offering or the accuracy or adequacy of this memorandum. Any representation to the contrary is a criminal offense.

This memorandum does not constitute an offer or a solicitation to any person in any jurisdiction in which such offer or solicitation is unlawful. This offering is not being made to, nor will subscriptions be accepted from or on behalf of, recipients of this memorandum in any jurisdiction in which the making or acceptance thereof would not be in compliance with the laws of such jurisdiction. However, we may, in our sole and absolute discretion, take such action as we may deem necessary to make this offering in any such jurisdiction and extend this offering to offerees in such jurisdiction.

This memorandum is submitted to prospective investors on a confidential basis for their informational use solely in connection with the offering described herein. The disclosure of any of the data contained herein or its use for any other purpose except with our prior written consent is prohibited. This memorandum may not be reproduced, in whole or in part, and it is accepted with the understanding that it will be returned to the placement agent on request if the recipient does not purchase the securities offered hereby.

This memorandum supersedes any documents previously supplied to prospective investors concerning us and the terms and conditions of the offering being made hereby. This memorandum contains summaries of the contents of certain agreements and other documents. Reference should be made to these agreements and documents for complete information concerning the rights and obligations of the parties thereto and the matters described therein. Subject to any applicable restrictions as to confidentiality, all of these agreements and documents shall be made available upon request of the placement agent.

This memorandum contains projections of future financial performance. These projections are based on numerous estimates and other assumptions about future events and circumstances, many of which will not be within our control. We believe that such estimates and other assumptions are reasonable under the circumstances, but no representation, warranty or other assurance is given that such projections will be realized. There will be variances between these projections and actual events and results, and these variations likely will be material and potentially adverse.

Market data and certain industry forecasts used throughout this memorandum were obtained from our internal analysis, market research, publicly available information and industry publications. Industry publications generally provide that

(i) the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. Similarly, internal surveys, industry forecasts and market research, while believed to be reliable, have not been independently verified by us or the placement agent and neither we nor the placement agent makes any representation as to the accuracy of this information. The placement agent expressly disclaims any representation respecting any projections concerning market size, pricing of our services and products or the amount or timing of revenue or expenses that are included in this memorandum.

No person has been authorized to make any representations concerning this Offering, and no person other than our designated representative has been authorized to furnish any information, other than as set forth in this memorandum or otherwise, and, if made or given, these other representations or information must not be relied upon by you.

The content of this memorandum or any prior or subsequent communication from or with us, the placement agent, or any professional associated with this Offering, is not legal, tax or investment advice. You should consult your own counsel, accountant or business advisor as to legal, tax, financial and related matters relating to your purchase of our Limited Partnership Units.

Neither the delivery of this memorandum nor any sale made hereunder shall, under any circumstances, create any implication that the information herein is correct as of any time subsequent to the date hereof or that there has not been any change in the information contained herein since the date hereof. Neither we nor the placement agent shall have any duty to update the information in this memorandum.

The securities are offered by this memorandum subject to acceptance of subscriptions by us and the other conditions, including receipt of a fully completed subscription agreement, as set forth in this memorandum. We reserve the right in our sole discretion to reject any subscription in whole or in part or to allot to any investor less than the number of units of Limited Partnership Units subscribed for, and to withdraw, cancel or modify this offering at any time without notice.

We reserve the right, in our sole discretion and for any reason whatsoever, to modify, amend and/or withdraw all or any portion of this offering and/or accept or reject in whole or in part my prospective investment in our Limited Partnership Units or to allot you less than the amount of Limited Partnership Units you desire to purchase. We will have no liability whatsoever to you and/or any prospective investor in the event that any of the foregoing shall occur. We may not sell any of our Limited Partnership Units or accept any offer to purchase units of our Limited Partnership Units until we have delivered to you and you have executed the Subscription Agreement reflecting the definitive terms and conditions of this offering. You should review carefully the full text of the Subscription Agreement and all other documents and agreements provided to you in connection with this offering prior to purchasing units of our Limited Partnership.

An investment in the securities is speculative, involves a high degree of risk and significant restrictions on transfer, and should be considered only by sophisticated investors who are able to bear the economic risks of their investment for an indefinite period of time and who can afford to sustain a total loss of their investment in the securities.

**NOTICES REQUIRED BY STATE LAW**

FOR CALIFORNIA RESIDENTS ONLY

**THE SECURITIES REFERRED TO IN THE MEMORANDUM HAVE NOT BEEN QUALIFIED WITH THE COMMISSIONER OF CORPORATIONS OF THE STATE OF CALIFORNIA, AND IN THE ABSENCE OF QUALIFICATION OR AN EXEMPTION THEREFROM, THE ISSUANCE OF THE SECURITIES OR THE PAYMENT OR RECEIPT OF ANY PART OF THE CONSIDERATION THEREFOR IS UNLAWFUL. THE RIGHTS OF ALL PARTIES TO PURCHASE THE SECURITIES ARE EXPRESSLY CONDITIONED UPON SUCH QUALIFICATION BEING OBTAINED OR AN EXEMPTION FROM REGISTRATION BEING APPLICABLE. FOR FLORIDA RESIDENTS ONLY**

**PROSPECTIVE INVESTORS WHO RESIDE IN FLORIDA ARE ADVISED THAT WHERE SALES ARE MADE TO FIVE (5) OR MORE PERSONS PURSUANT TO SECTION 517.061 (11) (a) (5) OF THE FLORIDA SECURITIES INVESTOR PROTECTION ACT, SUCH SALES ARE VOIDABLE BY THE PURCHASERS WITHIN THREE (3) DAYS AFTER THE FIRST TENDER OF CONSIDERATION IS MADE BY THE PURCHASER TO THE COMPANY OR ANY AGENT OF THE COMPANY OR WITHIN THREE (3) DAYS AFTER THE AVAILABILITY OF THAT PRIVILEGE IS COMMUNICATED TO THE PURCHASER, WHICHEVER OCCURS LATER. THE SECURITIES REFERRED TO IN THIS MEMORANDUM HAVE NOT BEEN REGISTERED UNDER THE FLORIDA SECURITIES ACT (RULE 3E500.05) (5)**

**(a) (12).**

FOR NEW YORK RESIDENTS ONLY

**THIS MEMORANDUM DOES NOT CONTAIN ANY UNTRUE STATEMENT OF A MATERIAL FACT OR OMIT TO STATE A MATERIAL FACT NECESSARY TO MAKE THE STATEMENTS MADE, IN LIGHT OF THE CIRCUMSTANCES UNDER WHICH THEY WERE MADE, NOT MISLEADING. IT CONTAINS A FAIR SUMMARY OF THE MATERIAL TERMS OF THE DOCUMENTS PURPORTED TO BE SUMMARIZED HEREIN.**

**THIS MEMORANDUM HAS NOT BEEN REVIEWED BY THE ATTORNEY GENERAL OF THE STATE OF NEW YORK PRIOR TO ITS DISTRIBUTION, ISSUANCE AND USE.**

**THE ATTORNEY GENERAL OF THE STATE OF NEW YORK HAS NOT PASSED UPON OR ENDORSED THE MERITS OF THIS OFFERING. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.**

FOR NEW JERSEY RESIDENTS ONLY

**THE ATTORNEY GENERAL OF THE STATE OF NEW JERSEY HAS NOT PASSED ON OR ENDORSED THE MERITS OF THIS OFFERING. ANY FILING OF THIS OFFERING WITH THE BUREAU OF SECURITIES DOES NOT CONSTITUTE**

(iii)

**APPROVAL OF THE ISSUE OR THE SALE THEREOF BY THE BUREAU OF SECURITIES OR THE DEPARTMENT OF LAW AND PUBLIC SAFETY OF THE STATE OF NEW JERSEY. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.**

FOR CONNECTICUT RESIDENTS

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISSAPPROVED BY THE BANKING COMMISSIONER OF THE STATE OF THE CONNECTICUT NOR HAS THE COMMISSIONER PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.**

**THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER SECTION 36485 OF THE CONNECTICUT UNIFORM SECURITIES ACT AND THEREFORE CANNOT BE RESOLD UNLESS THEY ARE REGISTERED UNDER SUCH ACT OR UNLESS AN EXEMPTION FROM REGISTRATION IS AVAILABLE.**

NOTICE TO ILLINOIS RESIDENTS

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECRETARY OF STATE OF ILLINOIS OR THE STATE OF ILLINOIS, NOR HAS THE SECRETARY OF STATE OF ILLINOIS OF THE STATE OF ILLINOIS PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

NOTICE TO TEXAS RESIDENTS

**THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER APPLICABLE SECURITIES LAWS OF TEXAS AND THEREFORE CANNOT BE RESOLD OR TRANSFERRED UNLESS THEY ARE SUBSEQUENTLY REGISTERED OR UNLESS AN EXEMPTION FROM REGISTRATION IS AVAILABLE.**

## NOTICE TO MASSACHUSETTS RESIDENTS

**THIS OFFER IS BEING MADE PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE FEDERAL AND STATE SECURITIES LAWS. NO SALE MAY BE MADE UNTIL THE OFFERING STATEMENT IS QUALIFIED BY THE SEC AND IS REGISTERED IN THIS STATE**

## NASAA UNIFORM LEGEND

**IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY**

**(iv) REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND REAL AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. INVESTORS SHOULD BE AWARE THAT THEY WILL BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.**

## FOR NON-UNITED STATES RESIDENTS

It is the responsibility of the prospective investor to satisfy itself as to full observance of the laws of any relevant territory or jurisdiction outside the United States in connection with any purchase of our Limited Partnership Units, including, without limitation, obtaining any required governmental or other consents or observing any other applicable requirements.

### **For Residents of the United Kingdom**

No prospectus or memorandum with respect to the Units of Limited Partnership Interest being offered hereby has been or will be prepared and filed in the United Kingdom by us pursuant to the U.K. Public Offers of Securities Regulations 1995 (as amended). Accordingly, our Limited Partnership Units may not be offered or sold or reoffered or resold to persons in the United Kingdom, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their business, or otherwise in circumstances that will not constitute or result in an offer to the public in the United Kingdom within the meaning of the U.K. Public Offers of Securities

Regulations 1995. This confidential memorandum may not be passed to any person in the United Kingdom who does not fall within Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996, as amended, or who is not otherwise a person to whom the document may lawfully be issued or passed.

The date of this memorandum is November 29, 2004

*The Offering:*

- The units will be offered on a best efforts basis to investors at \$\_\_\_\_\_ per partnership unit, Net asset value "NAV" per unit is \$\_\_\_\_\_.
- This offering will terminate on or before \_\_\_\_\_.
- It is possible that we will pay selling commissions to broker-dealers of 8-10% out of the offering proceeds raised.
- We will invest approximately 85% of the offering proceeds in real properties, and the balance will be used to pay fees and expenses.

**FORWARD-LOOKING STATEMENTS**

This memorandum contains or incorporates by reference certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (or the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (or the Exchange Act). When used, statements which are not historical in nature, including those containing words such as "anticipate," "estimate," "should," "expect," "believe," "intend" and similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to various risks and uncertainties, including those relating to:

Other risks, uncertainties and factors, including those discussed under "Risk Factors" in this memorandum or described in reports that we may file from time to time with the Securities and Exchange Commission (or the SEC), State Securities Commissions or Boards, or by public announcement, could cause our actual results to differ materially from those projected in any forward-looking statements we make. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**Blind Pool Offering**

It is important to note that this is what is commonly referred to as a "blind pool" offering in that we do not yet own any properties and have not yet identified any properties for acquisition. You will not have the opportunity to evaluate any properties in which we will invest. You must rely totally upon the ability of the General Partner to select such properties.

**ABOUT THIS MEMORANDUM**

This memorandum provides you with a general description of the securities we may offer. Each time we offer to sell securities, we will provide a supplement to this memorandum that will contain specific information about the terms of that offering if it is different than the terms described herein. The

memorandum supplement may also add, update or change information contained in this memorandum. We encourage you to read this memorandum and the related memorandum supplement, as well as the information which is incorporated by reference herein, in their entirety. You should carefully consider the factors set forth under "Risk Factors" in this memorandum before making an investment decision to purchase any of our securities. All references to "we," "us" or "our company" "The Partnership" in this memorandum mean AP Equity Properties, Ltd..

## **AP Equity Properties**

### **Our Business**

#### **AP Equity Properties, Ltd.:**

AP Equity Properties, Ltd., is a Texas limited partnership that will own and manage real properties. Our office is located at 7703 North Lamar Blvd. Suite 510, Austin Texas. We refer to AP Equity Properties as "The Partnership" in this memorandum.

### **Our General Partner**

Our General Partner is AP Equity Properties Management, LLC, a Texas Limited Liability Company. Although it is a new entity, it is controlled by experienced real estate and financial professionals with over 30 years of combined experience in commercial real estate. The General Partner is responsible for the management of the partnership. It has unlimited liability for all of the debts and liabilities of the Limited Partnership. The General Partner owns 2% of the limited partnership, this interest was purchased by the Members of the General Partner in August of 2004.

Composition of the General Partner (Estimated at the time of this memorandum)

#### Member Ownership Percentage

- John. F. Graham 50%

-Jeremy G. Stobie 50%

### **Biographies of the Members of the General Partners:**

#### **John F. Graham - Real Estate / Investments / Inventor**

John F. Graham graduated with a Bachelors degree in business Administration and has been actively involved in real estate ownership and property management in Austin, making significant contributions to the industry during the last 20 years. Although his focus is primarily the acquisition and management of local real property, Mr. Graham has successfully recognized the importance of broadening the scope of his business through the development of patents in fields that range from global credit systems and risk management, to the funding, research and development of alternative sources of energy. Atop his overlook at N. Lamar building Mr. Graham realized the need for roof vortex wind turbine technology. Some of his work can be viewed online at [www.austinpartners.net](http://www.austinpartners.net)

#### **Jeremy G. Stobie, CPA:**

Mr. Stobie is a certified public accountant in the State of Texas. He graduated UT Austin with a degree in Business and Economics. He is currently the Managing Shareholder and principal owner of Beacon Capital Inc., and investment advisory and investment banking practice here in Austin. Additionally, he is a Managing Partner of Pearce, Stobie and Co, LLC, an Austin based Certified Public Accountant. He also maintains an ownership interest in Stobie Ventures, a venture capital and incubation company and a managing interest in various other companies. Other relevant experience includes 8 years as a non-commissioned officer in the United States Marine Corps/ Marine Corps. Reserve, 4.5 years working for a prominent legal practice here in Austin and 4.5 years in real property management.

## **Our Manager**

We have no outside manager. Our Manager is The General Partner which is responsible for managing our affairs on a day-to-day basis, for identifying and making acquisitions on our behalf, and for managing the offering of partnership units to the public. We also may refer to the General Partner as “The Manager” in this memorandum.

## **Board of Advisors**

Our Board of Advisors is responsible for the oversight of the General Partner. Each member of the board of advisors will be appointed to serve five year terms. The advisors will be independent of the General Partner of AP Equity Properties, Ltd., and have responsibility for reviewing its performance.

The Initial Board of Advisors is as follows:

### Member

Not determined at this time

The members will be selected throughout the offering process.

## **Estimated Use of Proceeds of Offering:**

If we utilize the services of outside promoters and or salespeople we anticipate that we will invest at least 85% of the proceeds of this offering in real properties. We will use the remainder of the offering proceeds to pay selling commissions, fees and expenses relating to the selection and acquisition of properties and the costs of the offering. If partnership interests are offered directly to the public by the General Partner no selling concessions or fees for offering the units shall be charged with the exception of the reimbursement to the General Partner for any expenses incurred with the offering of those partnership interests and fees assessed in connection with management of the offering itself and reserves for future expenses.

## **USE OF PROCEEDS**

Unless otherwise indicated in an accompanying memorandum supplement, we intend to use the net proceeds from the sale of the securities offered by this memorandum and the related accompanying memorandum supplement to acquire real properties consistent with our investment

policy for general Partnership purposes. Pending investment, we will hold the net proceeds in interest-bearing bank accounts or in readily marketable, interest-bearing securities.

**AP Equity Partners, Ltd.**  
**Use of Proceeds Outline**  
% Summary

Gross Offering Proceeds	100.00%
Less: Dealer Concession	8.00%
Proceeds to The Partnership	92.00%
Proceeds to The Partnership	92.00%
Marketing Support Fee	-0.50%
Due Dilligence Reimbursements	-1.25%
Acquisition Fee Reserve	-4.50%
Working Capital Reserve	-0.75%
Cash Available for Purchase of Properties	85.00%

**AP Equity Partners, Ltd.**  
**Use of Proceeds Outline**  
Fully Subscribed

Gross Offering Proceeds \$10,000,000 Less: Dealer Concession (\$800,000)

Proceeds to The Partnership \$9,200,000

Proceeds to The Partnership \$9,200,000 Marketing Support Fee (\$50,000) Due  
Dilligence Reimbursements (\$125,000) Acquisition Fee Reserve (\$450,000)  
Working Capital Reserve (\$75,000)

Cash Available for Purchase of Properties \$8,500,000

This use of proceeds diagram is only accurate if the services of a broker dealer or outside sales representatives are employed. In the event that the offering proceeds are raised directly by the General Partner no concession shall be paid to Broker Dealers, in this event 92% of the Gross Offering Proceeds shall be used to purchase properties and reimburse other operating and offering costs.

**NOTE: As of the date of the memorandum, the Partnership does not own any real property interests.**

**Investment Objectives**

Our investment objectives are:

- To maximize cash distributions paid to you;

- To preserve, protect and return your capital contribution;
- To realize growth in the value of our properties upon our ultimate sale of such properties; and
- We aim to provide you with liquidity of your investment by listing the units/shares on a national exchange.

### **Terms of the Offering**

We will begin selling units in this offering upon the effective date of this memorandum, and this offering will terminate on or before \_\_\_\_\_. However, we may terminate this offering at any time prior to such termination date. We will hold your investment proceeds in our account until we withdraw funds for the acquisition of real properties or the payment of fees and expenses. We generally admit limited partners to the Partnership on a daily basis.

### **General**

- Units of limited partnership interest and preferred return units (if offered) of partnership interest are being offered — investor must choose
- \$\_\_\_\_\_ cost per unit
- \$\_\_\_\_\_ Net Asset Value per unit
- Minimum subscription — \$5,000
- Maximum subscription — \$5,000,000
- Maximum aggregate subscriptions for this offering — \$10,000,000

AP Equity Properties will offer for sale an aggregate of 1,062,500 Units at \$\_\_\_\_\_ per unit, aggregating \$10,000,000.00, of limited partnership interests. You may purchase units only if you meet the suitability standards set forth below. We will offer units for sale over a ten year period. In the event you purchase units on more than one occasion during the offering period of a partnership, the minimum purchase on each occasion is \$5,000.00 unless waived by the General Partner. You may elect to purchase units as a limited partner. Additionally, you may purchase units of limited partnership or units of preferred return limited partnership units. There is no restriction on the composition of the type of partnership interests with respect to The Partnership.

### **Distribution Reinvestment Plan**

You may participate in our distribution reinvestment plan pursuant to which you may have the distributions you receive reinvested in units of the Partnership. If you participate, you will be taxed on your share of our taxable income even though you will not receive the cash from your distributions. As a result, you may have a tax liability without receiving cash distributions to pay such liability. We may terminate the distribution reinvestment plan at our discretion at any time upon 10 days notice to you.

## **Partnership Unit Redemption Program**

We may use proceeds received from the sale of units pursuant to our distribution reinvestment plan to redeem your units. After you have held your units for a minimum of one year, our unit redemption program provides an opportunity for you to redeem your units, subject to certain restrictions and limitations, for the lesser of \$\_\_\_\_\_ per unit or 8% less than the price you actually paid for them. Our General Partner and the Board of Advisors reserves the right to amend or terminate the unit redemption program at any time. The General Partner has the right to (1) waive the one-year holding period in the event of the death or bankruptcy of a unit-holder or other exigent circumstances, or (2) reject any request for redemption at any time and for any reason. You will have no right to request redemption of your units should our units become listed on a national exchange.

Subscriptions for units are payable in cash purchased upon subscription. Your subscription is not revocable after you submit it to us. Investors should make their checks for units payable to “AP Equity Properties” and mail the subscriptions agreement and check to the primary office of the Partnership, 7703 North Lamar Blvd. Suite 510, Austin Texas 78752, Attn: Investor Relations. All subscription funds received from investor partners will be deposited by noon of the next business day after receipt to the Partnership’s Bank of Record. Your execution of the subscription agreement and its acceptance by us constitute your execution of the limited partnership agreement and your agreement to be bound by the terms of the limited partnership agreement as a partner, including your granting of a special power of attorney to us appointing us as your lawful representative to execute and file a certificate of limited partnership and any amendment of the certificate, governmental reports, certifications, contracts, and other matters.

## **Description of Units**

### **General**

Your investment will be recorded on our books only. We will not issue ownership certificates. If you wish to transfer your ownership interest, you are required to send us an executed transfer form. We will provide you the required form upon request.

### **Units of Partnership Interest.**

You may choose to purchase units of limited partnership interest. “Unit” means a partnership interest of a limited partner or of an additional general partner purchased by an investor partner. This interest is the right and obligation to share a proportional part of the investor partners’ share of partnership income, expense, assets and liabilities. The fractional interest purchased by a one unit investment in the investor partners’ interest in the partnership is the ratio of one unit to the total number of units outstanding. If you are an individual investor and invest as a limited partner, you will be able to use your deductions only to reduce taxable income from passive sources. Please contact your tax advisor for an explanation of what effect your investment may have with regard to your personal situation. Your liability as a limited partner is restricted to your investment in the partnership.

### **Types of Units**

Investors may choose to be a limited partner or purchase preferred return limited partner units (who shall also be considered a limited partner). Although investor partners will generally share income, gains, losses, deductions, and cash distributions allocable to them pro rata based upon the amount of their subscriptions, there are material differences in the federal income tax effects and the liability associated with these different types of units. You must indicate on the investor signature page of the subscription agreement the number of limited partnership units subscribed for. If you fail to indicate on the subscription agreement a choice between investing as a limited partner or as a subscriber of preferred return partnership units, we will not accept your subscription but will promptly return the subscription agreement and the tendered subscription funds to you.

### ***Limited Partners***

The liability of a limited partner of the partnership for the partnership's debts and obligations will not exceed that partner's capital contributions, his or her share of partnership assets, and the return of any part of his or her capital contribution (a) for a period of one year afterwards for the amount of his or her returned contribution if a limited partner has received the return without violation of the limited partnership agreement or the Texas Revised Limited Partnership Act, but only to the extent necessary to discharge the limited partner's liabilities to creditors who extended credit to the partnership during the period the contribution was held by the partnership. The General Partner reserves the right to change the unit price that it offers to the public at any time at its sole discretion due to prevailing market conditions. No guarantees are made that future issuance of partnership units will be at a price greater than the current offerings.

### ***General Partner.***

The general partner will consist of the general partner AP Equity Properties Management, LLC. A Texas limited liability company organized under the laws of the State of Texas. As a general partner of a partnership it will be fully liable for the debts, obligations and liabilities of the partnership individually and as a group with all other general partners as provided by the Texas Revised Limited Partnership Act to the extent liabilities are not satisfied from the proceeds of insurance, from the indemnification by us, or from the sale of partnership assets.

### ***Subscription***

All subscriptions are payable in cash upon subscription. Once you submit your subscription, your subscription is not revocable and you will not be able to get your subscription funds back. We will hold your subscription in escrow until the first day of the proceeding month, upon which you will be admitted to the Partnership as a Limited Partner. In addition, with the exception to the payment of selling commissions, offering expenses and reserves for future expenditures we may hold funds in escrow until a real property is purchased, every attempt shall be made to secure a favorable return on funds held in escrow.

### ***Suitability Standards — Long-Term Investment.***

We have instituted strict suitability standards for investment in the partnerships. You may not invest unless you satisfy the suitability requirements.

## **Compensation of the General Partner**

We and our affiliates will receive substantial compensation upon the formation and as a result of the operation of the partnership. We will receive fees for managing the properties, leasing the properties and operating the business of the partnership, for marketing the partnership, and for administering the partnerships, and possibly commissions and fees for selling the units of the partnership. The compensation payable to the General Partner and its affiliates will reduce the amount of cash distributions to investors. See “Compensation to the General Partner and Affiliates” where we discuss the General Partner’s equity interest in the partnership as well as the various fees, payments and reimbursements that the General Partner and/or its affiliates will receive during the life of the partnership.

## **Participation in Costs and Revenues**

Generally, investor partners will receive 98% and the General Partner will receive 2% of Partnership profits and losses throughout the term of each Partnership. Amounts will be paid to partners only *after* payment of fees and expenses to the General Partner and its affiliates and *only* if there is sufficient cash available.

## **Application of Proceeds**

We estimate that we will apply the proceeds from the aggregate funding of a partnership, after our cash contribution, as follows. See “Use of Proceeds” (page 5).

## **Rights of the Investor Partners**

The limited partnership agreement, which we attach to this memorandum as Appendix A, sets forth your rights as a limited partner.

## **Investor Suitability**

- Investment in the units involves a high degree of risk.
- You may invest only if you are qualified to purchase units. This determination is made by the State and Federal Securities regulators. You may not be able to purchase units if you reside within the jurisdiction in which this offering is not approved.
- Investment is suitable only for investors having substantial financial resources who understand the long term nature, tax consequences, and risk factors associated with this investment.
- You must be an accredited investor:

The federal securities laws define the term accredited investor in Rule 501 of Regulation D as:

1. a bank, insurance company, registered investment company, business development company, or small business investment company;

2. an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million;
3. a charitable organization, corporation, or partnership with assets exceeding \$5 million;
4. a director, executive officer, or general partner of the company selling the securities;
5. a business in which all the equity owners are accredited investors;
6. a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase;
7. a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year; or
8. a trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.

- Transferees of units must meet the suitability requirements set forth in this section.

It is the obligation of persons selling units to make every reasonable effort to assure that the units are suitable for investors, based on the investor's investment objectives and financial situation, regardless of the investor's income or net worth. We will sell units, including fractional units, to you only if you satisfy the following suitability requirements. Net worth will be determined exclusive of home, home furnishings and automobiles. In addition, we will sell units to you only if you make a written representation that you are the sole and true party in interest and that you are not purchasing for the benefit of any other person (or that you are purchasing for another person who meets all of the conditions set forth in this section). The following represent footnotes to various states set forth in the two following tables. Please refer to the following footnotes as appropriate.

### ***Purchasers of Units of Limited Partnership Interest.***

If you wish to purchase units of limited partnership interest in the partnership, you must satisfy the following suitability requirements for your state of residence.

### **Cash Distribution Policy**

- We plan to make distributions of partnership cash on a quarterly basis, but will make distributions no less often than annually, only to the extent there are funds available for distribution.
- We cannot presently predict amounts of cash distributions from the program. We intend to distribute substantially all of each partnership's available cash flow on a quarterly basis; however, we will review the accounts of each partnership at least annually for the purpose of determining the distributable cash available for distribution. Amounts will be paid to partners only *after* payment of fees and expenses to the General Partner and its affiliates and *only* if there is sufficient cash available. The ability of the partnerships to make or sustain cash distributions will

depend upon numerous factors. We can give no assurance that any level of cash distributions to the limited partners will be attained.

**Our distribution policy is not, and no investor should consider the policy to be, any form of guarantee or assurance of a rate of return on an investment in the partnership.** However, no investor partner will receive distributions to the extent the distributions would create or increase a deficit in that partner's capital account.

### **Termination**

Upon termination and final liquidation of a partnership, we will distribute the assets of the partnership to the partners based upon their capital account balances. If we have a deficit in our capital account, we must restore the deficit; however, no investor partner will be obligated to restore his or her deficit, if any.

### **Amendment of Partnership Allocation Provisions**

The General Partner may amend the limited partnership agreement without the approval of the Limited Partners, if necessary for partnership allocations to be recognized for federal tax purposes. We are authorized to amend the limited partnership agreement, if, in our sole discretion based on advice from our legal counsel or accountants, an amendment to revise the cost and revenue allocations is required for those allocations to be recognized for federal income tax purposes because of either the promulgation of Treasury Regulations or other developments in the tax law. Any new allocation provisions provided by an amendment must be made in a manner that would result in the most favorable aggregate consequences to the investor partners as nearly as possible consistent with the original allocations described in this prospectus.

### **COMPENSATION TO THE GENERAL PARTNER AND AFFILIATES**

The General Partner is AP Equity Properties, Ltd. It's affiliates are defined as it's Board of Advisors, and it's the member of the General Partner.

The following is a tabular presentation of the items of compensation discussed more fully below:

Note (Definition): FFO – Defined by the National Association of Real Estate Investment Trusts (NAREIT) as net income (computed in accordance with generally accepted accounting principles), excluding gains or losses from sales of property or debt restructuring, and adding back depreciation of real estate, and after adjustments for unconsolidated partnerships and joint ventures.

## Recipient Form of Compensation Amount

Position	Name	Compensation	Average Market Rate
Board of Advisors	Chairman Member(s)	Per Meeting \$250.00 200*  % of FFO above 10% 1.00%	Meetings \$3,000 per quarterly meeting \$1,000 per monthly meeting \$500.00 per special meeting Total = Approx \$21,000.00
General Partner	AP Equity Properties Management, LLC	<p>The dollar value of these fees are not determinable at this time.  <b>Mgt. Fee:</b> A competitive management <b>Subscription Fee: None</b> - However, if units are offered through broker dealers or outside sales persons. fee shall be charged which shall not exceed an amount customary for fees such as this. Such fees are compensation for the management of the affairs of the partnership and the partnership's investments.</p> <p><b>Leasing Concession:</b> No more than 3/4 of the market the Manager reserves the right to participate in the receipt of these fees, in no case, however, shall these fees be in excess of the total market rate for such services.</p> <p>rate for these services. If an outside leasing concession is paid and it is equal to the market rate, no leasing concession shall be paid to the Manager. <b>Monthly Asset Management Fee:</b></p> <p>the General Partner shall also receive a fee equal to  <b>Acquisition Fees:</b> The General Partner shall be reimbursed by the Partnership for any direct expenses incurred in connection with the acquisition of a property. In addition to this reimbursement the NONE</p> <p>3.0% of the gross purchase or contribution price of any real property acquired by the Partnership. This fee is used to compensate those members and their employees who perform the due diligence and acquisition function. The dollar amount of this fee is not determinable at this time.</p> <p>* Board of Advisors Meetings = \$500.00 per member of the General Partner in attendance</p>	<p>4.0 -4.5% of Gross Revenue</p> <p>6 -8.5%</p> <p>3 -5% Net Lease Value</p> <p>.08334% Monthly</p> <p>3.5% Acquisition Fees</p>
General Partner	Founders	" See Option Summary"	

The General Partner shall receive compensation in the form(s) listed above. In addition, the General Partner shall be reimbursed by the partnership for direct expenses incurred in connection with exercising control of the partnership business. In addition, the Members of the General Partner may purchase units of limited partnership at NAV, up to a maximum per member of \$1,000,000. The ability to purchase units at NAV shall terminate when the partnership units or a derivative of those units are listed on a public exchange.

### Asset Management Fee

NONE

### Advisory Board

Shall be compensated according to our Advisory Board Agreement. The major provisions of the agreement are outlined above. Payment shall be made in cash, however, the individual advisor shall have the option to accept cash compensation or limited partnership units purchased at a 8%

discount to the public offering price at the time compensation is paid. In addition to cash compensation the members of the Advisory Board shall also receive warrants pursuant to the Board of Advisor warrant plan. The amount of these warrants are not determinable at this time.

**Option Summary:**

For amounts subscribed to in excess of \$2,000,000.00 the partnership shall award options to the founders in these amounts:

General Partner and it's members shall receive an amount equal to .20% of the value of all properties at contribution or purchase, converted to option units at one dollar, in this and all subsequent offerings.

These options shall be vested according to the option agreement executed between the members of the general partner and the partnership. The exercise price for these options shall be \$\_\_\_\_\_ per unit. The terms may be changed by a majority vote of the board of advisors.

**The General Partner reserves the right to grant further options.**

**Warrants:**

A total of 3,000,000 Warrants have been authorized and reserved for issuance to initial partners, members of the General Partner and members of the Advisory Board for this offering. Most of these warrants shall be exercisable (purchase price) at the NAV at the time of issuance. Additional warrants may be issued in connection with further offerings. The value of these warrants is not determinable at this time.

**Subordinated Incentive Listing Premium:**

The subordinated incentive listing premium shall be defined as 10% of the amount by which the adjusted market value of the AP Equity Properties Ltd. plus the total distributions made to the Partners from inception, exceeds the aggregate capital contributions of the partners in the event that the Partnership (or a derivative of the partnership) is listed on a National Exchange. This listing premium shall be paid to the following individuals and entities in the following percentages. The dollar amount of this fee is not determinable at this time. Payment may be made in partnership units or cash as directed by the individual or entity.

Estimated Distribution Schema:

John F. Graham - 50%  
Jeremy G. Stobie - 50%

**Deferred, subordinated share of net sales proceeds from the sale of Partnership Assets:**

This fee shall be defined as 10% of the net sales proceeds from the sale of properties or other Partnership assets plus the total distributions made to the Partners from inception, less an amount equal to the original equity invested into that property plus an amount equal to a 7%

annual rate of return on that investment, compounded annually. The dollar value of this fee is not determinable at this time. Payment may be made in partnership units or cash as directed by the individual or entity.

Estimated Distribution Schema:

John F. Graham -50%  
Jeremy G. Stobie -50%

**Deferred, subordinated disposition fee at liquidation or sale to third party:**

In the event that the Partnership is not listed on a public exchange a fee shall be charged in an amount equal to 10% of the net sales proceeds from the sale of properties or other Partnership assets plus the total distributions made to the Partners from inception, less an amount equal to the original equity invested into that property plus an amount equal to a 7% annual rate of return on that investment, compounded annually. Or -10% of the net sales proceeds of the substantially all of the assets of the Partnership plus the total distributions made to the Partners from inception, less an amount equal to the original equity invested into that property plus an amount equal to a 7% annual rate of return on that investment, compounded annually. A stock, cash or asset purchase by either securities of another entity or cash shall be deemed a sale. The amount of this fee is not determinable at this time. Payment may be made in partnership units or cash as directed by the individual or entity.

Estimated Distribution Schema:

John F. Graham -50%  
Jeremy G. Stobie -50%

**MANAGEMENT**

**General Management**

The General Partner of the partnership is AP Equity Properties Management, LLC, a limited liability company organized under the laws of the State of Texas in 2004. Although it is a new entity, it is controlled by experienced real estate and financial professionals with over 30 years of combined experience in commercial real estate. The General Partner have the full and complete power to do any and all things necessary and incident to the management and conduct of each partnership's business. They will be responsible for maintaining partnership bank accounts, collecting partnership revenues, making distributions to the partners, delivering reports to the partners, and supervising acquisition, completion, and operation of the partnerships' real estate investments. In addition to managing the affairs of the partnership, the management and technical staff of AP Equity Properties, Ltd, and manage the corporate affairs of the company. Since we must divide our attention and efforts among many unrelated parties, your partnership will not receive our full attention or efforts at all times.

## TAX CONSIDERATIONS

The following is a summary of what we believe to be some, but not all of the material federal income tax consequences to the partnership and to you as an investor partner. There may be aspects of your particular tax situation which are not addressed in the following discussion. Additionally, the resolution of tax issues depends upon future facts and circumstances not known to us as of the date of this memorandum; thus, no assurance as to the final resolution of these issues should be drawn from the following discussion. The following statements are based upon the provisions of the Internal Revenue Code of 1986, which we refer to as the "Code," existing and proposed regulations thereunder, current administrative rulings, and court decisions. On May 28, 2003, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Tax Act"). The following discussion takes into account the 2003 Tax Act as it affects you as an investor in the partnership. It is possible that legislative or administrative changes or future court decisions may significantly affect the statements and opinions expressed in this prospectus. Changes could be retroactive with respect to the transactions prior to the date of the changes. Moreover, uncertainty exists concerning some of the federal income tax aspects of the transactions being undertaken by the partnership. Some of the tax positions being taken by the Partnership may be challenged by the Internal Revenue Service, which we refer to as the "Service," and any challenge could be successful. Thus, there can be no assurance that all of the anticipated tax benefits of an investment in the partnership will be realized. **BEFORE MAKING AN INVESTMENT IN THE PARTNERSHIP PLEASE CONTACT YOUR TAX ADVISOR.**

### Summary of Conclusions

#### *Opinions expressed:*

1. The material federal income tax benefits in the aggregate from an investment in the partnership will be realized.
2. The partnership will be treated as a partnership for federal income tax purposes and not as an association taxable as a corporation or as a "publicly traded partnership." See "General Tax Effects of Partnership Structure."
3. Neither the at risk nor the limitations related to the adjusted basis of an investor in his or her Partnership interest will limit the deductibility of losses generated from the partnership so long as the investor contributes cash to the partnership from "personal funds" (funds not borrowed by the investor). See "Basis and At Risk Limitations."
4. Limited partners' interests (other than those held by additional general partners who convert their interests into limited partners' interests) will be considered interests in a passive activity within the meaning of Code Section 469 and losses generated therefrom will be limited by the passive activity provisions. See "Passive Loss Limitations."
5. The partnership will not be terminated solely as the result of the conversion of partnership interests. See "Conversion of Interests."
6. To the extent provided in this section of the prospectus, the partners' distributive portion of partnership tax items will be determined and allocated substantially in accordance with the terms of the limited partnership agreement. See "Partnership Allocations."

7. The partnership will not be required to register with the Service as a tax shelter; the partners will not be required to disclose the partnership as a tax shelter on Form 8886; and the organizers of the partnership will not be required to maintain a list of the partners as participants in a tax shelter. See “Tax Shelter Rules.”

No opinion is expressed on the following:

1. The impact of an investment in the partnership on an investor’s alternative minimum tax. See “Alternative Minimum Tax.”
2. Whether, under Code Section 183, the losses of the partnership will be treated as derived from “activities not engaged in for profit,” and therefore nondeductible from other gross income, due to the inherently factual nature of a partner’s interest and motive in engaging in the transaction. See “Profit Motive.”
3. Without any assistance from us, some partners may choose to borrow the funds necessary to acquire a Unit and may incur interest expense in connection with that borrowing. Whether any interest incurred by a partner with respect to any borrowings will be deductible or subject to limitations on deductibility, due to the factual nature of the issue. See “Interest Deductions.”
4. Whether the fees to be paid to us and to third parties will be deductible, due to the factual nature of the issue. Due to the inherently factual nature of the proper allocation of expenses among nondeductible syndication expenses, amortizable organization expenses, amortizable “start-up” expenditures, and currently deductible items, and because the issues involve questions concerning both the nature of the services performed and to be performed and the reasonableness of amounts charged, we are unable to express an opinion regarding that treatment. See “Transaction Fees.”

*General Information:*

Certain matters contained in this “Tax Considerations” section are not considered to address a material tax consequence and are for general information, including the matters contained in sections dealing with gain or loss on the sale of units or of property, partnership distributions, tax audits, penalties, and state, local, and self-employment tax. See “General Tax Effects of Partnership Structure,” “Gain or Loss on Sale of Properties or Units,” “Partnership Distributions,” “Administrative Matters,” “Accounting Methods and Periods,” “Social Security Benefits; Self-Employment Tax,” and “State and Local Tax.”

*Facts and Representations:*

The opinions expressed in this memorandum are also based upon the facts described in this memorandum and upon representations including the following representations with respect to the program:

1. The limited partnership agreement to be entered into by and among the investor partners and us and any amendments to the agreement will be duly executed and will be made available to you upon written request. The limited partnership agreement will be duly recorded in all places required under the Texas Revised Limited Partnership Act for the due formation of the partnership and for its continuation in accordance with the terms of the limited partnership agreement. The partnership will at all times be operated in

accordance with the terms of the limited partnership agreement, the memorandum, and the Texas Act.

2. No election will be made by the partnership, investor partners, or us to be excluded from the application of the provisions of Subchapter K of the Code.
3. The amounts that will be paid to the General Partner or its affiliates such management and leasing fees, operating fees, and other fees will be amounts that would not exceed amounts that would be ordinarily paid for similar transactions between persons having no affiliation and dealing with each other at arms' length.
4. The partnership will have a December 31 taxable year and will report its income on the accrual basis.
5. The partnership will have the objective of carrying on business for profit and dividing the gain from its operations.

**There can be no assurance that the Service will not successfully assert positions which are inconsistent with the opinions set forth in this discussion and Appendix D or in the tax reporting positions taken by the partners or the partnership. You should consult your own tax advisor to determine the effect of the tax issues discussed in this and other sections.**

#### **General Tax Effects of Partnership Structure**

The partnership will be formed as a limited partnership under the limited partnership agreement and the laws of the State of Texas.

**No tax ruling will be sought from the Service as to the status of the partnership as a partnership for federal income tax purposes.**

- Any tax benefits anticipated from an investment in a partnership would be adversely affected or eliminated if the partnership is treated as a corporation for federal income tax purposes.
- While we believe that the partnership will initially be treated as a partnership for federal tax purpose, that opinion is not binding on the Service. The applicability of the federal income tax consequences described in this section depends on the treatment of the partnerships as partnerships for federal income tax purposes and not as corporations and not as associations taxable as corporations. Any tax benefits anticipated from an investment in a partnership would be adversely affected or eliminated if the partnership is treated as a corporation for federal income tax purposes. In addition, we can give no assurance that a partnership will not lose partnership status as a result of changes in the manner in which it is operated or other facts upon which these opinions are based.

General:

Under the Code, a partnership is not a taxable entity and, accordingly, incurs no federal income tax liability. Rather, a partnership is a "pass-through" entity which is required to file an

information return with the Service. In general, the character of a partner's share of each item of income, gain, loss, deduction, and credit is determined at the partnership level. Each partner is allocated a distributive share of those items in accordance with the partnership agreement and is required to take those items into account in determining the partner's income. Each partner includes those amounts in income for any taxable year of the partnership ending within or with the taxable year of the partner, without regard to whether the partner has received or will receive any cash distributions from the Partnership.

### **Depreciation Deductions**

The partnership will claim depreciation, cost recovery, and amortization deductions with respect to its basis in partnership property as permitted by the Code. For certain tangible property, the partnership will be allowed an additional depreciation deduction equal to 30% (or 50% for such property acquired and placed in service after May 5, 2003) of the adjusted basis of the property for the year in which the property is placed in service. The adjusted basis of the property is reduced by the additional depreciation deduction before computing the amount otherwise allowable as a depreciation deduction for the tax year in which the property is placed in service and all later years. In order to be entitled to this deduction, the partnership generally must purchase the property and place it in service before January 1, 2005.

### **Transaction Fees**

- Partnership expenditures classified as organizational expenses, and start-up expenses may be amortized over a period of not less than 60 months.
- No deduction is permitted for syndication expenses, including sales commissions for the purchase of Units. The partnership may classify a portion of the fees to be paid to third parties and to us or to the operator and its affiliates as organizational expenses or other expenses that are required to be capitalized. There is no assurance that the Service will agree with, the allocation of the fees to deductible and nondeductible items. Generally, expenditures made in connection with the creation of, and with sales of interests in, a partnership will fit within one of several categories: organizational expenses; syndication expenses; and start-up expenditures. A partnership may elect to amortize and deduct its capitalized organizational expenses ratably over a period of not less than 60 months commencing with the month the partnership begins business. Examples of organizational expenses are legal fees for services incident to the organization of the partnership, such as negotiation and preparation of a partnership agreement, accounting fees for services incident to the organization of the partnership, and filing fees. No deduction is allowable for "syndication expenses," examples of which include brokerage fees, registration fees, legal fees of the underwriter or placement agent and the issuer (general partner or the partnership) for securities advice and for advice pertaining to the adequacy of tax disclosures in the private placement memorandum for securities law purposes, printing costs, and other selling or promotional material. These costs must be capitalized. Payments for services performed in connection with the acquisition of capital assets must be amortized over the useful life of the assets. No deduction is allowable with respect to "start-up expenditures," although the expenditures may be capitalized and amortized over a period of not less than 60 months. The partnership intends to make payments to us, as described in greater detail in the prospectus. To be deductible, compensation paid to a general partner must be for services rendered by the partner other than in his capacity as a partner or for compensation determined without regard to partnership income. Fees which are not deductible because they fail to meet this test may be treated as special allocations of income to the recipient partner and decrease the net loss, or

increase the net income among all partners. If the Service were to successfully challenge our allocations, a partner's taxable income could be increased, resulting in increased taxes and in liability for interest and penalties.

### **Basis and At Risk Limitations**

• Partners contributing cash from “personal funds” (i.e., funds not borrowed by the partner) will not be limited, to the extent of cash contributed, in their deductibility of partnership losses by the ‘at risk’ basis rules or the limitations related to a partner’s basis in his partnership interest. A partner’s share of partnership losses will be allowed only to the extent of the aggregate amount with respect to which the taxpayer is “at risk” for the activity at the close of the taxable year. In general, a partner is “at risk” to the extent of the amount of cash and the adjusted basis of other property contributed to the partnership. Any loss disallowed by the “at risk” limitation shall be treated as a deduction allocable to the activity in the first succeeding taxable year. The Code provides that a taxpayer must recognize taxable income to the extent that his “at risk” amount is reduced below zero. This recaptured income is limited to the sum of the loss deductions previously allowed to the taxpayer, less any amounts previously recaptured. A taxpayer may be allowed a deduction for the recaptured amounts included in his taxable income if and when he increases his amount “at risk” in a subsequent taxable year. The partners will purchase units by tendering cash to the partnership. To the extent the cash contributed constitutes the “personal funds” of the partners (i.e., funds not borrowed by the partner), the partners should be considered at risk with respect to those amounts. To the extent the cash contributed constitutes “personal funds,” in the opinion of counsel, neither the at risk rules nor the adjusted basis rules will limit the deductibility of losses generated from the partnership. In no event, however, may a partner utilize his distributive share of partnership loss where the share exceeds the partner’s basis in the partnership.

### **Passive Loss Limitations**

#### *A. Introduction*

The deductibility of losses generated from passive activities will be limited for certain taxpayers. The passive activity loss limitations apply to individuals, estates, trusts, and personal service corporations as well as, to a lesser extent, closely held C corporations. The definition of a “passive activity” generally encompasses all rental activities as well as all activities with respect to which the taxpayer does not “materially participate.” Notwithstanding this general rule, however, the term “passive activity” does not include “any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to the interest.” A taxpayer will be considered as materially participating in a venture only if the taxpayer is involved in the operations of the activity on a “regular, continuous, and substantial” basis. In addition, no limited partnership interest will be treated as an interest with respect to which a taxpayer materially participates. A passive activity loss is the amount by which the aggregate losses from all passive activities for the taxable year exceed the aggregate income from all passive activities for the year. Individuals and personal service corporations will be entitled to passive activity losses only to the extent of their passive income whereas closely held C corporations (other than personal service corporations) can offset passive activity losses against both passive and net active income, but not against portfolio income. In calculating passive income and loss, however, all activities of the taxpayer are aggregated. Passive activity losses disallowed as a result of the above rules will be suspended and can be carried forward indefinitely to offset future passive (or passive and active, in the case of a closely held C corporation) income. Upon the disposition of an entire interest in a passive

activity in a fully taxable transaction not involving a related party, any passive loss that was suspended by the provisions of the passive activity rules generally is deductible from either passive or non-passive income.

#### *B. General Partner Interests*

- General partner interests will not be considered as investments in passive activities for federal tax purposes.
- *Limited Partner Interests*
- Income and losses of limited partners will be treated as “passive” for federal tax purposes. If an investor partner invests in the partnership as a limited partner, his distributive share of the partnership’s losses will be treated as passive activity losses, the availability of which will be limited to the partner’s passive income. If the partner does not have sufficient passive income to utilize the passive activity loss, the disallowed passive activity loss will be suspended and may be carried forward to be deducted against passive income arising in future years. Further, upon the disposition of the interest to an unrelated party, in a fully taxable transaction the suspended losses will be available, as described above. Limited partners should generally be entitled to offset their distributive portions of passive income from the partnerships with deductions from other passive activities.

#### **Alternative Minimum Tax**

Due to the potentially significant impact of a purchase of units on an investor’s tax liability, investors should discuss the implications of an investment in the partnership on their regular and AMT liabilities with their tax advisors prior to acquiring units. A taxpayer is subject to an alternative minimum tax (“AMT”) to the extent that its “tentative minimum tax” exceeds its regular income tax liability. A corporate taxpayer’s tentative minimum tax generally equals 20 percent of its alternative minimum taxable income (“AMTI”) in excess of an exemption amount. The AMT rate for a noncorporate taxpayer is 26% or 28%, depending on the amount of its AMTI above an exemption amount. Alternative minimum taxable income is the taxpayer’s regular taxable income increased by certain tax preferences and increased or decreased by certain tax adjustments. Certain items of income, deduction, gain and loss from the partnership will give rise to preferences or adjustments for AMT purposes.

#### **Gain or Loss on Sale of Property or Units**

- Sale or exchange of property by the partnership or a unit by an investor could result in ordinary income rather than capital gain. In the case of a sale or exchange of a unit, an investor could be required to recognize ordinary income greater than the amount of the gain realized on the sale. If so, the additional ordinary income would be offset by additional capital loss, but that capital loss may not be immediately deductible.
- Investors who fail to report a sale or exchange of a unit in the partnership could be subject to a penalty. An investor may recognize gain either upon the sale of his or her partnership units or from the allocation of partnership gain as a result of the partnership’s sale of its property. The maximum federal income tax rate on long-term capital gains for individual taxpayers is general 15%, Prior to the passage of the 2003 Tax Act, such rate was generally 20%. Because of the recapture depreciation or amortization, the sale may result in ordinary income to the investor, which is currently taxed at a maximum rate of 35% for individuals. If the amount of gain exceeds

the amount of the deductions to be recaptured, the investor will recognize ordinary income to the extent of the recaptured deductions and capital gain for the remainder. If, upon the sale of units, the amount of deductions to be recaptured exceeds the gain realized, an investor may be required to recognize ordinary income greater than the amount of gain realized. To balance the excess income, the investor would recognize a capital loss for the difference between the gain and the income. Depending on an investor's particular tax situation, some or all of this loss might be deferred to future years, resulting in a greater tax liability in the year in which the sale was made and a reduced future tax liability. Any partner who sells or exchanges interests in a partnership must generally notify the partnership in writing within 30 days of the transaction in accordance with Regulations and must attach a statement to his tax return reflecting the facts regarding the sale or exchange. The notice must include names, addresses, and taxpayer identification numbers (if known) of the transferor and transferee and the date of the exchange. The partnership also is required to provide copies of the information it provides to the Service to the transferor and the transferee. Any investor who is required to notify the partnership of a transfer of his partnership interest, and, who fails to do so, may be fined \$50 for each failure, limited to \$100,000, provided there is no intentional disregard of the filing requirement. Similarly, the partnership may be fined for failure to report the transfer. The partnership's penalty is \$50 for each failure, limited to \$250,000, provided there is no intentional disregard of the filing requirement. The tax consequences to an assignee purchaser of a unit from a partner are not described in this prospectus. Any assignor of a unit should advise his assignee to consult his own tax advisor regarding the tax consequences of the assignment.

### **Partnership Distributions**

Under the Code, any increase in a partner's share of partnership liabilities, or any increase in the partner's individual liabilities by reason of an assumption by him of partnership liabilities is considered to be a contribution of money by the partner to the partnership. Similarly, any decrease in a partner's share of partnership liabilities or any decrease in the partner's individual liabilities by reason of the partnership's assumption of the individual liabilities will be considered as a distribution of money to the partner by the partnership. The partners' adjusted bases in their units will initially consist of the cash they contribute to the partnership. Their bases will be increased by their share of partnership income and additional contributions and decreased by their share of partnership losses and distributions. To the extent that the actual or constructive distributions are in excess of a partner's adjusted basis in his partnership interest (after adjustment for contributions and his share of income and losses of the partnership), that excess will generally be treated as gain from the sale of a capital asset. In addition, gain could be recognized by a distributee partner upon the disproportionate distribution to that partner of unrealized receivables or substantially appreciated inventory. The limited partnership agreement prohibits distributions to any investor partner to the extent the distributions would create or increase a deficit in the partner's capital account.

### **Partnership Allocations**

The partners' distributive shares of partnership income, gain, loss, and deduction should be determined and allocated substantially in accordance with the terms of the limited partnership agreement. The Service could contend that the allocations contained in the limited partnership agreement do not have substantial economic effect or are not in accordance with the partners' interests in the partnership and may seek to reallocate these items in a manner that will increase the income or gain or decrease the deductions allocable to a partner.

### **Tax Shelter Rules**

Under federal tax law, there are various definitions of “tax shelters” and, depending upon which definition is satisfied, different obligations are required by the participants in or promoters of the tax shelter. Certain types of tax shelters must be “registered” with the Service by the organizer of the shelter. The Service assigns a tax shelter registration number to these types of shelters, and such number generally must be reported on the participants’ tax returns. Another type of tax shelter (a so-called “Reportable Transaction”) generally must be disclosed to the Service by the participants in the tax shelter using a Form 8886. In addition, promoters and organizers of either of these types of tax shelters generally must prepare and maintain a list of each of the participants in the tax shelter. The Service issued regulations on February 28, 2003, which define certain of these tax shelters and provide the disclosure and list maintenance requirements for these tax shelters. We believe the partnership will not be considered a tax shelter for these purposes. Accordingly, the partnership will not be required to register with the Service as a tax shelter, the partners will not be required to disclose the partnership as a tax shelter on Form 8886, and the organizers of the partnership will not be required to maintain a list of the partners as participants in a tax shelter.

### **Profit Motive**

- Investors who enter a business without economic, nontax profit motive may be denied the benefits of deductions associated with the business to the extent they exceed the income from the business. The existence of economic, nontax motives for entering into the transaction is essential if the partners are to obtain the tax benefits associated with an investment in the partnership. Where an activity entered into by an individual is not engaged in for profit, the individual’s deductions with respect to that activity are limited to those not dependent upon the nature of the activity (e.g., interest and taxes); any remaining deductions will be limited to gross income from the activity for the year. Should it be determined that a partner’s activities with respect to the transaction are “not for profit,” the Service could disallow all or a portion of the deductions generated by the partnership’s activities. The Code generally provides for a presumption that an activity is entered into for profit where gross income from the activity exceeds the deductions attributable to the activity for three or more of the five consecutive taxable years ending with the taxable year in question. At the taxpayer’s election, the presumption can relate to three or more of the taxable years in the 5-year period beginning with the taxable year in which the taxpayer first engages in the activity. Due to the inherently factual nature of a partner’s intent and motive in engaging in the transaction, counsel does not express an opinion as to the ultimate resolution of this issue in the event of a challenge by the Service. Partners must, however, seek to make a profit from their activities with respect to the transaction beyond any tax benefits derived from those activities or risk losing those tax benefits.

### **Administrative Matters**

#### *Returns and Audits.*

While no federal income tax is required to be paid by an organization classified as a partnership for federal income tax purposes, a partnership must file federal income tax information returns, which are subject to audit by the Service. Any audit may lead to adjustments, in which event you may be required to file amended personal federal income tax returns. Any audit may also lead to an audit of your individual tax return and adjustments to items unrelated to an investment in units. For purposes of reporting, audit, and assessment of additional federal income tax, the tax treatment of “partnership items” is determined at the partnership level. Partnership items will include those items that the Regulations provide are more appropriately determined at the

partnership level than the partner level. The Service generally cannot initiate deficiency proceedings against an individual partner with respect to partnership items without first conducting an administrative proceeding at the partnership level as to the correctness of the partnership's treatment of the item. An individual partner may not file suit for a credit or a refund arising out of a partnership item without first filing a request for an administrative proceeding by the Service at the partnership level. Individual partners are entitled to notice of the administrative proceedings and decisions, except in the case of partners with less than 1% profits interest in a partnership having more than 100 partners. If a group of partners having an aggregate profits interest of 5% or more in a partnership so requests, however, the Service also must mail notice to a partner appointed by that group to receive notice. All partners, whether or not entitled to notice, are entitled to participate in the administrative proceedings at the partnership level, although the limited partnership agreement provides for waiver of some of these rights by the investor partners. All investor partners, including those not entitled to notice, may be bound by a settlement reached by the partnership's representative "tax matters partner," which will be Petroleum Development Corporation. If a proposed tax deficiency is contested in any court by any partner of a partnership or by us, all partners of that partnership may be deemed parties to the litigation and bound by the result reached.

#### *Consistency Requirements.*

You must generally treat partnership items on your federal income tax returns consistently with the treatment of the items on the partnership information return unless you file a statement with the Service identifying the inconsistency or otherwise satisfy the requirements for waiver of the consistency requirement. Failure to satisfy this requirement will result in an adjustment to conform your treatment of the item with the treatment of the item on the partnership return. Intentional or negligent disregard of the consistency requirement may subject you to substantial penalties.

#### *Compliance Provisions.*

Taxpayers are subject to several penalties and other provisions that encourage compliance with the federal income tax laws, including an accuracy-related penalty in an amount equal to 20% of the portion of an underpayment of tax caused by negligence, intentional disregard of rules or regulations or any "substantial understatement" of income tax. A "substantial understatement" of tax is an understatement of income tax that exceeds the greater of (a) 10% of the tax required to be shown on the return (the correct tax), or (b) \$5,000 (\$10,000 in the case of a corporation other than an S corporation or personal holding corporation). Except in the case of understatements attributable to "tax shelter" items, an item of understatement may not give rise to the penalty if (a) there is or was "substantial authority" for the taxpayer's treatment of the item or (b) all facts relevant to the tax treatment of the item are disclosed on the return or on a statement attached to the return, and there is a reasonable basis for the tax treatment of the item by the taxpayer. In the case of partnerships, the disclosure is to be made on the return of the partnership. Under the applicable Regulations, however, an individual partner may make adequate disclosure with respect to partnership items if conditions are met. In the case of understatements attributable to "tax shelter" items, the substantial understatement penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for his position, he reasonably believed the treatment claimed was more likely than not the proper treatment of the item. A "tax shelter" item, for these purposes, is one that arises from a partnership (or other form of investment) the principal purpose of which is the avoidance or evasion of federal income tax. The definition of "tax shelter" for these purposes is different from the definitions for registration, disclosure and list maintenance purposes discussed above under "Tax Shelter Rules." A corporation is generally

held to a higher standard to avoid the substantial understatement penalty attributable to tax shelter items. However, we do not believe the partnership will be considered a “tax shelter” for these purposes.

### **Accounting Methods and Periods**

The partnership will use the accrual method of accounting and intends to select the calendar year as its taxable year.

### **Social Security Benefits; Self-employment Tax**

A general partner’s share of any income or loss attributable to units will constitute “net earnings from self employment” for both social security and self-employment tax purposes, while a limited partner’s share of these items will not constitute “net earnings from self-employment.”

### **State and Local Taxes**

The opinions expressed in this memorandum are limited to issues of federal income tax law and do not address issues of state or local law. We urge you to consult your tax advisors regarding the impact of state and local laws on your investment in the partnership.

### **Individual Tax Advice Should Be Sought**

We have presented only a summary of the material tax considerations that may affect your decision regarding the purchase of units. The tax considerations attendant to an investment in a partnership are complex, vary with individual circumstances, and depend in some instances upon whether the investor acquires general partner interests or limited partner interests. You should review the tax consequences with your tax advisor and attorney.

## **RISK FACTORS**

*An investment in our securities involves a number of risks. Before making an investment decision to purchase any of our securities, you should carefully consider all of the risks described in this memorandum, as well as the other information contained in, or incorporated by reference into, this memorandum or the related memorandum supplement. If any of these risks actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the value of our securities could decline significantly and you may lose all or part of your investment.*

### **An increase in our borrowing costs may adversely affect our profitability.**

We earn money based upon the cash flow that we receive from commercial and residential properties. In order to purchase these properties they are generally secured by borings. An increase in the cost of these borrowings, whether during acquisition or in interest may adversely affect our profitability.

***Changes in interest rates, cyclical or otherwise, may adversely affect our profitability.***

Interest rates are highly sensitive to many factors, including fiscal and monetary policies and domestic and international economic and political considerations, as well as other factors beyond our control. During a period of rising interest rates, our borrowing costs could increase at a faster pace than our ability to purchase properties that provide a greater percentage of cash flow. If this happens, we could experience a decrease in net income or incur a net loss during these periods, which may negatively impact our distribution. Further, an increase in short-term interest rates without a corresponding increase in long-term interest rates (i.e., a flattening of the yield curve) could also have a negative impact on the market value of our partnership units.

**Our business strategy involves a significant amount of borrowing that exposes us to additional risks.**

We borrow against a substantial portion of the market value of our properties and use the borrowed funds to acquire additional investment assets. Our operating policies allow us to generally maintain an assets-to-equity ratio of less than 11 to 1. The use of borrowing, or "leverage," to finance our the purchase or operations or our real estate holdings and other assets involves a number of risks, including the following:

***If we are unable to renew our borrowings at favorable rates, it may force us to sell assets and our profitability may be adversely affected.***

Although it is not our primary source of funding we may rely on short-term borrowings, such as repurchase agreements, to finance our properties, our ability to achieve our investment objectives depends on our ability to borrow money in sufficient amounts and on favorable terms and on our ability to renew or replace maturing short-term borrowings on a continuous basis. If we are not able to renew or replace maturing borrowings, we would be forced to sell some of our assets under possibly adverse market conditions, which may adversely affect our profitability.

***A decline in the market value of our assets may force us to sell assets under adverse market conditions.***

A decline in the market value of our properties result in our lenders initiating margin calls that require us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of our borrowings. If we are unable to satisfy these capital calls, our lenders may foreclose on our collateral. This could force us to sell properties under adverse market conditions.

**We may experience a decline in the market value of our assets.**

The market value of our interest-bearing assets, such as mortgage-backed securities or hedging instruments, may move inversely with changes in interest rates. A decline in the market

value of our mortgage-backed securities may limit our ability to borrow or result in lenders initiating margin calls under our repurchase agreements. As a result, we could be required to sell some of our investments under adverse market conditions in order to maintain liquidity. If these sales were made at prices lower than the amortized cost of such investments, we would incur losses. A default under our repurchase agreements could also result in a liquidation of the underlying collateral and a resulting loss of the difference between the value of the collateral and the amount borrowed.

**Our profitability may be limited by restrictions on our use of leverage.**

As long as we earn a positive margin between our borrowing costs and the income we earn on our assets, we can generally increase our profitability by using greater amounts of leverage. However, the amount of leverage that we use may be limited because our lenders might not make funding available to us at acceptable rates or they may require that we provide additional collateral to cover our borrowings.

**Our use of derivatives to mitigate our prepayment and interest rate risks may not be effective.**

Our policies permit us to enter into interest rate swaps, caps and floors and other derivative transactions to help us mitigate our prepayment and interest rate risks. No hedging strategy, however, can completely insulate us from the prepayment and interest rate risks to which we are exposed

**We may change our policies without the approval of our limited partners.**

Our board of advisors establishes all of our fundamental operating policies, including our investment, financing and distribution policies, and any revisions to such policies would require the approval of our board of advisors. Although our board of advisors has no current plans to do so, it may amend or revise these policies at any time without a vote of our limited partners. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock (in the event that we form a REIT) or limited partnership units or our ability to pay distributions.

**We have not established a minimum distribution payment level.**

We intend to pay distributions on our limited partnership interests. Distributions will be declared and paid at the discretion of our board of advisors and will depend on our earnings, our financial condition, and such other factors as our board of advisors may deem relevant from time to time. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected for the reasons set forth in this section of, and the information incorporated by reference into, this memorandum.

**We are dependent on our executives and employees.**

As a self-advised Partnership, we are dependent on the efforts of our key officers and employees. The loss of any of their services could have an adverse effect on our operations.

**The economic return from our investments and interests in real estate will be affected by a number of factors.**

Our interests in commercial and multifamily apartment properties expose us to risks associated with investing in real estate. These risks include the possibility that the properties will not perform in accordance with our expectations. In addition, the economic returns from our interests in these properties may be affected by a number of factors, many of which are beyond our direct control. These factors include general and local economic conditions, the relative supply of apartments and commercial office space and other housing in the applicable market area, interest rates on mortgage loans, the need for and costs of repairs and maintenance of the properties, government regulations and the cost of complying with them, taxes and inflation.

**The concentration of real estate in a geographical area may make us vulnerable to adverse changes in local economic conditions.**

We do not have specific limitations on the total percentage of our real estate investments that may be located in any one geographical area. Consequently, real estate investments that we own may be located in the same or a limited number of geographical regions. As a result, adverse changes in the economic conditions of the geographic regions in which our real estate investments are concentrated may have an adverse effect on real estate values, rental rates and occupancy rates. Any of these could reduce the income we earn from, or the market value of, these real estate investments.

**Our interests in real estate may be illiquid and their value may decrease.**

Our interests in our properties are relatively illiquid. Our ability to sell these assets, and the price we receive upon their sale, will be affected by the number of potential buyers, the number of competing properties on the market in the area and a number of other market conditions. As a result, we cannot make any assurances that we will be able to sell these interests without incurring a loss.

**Owning real estate may subject us to liability for environmental contamination.**

The owner or operator of real property may become liable for the costs of removal or remediation of hazardous substances released on its property. Various federal, state and local laws often impose such liability without regard to whether the owner or operator knew of, or was responsible for, the release of such hazardous substances. We cannot make any assurances that our properties in which we currently hold interests, or those we may acquire in the future, will not be contaminated. The costs associated with the remediation of any such contamination may be significant and may exceed the value of the property causing us to lose our entire investment. In addition, environmental laws may materially limit the use of the properties underlying our real estate investments and future laws, or more stringent interpretations or enforcement policies of existing environmental requirements, may increase our exposure to environmental liability.

*There will be no public market for the units, and as a result an investor partner may not be able to sell his or her units.* There will be no public market for the units nor will a public market develop for the units. You may not be able to sell your partnership interests or may be able to sell them only for less than fair market value. A sale or transfer of units by you requires our prior written consent.

*Sufficient insurance coverage may not be available for the partnership, thereby increasing the risk of loss for the investor partners.* It is possible that some or all of the insurance coverage which the partnership has available may become unavailable or prohibitively expensive. In that case, we may elect to change the insurance coverage. See “Proposed Activities — Insurance” (page 44) for a discussion of the extent of our insurance coverage. Additional general partners could be exposed to additional financial risk due to the reduced insurance coverage and due to the fact that additional general partners would continue to be individually liable for obligations and liabilities of the partnership. As an investor partner, you could be subject to greater risk of loss of your investment since less insurance would be available to protect your partnership from casualty losses.

**Because of competition, we may not be able to acquire investment assets at favorable prices.**

Our profitability depends, in large part, on our ability to acquire our properties or other investment assets at favorable prices. In acquiring our investment assets, we compete with a variety of institutional investors including REITs, insurance companies, mutual funds, pension funds, investment banking firms, banks and other financial institutions. Many of the entities with which we compete have greater financial and other resources than us. As a result, we may not be able to acquire properties or other investment assets for investment or we may have to pay more for these assets than we otherwise would.

**Issuances of large amounts of our partnership units cause our price to decline.**

This memorandum may be used for the issuance of additional partnership units. If we issue a significant number of partnership units in a short period of time, there could be a dilution of the existing limited partners and a decrease in the market price of the partnership interests.

**Tax Status and Tax Risks**

It is possible that the tax treatment currently available with respect to natural gas and oil exploration and production will change on a retroactive or prospective basis as a result of additional legislative, judicial, or administrative actions. *Partnership classification as a corporation or a publicly traded partnership would substantially alter the tax treatment of the partnership.*

The Service could assert that a partnership should be classified as one of these other structures. If a partnership were so classified, any income, gain, loss, deduction, or credit of the partnership would remain at the entity level, and not flow through to you, the income of the partnership would be subject to corporate tax rates at the entity level and distributions to you may be considered dividend distributions subject to federal income tax at the investor partners’ level. Net losses generated by the partnership and allocable to a limited partner generally will be subject to the passive activity rules. Under the passive activity rules, passive activity losses of limited partners who are individuals, estates, trusts, and personal service corporations are deductible only to the extent of that limited partner’s passive activity income (less restrictive limitations apply to closely held C corporations). Therefore, limited partners may not be able to currently deduct all of the expenses and losses allocated to them from the partnership.

*Under the Code, a partner’s tax liabilities may exceed the cash distributions received by that*

*partner.* Federal income tax payable by you by reason of your distributive share of partnership taxable income for any year may exceed the cash distributed to you by the partnership. You must include in your own return for a taxable year your share of the items of the partnership's income, gain, profit, loss, and deductions for the year, to the extent required under the Internal Revenue Code as then in effect, whether or not cash proceeds are actually distributed to you. For example, income from the partnership's sale of gas production is taxable to you as ordinary income subject to depletion and other deductions; your distributive share of the partnership's taxable income will be taxable to you whether or not the income is actually distributed to you. *If the Service audits the partnership's tax returns, an investor partner might owe more taxes plus interest and penalties.* Although the partnerships will not be registered with the Service as "tax shelters," it is possible that the Service will audit each partnership's returns. If audits occur, tax adjustments might be made that would increase the amount of taxes due or increase the risk of audit of your individual tax return. If additional tax is owed, you may also owe interest and penalties in addition to that tax. In addition, costs and expenses may be incurred by a partnership in contesting the adjustments. The cost of responding to audits of your tax return will be borne solely by you.