

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2004

OR

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

Commission File Number 0-11176

**NTS-PROPERTIES III**

*(Exact name of registrant as specified in its charter)*

Georgia

*(State or other jurisdiction of  
incorporation or organization)*

61-1017240

*(I.R.S. Employer Identification No.)*

10172 Linn Station Road, Louisville, Kentucky 40223

*(Address of principal executive offices)*

(502) 426-4800

*(Registrant's telephone number, including area code)*

*(Former name, former address and former fiscal year, if changed since last report)*

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

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

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Some of the statements included in this quarterly report on Form 10-Q, particularly those included in Part I, Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), may be considered "forward-looking statements" because the statements relate to matters which have not yet occurred. For example, phrases such as "we anticipate," "believe" or "expect" indicate that it is possible that the event anticipated, believed or expected may not occur. If these events do not occur, the result which we expected also may, or may not, occur in a different manner, which may be more or less favorable to us. We do not undertake any obligation to update these forward-looking statements.

Any forward-looking statements included in MD&A, or elsewhere in this report, reflect our general partner's best judgment based on known factors, but involve risks and uncertainties. Actual results could differ materially from those anticipated in any forward-looking statements as a result of a number of factors, including but not limited to those described in our filings with the Securities and Exchange Commission, particularly our annual report on Form 10-K for the year ended December 31, 2003. Any forward-looking information provided by us pursuant to the safe harbor established by the Private Securities Litigation Reform Act of 1995 should be evaluated in the context of these factors.

**PART I - FINANCIAL INFORMATION****Item 1 - Financial Statements****NTS-PROPERTIES III  
BALANCE SHEETS**

	As of June 30, 2004 (UNAUDITED)	As of December 31, 2003
<b><u>ASSETS</u></b>		
Cash and equivalents	\$ 335,311	\$ 180,911
Cash and equivalents - restricted	46,199	9,233
Accounts receivable, net	908,121	804,027
Land, buildings and amenities, net	8,733,237	9,118,287
Other assets	<u>354,375</u>	<u>347,164</u>
<b>TOTAL ASSETS</b>	<b>\$ <u>10,377,243</u></b>	<b>\$ <u>10,459,622</u></b>
<b><u>LIABILITIES AND PARTNERS' EQUITY</u></b>		
Mortgages payable	\$ 6,090,708	\$ 6,309,037
Accounts payable and accrued expenses	195,638	291,500
Security deposits	150,196	143,292
Other liabilities	<u>167,900</u>	<u>34,246</u>
<b>TOTAL LIABILITIES</b>	<b>6,604,442</b>	<b>6,778,075</b>
<b>COMMITMENTS AND CONTINGENCIES (Note 8)</b>		
<b>PARTNERS' EQUITY</b>	<b><u>3,772,801</u></b>	<b><u>3,681,547</u></b>
<b>TOTAL LIABILITIES AND PARTNERS' EQUITY</b>	<b>\$ <u>10,377,243</u></b>	<b>\$ <u>10,459,622</u></b>

**NTS-PROPERTIES III  
STATEMENT OF PARTNERS' EQUITY  
(UNAUDITED)**

	Limited Partners	General Partner	Total
<b><u>PARTNERS' EQUITY/(DEFICIT)</u></b>			
Initial equity	\$ 15,600,000	\$ 8,039,710	\$ 23,639,710
Adjustment to historical basis	<u>--</u>	<u>(5,455,030)</u>	<u>(5,455,030)</u>
<b>EQUITY</b>	<b>\$ 15,600,000</b>	<b>\$ 2,584,680</b>	<b>\$ 18,184,680</b>
Net income (loss) - prior years	551,145	(2,799,208)	(2,248,063)
Net income (loss) - current year	113,778	(22,525)	91,253
Cash distributions declared to date	(11,349,844)	(206,985)	(11,556,829)
Repurchase of limited partnership interests	<u>(698,240)</u>	<u>--</u>	<u>(698,240)</u>
<b>BALANCES ON JUNE 30, 2004</b>	<b>\$ <u>4,216,839</u></b>	<b>\$ <u>(444,038)</u></b>	<b>\$ <u>3,772,801</u></b>

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

**NTS-PROPERTIES III**  
**STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
<u>REVENUES</u>				
Rental income	\$ 784,515	\$ 759,267	\$ 1,555,978	\$ 1,585,597
Rental income - affiliated	73,834	73,834	147,668	147,668
Tenant reimbursements	83,008	89,672	171,778	182,372
 TOTAL REVENUES	 941,357	 922,773	 1,875,424	 1,915,637
<u>EXPENSES</u>				
Operating expenses	218,401	218,746	409,569	430,994
Operating expenses - affiliated	82,051	86,801	169,512	157,271
Management fees	46,041	44,569	88,963	92,911
Real estate taxes	52,146	52,041	104,292	104,082
Professional and administrative expenses	81,478	77,660	208,088	142,012
Professional and administrative expenses - affiliated	39,898	38,505	75,941	74,326
Depreciation and amortization	251,487	269,705	530,575	553,553
 TOTAL OPERATING EXPENSES	 771,502	 788,027	 1,586,940	 1,555,149
 OPERATING INCOME	 169,855	 134,746	 288,484	 360,488
 Interest and other income	 2,774	 5,549	 5,694	 10,200
Interest expense	(100,225)	(110,789)	(201,664)	(224,729)
Loss on disposal of assets	(813)	--	(1,261)	--
 Net income	 \$ 71,591	 \$ 29,506	 \$ 91,253	 \$ 145,959
 Net income allocated to the limited partners	 \$ 82,594	 \$ 40,930	 \$ 113,778	 \$ 168,425
 Net income per limited partnership interest	 \$ 6.57	 \$ 3.26	 \$ 9.05	 \$ 13.40
 Weighted average number of limited partnership interests	 12,570	 12,570	 12,570	 12,570

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

**NTS-PROPERTIES III**  
**STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Six Months Ended June 30,	
	2004	2003
<b><u>CASH FLOWS FROM OPERATING ACTIVITIES</u></b>		
Net income	\$ 91,253	\$ 145,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of assets	1,261	--
Depreciation and amortization	587,054	609,749
Changes in assets and liabilities:		
Cash and equivalents - restricted	(36,966)	(38,742)
Accounts receivable	(104,094)	(58,381)
Other assets	(72,460)	(51,736)
Accounts payable and accrued expenses	(95,862)	64,780
Security deposits	6,904	(13,089)
Other liabilities	133,654	51,149
Net cash provided by operating activities	<u>510,744</u>	<u>709,689</u>
<b><u>CASH FLOWS FROM INVESTING ACTIVITIES</u></b>		
Additions to land, buildings and amenities	<u>(136,040)</u>	<u>(159,314)</u>
Net cash used in investing activities	<u>(136,040)</u>	<u>(159,314)</u>
<b><u>CASH FLOWS FROM FINANCING ACTIVITIES</u></b>		
Principal payments on mortgages payable	(218,329)	(607,817)
Increase in loan costs	<u>(1,975)</u>	<u>--</u>
Net cash used in financing activities	<u>(220,304)</u>	<u>(607,817)</u>
Net increase (decrease) in cash and equivalents	154,400	(57,442)
CASH AND EQUIVALENTS, beginning of period	<u>180,911</u>	<u>388,449</u>
CASH AND EQUIVALENTS, end of period	<u>\$ 335,311</u>	<u>\$ 331,007</u>
Interest paid on a cash basis	<u>\$ 199,691</u>	<u>\$ 224,350</u>

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

**NTS-PROPERTIES III**  
**NOTES TO FINANCIAL STATEMENTS**  
**(UNAUDITED)**

The unaudited financial statements included herein should be read in conjunction with NTS-Properties III's 2003 annual report on Form 10-K as filed with the Securities and Exchange Commission on March 26, 2004. In the opinion of our general partner, all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation have been made to the accompanying financial statements for the three and six months ended June 30, 2004 and 2003. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. As used in this quarterly report on Form 10-Q the terms "we," "us" or "our," as the context requires, may refer to NTS-Properties III or its interests in its properties.

**Note 1 - Use of Estimates in the Preparation of Financial Statements**

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

**Note 2 - Concentration of Credit Risk**

We own and operate three commercial properties - Peachtree Corporate Center, in Norcross, Georgia, a suburb of Atlanta, and NTS Center and Plainview Center, both in Jeffersontown, Kentucky, a suburb of Louisville. One tenant in NTS Center occupies 46% of the office building's net rentable area. One tenant in Plainview Center occupies 50% of the office building's net rentable area.

Our financial instruments that are exposed to concentrations of credit risk consist of cash and equivalents. We maintain our cash accounts primarily with banks located in Kentucky. Cash balances are insured by the FDIC up to \$100,000 per bank account. We may at times, in certain accounts, have deposits in excess of \$100,000.

**Note 3 - Cash and Equivalents**

Cash and equivalents include cash on hand and short-term, highly liquid investments with initial maturities of three months or less. We have a cash management program which provides for the overnight investment of excess cash balances. Under an agreement with a bank, excess cash is invested in a repurchase agreement for U.S. government or agency securities each night. As of June 30, 2004, approximately \$239,000 of our overnight investment was included in cash and equivalents.

#### **Note 4 - Cash and Equivalents - Restricted**

Cash and equivalents - restricted represents funds which have been escrowed with a mortgage company for NTS Center's property taxes in accordance with the loan agreement.

#### **Note 5 - Basis of Property and Depreciation**

Land, buildings and amenities are stated at historical cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets which are 6-30 years for land improvements, 5-30 years for buildings and improvements, 3-27 years for amenities and the applicable lease term for tenant improvements. The aggregate cost of our properties for federal tax purposes is approximately \$28,700,000.

Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," specifies circumstances in which certain long-lived assets must be reviewed for impairment. If the carrying amount of an asset exceeds the sum of its expected future cash flows, the asset's carrying value must be written down to fair value. There were no impairment losses during any of the periods presented.

#### **Note 6 - Mortgages Payable**

Mortgages payable consists of the following:

	June 30, 2004	December 31, 2003
Mortgage payable to an insurance company in monthly installments, bearing interest at 6.89%, maturing April 10, 2015, secured by land and buildings.	\$ 5,180,708	\$ 5,339,037
Mortgage payable to a bank in monthly installments, bearing a variable interest rate of Prime -.25%, due March 1, 2005, secured by land and a building. The rate on June 30, 2004 was 3.75%.	910,000	970,000
	<u>\$ 6,090,708</u>	<u>\$ 6,309,037</u>

Our mortgages may be prepaid but are subject to a yield-maintenance premium.

As of June 30, 2004, the fair value of long-term debt was approximately \$6,035,000, based on the borrowing rates currently available to us for mortgages with similar terms and average maturities.



## Note 7 - Related Party Transactions

Pursuant to an agreement with us, NTS Development Company, an affiliate of our General Partner, receives property management fees. The fees are paid in an amount equal to 5% of the gross receipts from our properties. Also pursuant to an agreement, NTS Development Company receives a repair and maintenance fee equal to 5.9% of the costs incurred which relate to capital improvements. These repair and maintenance fees are capitalized as part of land, buildings and amenities.

We were charged the following amounts pursuant to an agreement with NTS Development Company for the six months ended June 30, 2004 and 2003. These charges include items which have been expensed as operating expenses - affiliated or professional and administrative expenses - affiliated and items which have been capitalized as other assets or as land, buildings and amenities.

	Six Months Ended June 30,	
	2004	2003
Property management fees	\$ 88,963	\$ 92,911
Property management	107,264	98,220
Leasing	24,385	37,013
Administrative - operating	33,233	17,550
Other	4,630	4,488
Total operating expenses - affiliated	169,512	157,271
Professional and administrative expenses - affiliated	75,941	74,326
Repair and maintenance fees	5,706	6,640
Leasing commissions	4,682	--
Total related party transactions capitalized	10,388	6,640
Total related party transactions	\$ 344,804	\$ 331,148

During the six months ended June 30, 2004 and 2003, we were charged \$3,657 and \$3,976, respectively, for property maintenance fees from an affiliate of NTS Development Company.

During the six months ended June 30, 2004 and 2003, NTS Development Company leased 20,368 square feet in NTS Center at a rental rate of \$14.50 per square foot. We received approximately \$148,000 in rental payments from NTS Development Company during each of the six months ended June 30, 2004 and 2003. The lease term for NTS Development Company ended on March 31, 2004. The lease was extended for one year to March 31, 2005, at a rental rate of \$14.50 per square foot for 20,368 square feet.

## Note 8 - Commitments and Contingencies

As an owner of real estate, we are subject to various environmental laws of federal, state and local governments. Our compliance with existing laws has not had a material adverse effect on our financial condition or results of operations. However, we cannot predict the impact of new or changed laws or regulations on our current properties or on properties that we may acquire in the future.

### *Litigation*

On December 12, 2001, three individuals filed an action in the Superior Court of the State of California for the County of Contra Costa (the “Superior Court”) originally captioned *Buchanan, et al. v. NTS-Properties Associates, et al.* (Case No. C 01-05090) against the general partners (the “General Partners”) of NTS-Properties III, NTS-Properties IV, NTS-Properties V, NTS-Properties VI and NTS-Properties VII, Ltd. (the “Partnerships”), as well as several individuals and entities affiliated with us. The action purported to bring claims on behalf of a class of limited partners. These claims were based on, among other things, tender offers made by the Partnerships and an affiliate of the General Partners, as well as the operation of the Partnerships by the General Partners. The plaintiffs alleged, among other things, that the prices at which limited partnership interests were purchased in these tender offers were too low. The plaintiffs sought monetary damages and equitable relief, including an order directing the disposition of the properties owned by the Partnerships and the distribution of the proceeds. No amounts have been accrued as a liability for this action in our financial statements. Under an indemnification agreement with our general partner, we are responsible for the costs of defending any such action.

On February 27, 2003, two individuals filed a class and derivative action in the Circuit Court of Jefferson County, Kentucky captioned *Bohm, et al. v. J.D. Nichols, et al.* (Case No. 03-CI-01740) against certain of the General Partners and several individuals and entities affiliated with us. The complaint was amended to include the general partner of NTS-Properties III and the general partner of NTS-Properties Plus Ltd., which is no longer in existence. In the amended complaint, the plaintiffs purport to bring claims on behalf of a class of limited partners and derivatively on behalf of us and the Partnerships based on alleged overpayment of fees, prohibited investments, improper failures to make distributions, purchases of limited partnerships interests at insufficient prices and other violations of the limited partnership agreements. The plaintiffs are seeking, among other things, compensatory and punitive damages in an unspecified amount, an accounting, the appointment of a receiver or liquidating trustee, the entry of an order of dissolution against the Partnerships, a declaratory judgment and injunctive relief. No amounts have been accrued as a liability for this action in our financial statements. Our general partner and legal counsel believe that this action is without merit and are vigorously defending it.

On June 20, 2003, the General Partners reached an agreement in principle with the representatives of the class of plaintiffs to settle the *Buchanan* litigation. This agreed upon settlement includes releases for all of the parties for all of the claims asserted in the *Buchanan* litigation and the *Bohm* litigation. As part of the agreed upon settlement, the General Partners agreed to pursue a merger of the Partnerships and other real estate entities affiliated with the General Partners into a newly-formed entity named NTS Realty Holdings Limited Partnership (“NTS Realty”). NTS Development Company agreed to pay the Partnerships \$1,500,000 on the closing date of the merger. We expect to receive \$202,500 of this payment.

On December 5, 2003, the General Partners, certain of their affiliates and the class of plaintiffs in the *Buchanan* litigation jointly filed a Stipulation and Agreement of Settlement (the “Settlement Agreement”) with the Superior Court. The Settlement Agreement sets forth the terms of the agreed upon settlement the parties reached on June 20, 2003. On February 26, 2004, the Superior Court preliminarily approved the Settlement Agreement as within the range of reasonableness and that it is fair, just and adequate to the class of plaintiffs. The Superior Court scheduled a hearing to finally determine whether the Settlement Agreement is in the best interests of the class of plaintiffs and whether the *Buchanan* litigation should be dismissed with prejudice.

On March 2, 2004, we, along with all defendants, filed a Motion to Dismiss the *Bohm* litigation. After the Motion to Dismiss was fully briefed, the settlement agreement in the *Buchanan* litigation received final court approval. The Circuit Court of Jefferson County, Kentucky, instructed the plaintiffs in the *Bohm* litigation to file an amended complaint in light of the approved settlement of the *Buchanan* litigation. The plaintiffs in the *Bohm* litigation filed a corrected Second Amended Complaint on August 11, 2004. Our general partner believes that the claims asserted in the corrected Second Amended Complaint have no merit.

On May 6, 2004, the Superior Court granted its final approval of the Settlement Agreement. At the final hearing, any member of the class of plaintiffs was given the opportunity to object to the final approval of the Settlement Agreement, the entry of a final judgment dismissing with prejudice the *Buchanan* litigation, or an application of an award for attorneys’ fees and expenses to plaintiffs’ counsel. The Superior Court’s order provides, among other things, that: (1) the Settlement Agreement, and all transactions contemplated thereby, including the proposed merger of the Partnerships into NTS Realty, are fair, reasonable and adequate, and in the best interests of the class of plaintiffs; (2) the plaintiffs’ complaint and each and every cause of action and claim set forth therein is dismissed with prejudice; (3) each class member is barred from (a) transferring, selling or otherwise disposing of (other than by operation of law) their interests until the earlier of the closing date of the merger, the termination of the settlement or June 30, 2004; and (4) each class member who requested to be excluded from the settlement released their claims in the *Bohm* litigation.

On June 11, 2004, Joseph Bohm and David Duval, class members who objected to the Settlement Agreement but were overruled by the Superior Court, filed an appeal in the Court of Appeals of the State of California, first Appellate District. Our general partner believes that this appeal has no merit and intends to defend it and the decision of the Superior Court.

For the six months ended June 30, 2004 and 2003, our share of the legal costs for the *Buchanan* and *Bohm* litigations was approximately \$65,000 and \$9,000, respectively, which was included in our professional and administrative expenses.

We do not believe there is any other litigation threatened against us other than routine litigation arising out of the ordinary course of business, some of which is expected to be covered by insurance, none of which is expected to have a material effect on our financial position or results of operations, except as discussed herein.

### ***Proposed Merger***

As part of the Settlement Agreement, our general partner and the general partners of the four public partnerships affiliated with us, have agreed to pursue a merger of the partnerships and several other affiliated real estate entities into a newly formed limited partnership known as NTS Realty. The merger is subject to, among other things, approval by a majority of the limited partner interests in each partnership. We may not seek the approval of the limited partners until a filing made by NTS Realty with the Securities and Exchange Commission is declared effective. For the six months ended June 30, 2004 and 2003, our share of the legal and professional fees for the proposed merger was approximately \$101,000 and \$28,000, respectively.

On February 4, 2004, NTS Realty filed a joint consent solicitation statement/prospectus on Form S-4 with the Securities and Exchange Commission. The solicitation statement/prospectus presents the merger of NTS-Properties III; NTS-Properties IV; NTS-Properties V; NTS-Properties VI; and NTS-Properties VII, Ltd. with NTS Realty. Concurrent with the merger, ORIG, LLC, a Kentucky limited liability company, which is affiliated with our general partner, will contribute substantially all its real estate assets and all of its liabilities to NTS Realty.

On June 24, 2004 and August 13, 2004, NTS Realty filed first and second amendments, respectively, to Form S-4 with the Securities and Exchange Commission. Both amendments are in response to comments made by the Securities and Exchange Commission.

### **Note 9 - Segment Reporting**

Our reportable operating segments include only one segment - Commercial Real Estate Operations.

## **Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Financial Statements in Item 1 and the cautionary statements below.

### **Critical Accounting Policies**

#### ***General***

A critical accounting policy is one that would materially affect our operations or financial condition, and requires management to make estimates or judgments in certain circumstances. These judgments often result from the need to make estimates about the effect of matters that are inherently uncertain. Critical accounting policies discussed in this section are not to be confused with accounting principles and methods disclosed in accordance with U.S. generally accepted accounting principles ("GAAP"). GAAP requires information in financial statements about accounting principles, methods used and disclosures pertaining to significant estimates. The following disclosure discusses judgments known to management pertaining to trends, events or uncertainties known which were taken into consideration upon the application of those policies and the likelihood that materially different amounts would be reported upon taking into consideration different conditions and assumptions.

#### ***Impairment and Valuation***

Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," specifies circumstances in which certain long-lived assets must be reviewed for impairment. If the carrying amount of an asset exceeds the sum of its expected future cash flows, the asset's carrying value must be written down to fair value. In determining the value of an investment property and whether the investment property is impaired, management considers several factors such as projected rental and vacancy rates, property operating expenses, capital expenditures and interest rates. The capitalization rate used to determine property valuation is based on the market in which the investment property is located, length of leases, tenant financial strength, the economy in general, demographics, environment, property location, visibility, age and physical condition among others. All of these factors are considered by management in determining the value of any particular investment property. The value of any particular investment property is sensitive to the actual results of any of these factors, either individually or taken as a whole. If the actual results differ from management's judgment, the valuation could be negatively or positively affected.

### ***Recognition of Rental Income***

Our commercial property leases are accounted for as operating leases. We accrue minimum rents on a straight-line basis over the terms of their respective leases. We structure our leases to allow us to recover a significant portion of our property operating, real estate taxes and repairs and maintenance expenses from our tenants. Property operating expenses typically include utility, insurance, security, janitorial, landscaping and other administrative expenses. We accrue reimbursements from tenants for recoverable portions of all these expenses as revenue in the period the applicable expenditures are incurred. We also receive estimated payments for these reimbursements from substantially all our tenants throughout the year. We do this to reduce the risk of loss on uncollectible accounts once we perform the final year-end billings for recoverable expenditures. We recognize the difference between estimated recoveries and the final billed amounts in the subsequent year and we believe these differences were not material in any period presented.

Under GAAP, we are required to recognize rental income based on the effective monthly rent for each lease. The effective monthly rent is equal to the average monthly rent during the term of the lease, not the stated rent for any particular month. The process, known as "straight-lining" or "stepping" rent generally has the effect of increasing rental revenues during the early phases of a lease and decreasing rental revenues in the latter phases of a lease. Due to the impact of "straight-lining," rental income exceeded the cash collected for rent by approximately \$95,000 and \$68,000, for the six months ended June 30, 2004 and 2003, respectively. If rental income calculated on a straight-line basis exceeds the cash rent due under the lease, the difference is recorded as an increase in deferred rent receivable and included as a component of accounts receivable on the relevant balance sheet. If the cash rent due under the lease exceeds rental income calculated on a straight-line basis, the difference is recorded as a decrease in deferred rent receivable and is recorded as a decrease of accounts receivable on the relevant balance sheet. We defer recognition of contingent rental income, such as percentage or excess rent, until the specified target that triggers the contingent rental income is achieved. We periodically review the collectability of outstanding receivables. Allowances are generally taken for tenants with outstanding balances due for a period greater than ninety days and for tenants with potentially uncollectible outstanding balances due for a period less than ninety days.

### ***Recognition of Lease Termination Income***

We recognize lease termination income upon receipt of the income. We accrue lease termination income if there is a signed termination agreement, all of the conditions of the agreement have been met and the tenant is no longer occupying the property.

### ***Cost Capitalization and Depreciation Policies***

We review all expenditures and capitalize any item exceeding \$1,000 deemed to be an upgrade or a tenant improvement with an expected useful life greater than one year. Land, buildings and amenities are stated at cost. Depreciation expense is computed using the straight-line method over the estimated useful lives of the assets. Buildings and improvements have estimated useful lives between 5-30 years, land improvements have estimated useful lives of between 6-30 years and amenities have estimated useful lives between 3-27 years.

### **Results of Operations**

The following tables include our selected summarized operating data for the three and six months ended June 30, 2004 and 2003. This data is presented to provide assistance in identifying trends in our operating results and other factors affecting our business. This data should be read in conjunction with our financial statements, including the notes thereto, in Part I, Item 1 of this report.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Total revenues	\$ 941,357	\$ 922,773	\$ 1,875,424	\$ 1,915,637
Operating expenses and operating expenses - affiliated	300,452	305,547	579,081	588,265
Depreciation and amortization	251,487	269,705	530,575	553,553
Interest expense	100,225	110,789	201,664	224,729
Net income	71,591	29,506	91,253	145,959

Rental income and tenant reimbursements generated by our properties for the three and six months ended June 30, 2004 and 2003 were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
NTS Center	\$ 274,356	\$ 261,085	\$ 540,633	\$ 596,452
Plainview Center	330,367	305,541	665,084	614,249
Peachtree Corporate Center	336,634	356,147	669,707	704,936

We believe the changes in rental income and tenant reimbursements from period to period are temporary effects of each property's specific mix of lease maturities and are not indicative of any known trend.

The occupancy levels at our properties as of June 30, 2004 and 2003 were as follows:

	June 30,	
	2004	2003
NTS Center	75%	72%
Plainview Center	79%	69%
Peachtree Corporate Center	87%	88%

We believe the changes in occupancy on June 30 from year to year are temporary effects of each property's specific mix of lease maturities and are not indicative of any known trend.

The average occupancy levels at our properties for the three and six months ended June 30, 2004 and 2003 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
NTS Center	75%	72%	73%	79%
Plainview Center	79%	69%	79%	70%
Peachtree Corporate Center	86%	86%	85%	85%

We believe the changes in average occupancy from period to period are temporary effects of each property's specific mix of lease maturities and are not indicative of any known trend.

We are making efforts to increase the occupancy levels at our properties. The leasing and renewal negotiations for NTS Center and Plainview Center are handled by leasing agents that are employees of NTS Development Company, in Louisville, Kentucky. At Peachtree Corporate Center, in Norcross, Georgia, we have an off-site leasing agent, who makes calls to potential tenants, negotiates lease renewals with current tenants and manages local advertising with the assistance of NTS Development Company's marketing staff located in Louisville, Kentucky.

The following discussion relating to changes in our results of operations includes only material line items within our Statements of Operations or line items for which there was a material change between the three and six months ending June 30, 2004 and 2003.

### ***Rental Income and Tenant Reimbursements***

Our rental income and tenant reimbursements for the three months ended June 30, 2004 and 2003 were approximately \$941,000 and \$923,000, respectively. The increase of \$18,000, or 2%, was primarily due to increased average occupancy at Plainview Center and NTS Center. Our rental income and tenant reimbursements for the six months ended June 30, 2004 and 2003 were approximately \$1,875,000 and \$1,916,000, respectively. The decrease of \$41,000, or 2%, was primarily due to decreased average occupancy at NTS Center and increased free rent at Peachtree Corporate Center and Plainview Center. The decrease is partially offset by increased average occupancy at Plainview Center. Rental income – affiliated did not change for the three and six months ended June 30, 2004 and 2003.



Quarter-ending occupancy percentages represent occupancy only on a specific date; therefore, the above analysis considers average occupancy percentages, which are more representative of the entire year-to-date results.

### ***Operating Expenses and Operating Expenses – Affiliated***

Our operating expenses and operating expenses – affiliated did not change significantly for the three and six months ended June 30, 2004 and 2003. There were no offsetting material changes.

Operating expenses – affiliated are for the services performed by employees of NTS Development Company, an affiliate of our General Partner. These employee services include property management, leasing, maintenance, security and other services necessary to manage and operate our business.

### ***Professional and Administrative Expenses and Professional and Administrative Expenses – Affiliated***

Our professional and administrative expenses did not change significantly for the three months ended June 30, 2004 and 2003. There were no offsetting material changes. Our professional and administrative expenses for the six months ended June 30, 2004 and 2003 were approximately \$208,000 and \$142,000, respectively. The increase of \$66,000, or 47%, was a result of costs incurred for legal and professional fees related to our proposed merger and litigation filed by limited partners. See Item 1 – Note 8 for information regarding our proposed merger and litigation filed by limited partners.

Our professional and administrative expenses – affiliated did not change significantly for the three and six months ended June 30, 2004 and 2003. There were no offsetting material changes.

Professional and administrative expenses – affiliated are for the services performed by employees of NTS Development Company, an affiliate of our General Partner. These employee services include legal, financial and other services necessary to manage and operate our business.

### ***Depreciation and Amortization Expense***

Our depreciation and amortization expense did not change significantly for the three and six months ended June 30, 2004 and 2003. There were no offsetting material changes.

### ***Interest Expense***

Our interest expense did not change significantly for the three months ended June 30, 2004 and 2003. There were no offsetting material changes. Our interest expense for the six months ended June 30, 2004 and 2003 was approximately \$202,000 and \$225,000, respectively. The decrease of \$23,000, or 10%, was primarily the result of additional principal payments made in 2003 which reduced the outstanding balance on our mortgage payable secured by Plainview Center.

### **Liquidity and Capital Resources**

The following table sets forth the cash provided by or used in operating activities, investing activities and financing activities for the six months ended June 30, 2004 and 2003.

Cash flows provided by (used in):

	Six Months Ended June 30,	
	2004	2003
Operating activities	\$ 510,744	\$ 709,689
Investing activities	(136,040)	(159,314)
Financing activities	(220,304)	(607,817)
Net increase (decrease) in cash and equivalents	\$ <u>154,400</u>	\$ <u>(57,442)</u>

Net cash provided by operating activities decreased from approximately \$710,000 for the six months ended June 30, 2003 to approximately \$511,000 for the six months ended June 30, 2004. The \$199,000 decrease was due to decreased cash available from operations as a result of increased expenses associated with our litigation filed by limited partners and our proposed merger and decreased average occupancy at NTS Center.

Net cash used in investing activities decreased from approximately \$159,000 for the six months ended June 30, 2003 to approximately \$136,000 for the six months ended June 30, 2004. The \$23,000 decrease in net cash used was primarily due to a decrease in additions to land, buildings and amenities at NTS Center for tenant finish.

Net cash used in financing activities decreased from approximately \$608,000 for the six months ended June 30, 2003 to approximately \$220,000 for the six months ended June 30, 2004. The \$388,000 decrease was primarily the result of additional principal payments made on the Plainview Center mortgage in 2003.

Due to the fact that no distributions were made during the six months ended June 30, 2004 or 2003, the table which presents that portion of the distributions that represents a return of capital in accordance with GAAP has been omitted.

### ***Future Liquidity***

We believe the current occupancy levels are adequate to fund the operations of our properties. However, our future liquidity depends significantly on our properties' occupancy remaining at a level which provides for debt payments and adequate working capital, currently and in the future. If occupancy were to fall below that level and remain at or below that level for a significant period of time, our ability to make payments due under our debt agreements and to continue paying daily operational costs would be greatly impaired. In addition, we may be required to obtain financing in connection with the capital improvements and leasing costs described below.

A major tenant at NTS Center with a near lease term expiration is seeking alternatives to renewing its expiring lease with us. This tenant is currently occupying 53,435 square feet, or 46% of the total rentable square feet of the building, at an annual rate of \$13.59 per square foot. The failure of this tenant to renew its lease at NTS Center would result in a loss of annual rental revenue and operating expense recoveries of approximately \$726,000, or 19% of 2003's total revenues. This would significantly impair our liquidity, and could result in significant costs to refurbish the vacated space and locate new tenants. At this time, we are not certain whether the tenant intends to renew its lease as allowed by the lease agreement, or vacate its space. Approximately \$1,000,000 will be needed for renovations if this tenant renews its lease. We do not have an estimate for the costs to locate a replacement tenant or refinish the space occupied by this tenant.

On March 31, 2003, a major tenant at NTS Center vacated its space. This tenant occupied 16,937 square feet, or 15% of the total rentable square feet of the building, at an annual rate of \$15.28 per square foot. This will result in an annual loss of approximately \$259,000, or 7% of 2003's total revenues if no suitable replacement tenant can be found. There may be significant demands on future liquidity as a result of this vacancy.

In the next 12 months, we expect the demand on future liquidity to increase as a result of future leasing activity. There has been and will likely continue to be a protracted period for Plainview Center and NTS Center to become fully leased again. At June 30, 2004 there were approximately 29,000, 20,000 and 22,000 square feet of vacant space available to lease at NTS Center, Plainview Center and Peachtree Corporate Center, respectively. Approximately \$1,150,000 will be needed for leasing costs, especially those needed to refinish these spaces for new tenants. As of June 30, 2004, we had not made any commitments for tenant finish improvements at Plainview Center, NTS Center or Peachtree Corporate Center.

As of June 30, 2004, we anticipate making certain building improvements in 2004 totaling approximately \$100,400. These improvements include HVAC replacements, window seal repairs and a water heater replacement at Peachtree Corporate Center, estimated to cost \$49,900, HVAC replacements, electrical panel repairs and exterior stairwell repairs at NTS Center, estimated to cost \$33,500 and HVAC replacements at Plainview Center, estimated to cost \$17,000.

We anticipate using cash provided by operations and cash reserves to fund a portion of the capital improvements and leasing costs described above. However, we believe that funding these expenses may also require existing financing or additional financing secured by our properties and there is no assurance that this financing will be available.

We have no other material commitments for renovations or capital expenditures as of June 30, 2004.

### **Proposed Merger**

As part of the Settlement Agreement, our general partner and the general partners of the four public partnerships affiliated with us, have agreed to pursue a merger of the partnerships and several other affiliated real estate entities into a newly formed limited partnership known as NTS Realty Holdings Limited Partnership (“NTS Realty”). The merger is subject to, among other things, approval by a majority of the limited partner interests in each partnership. We may not seek the approval of the limited partners until a filing made by NTS Realty with the Securities and Exchange Commission is declared effective. For the six months ended June 30, 2004 and 2003, our share of the legal and professional fees for the proposed merger was approximately \$101,000 and \$28,000, respectively.

On February 4, 2004, NTS Realty filed a joint consent solicitation statement/prospectus on Form S-4 with the Securities and Exchange Commission. The solicitation statement/prospectus presents the merger of NTS-Properties III; NTS-Properties IV; NTS-Properties V; NTS-Properties VI; and NTS-Properties VII, Ltd. with NTS Realty. Concurrent with the merger, ORIG, LLC, a Kentucky limited liability company, which is affiliated with our general partner, will contribute substantially all its real estate assets and all of its liabilities to NTS Realty.

On June 24, 2004 and August 13, 2004, NTS Realty filed first and second amendments, respectively, to Form S-4 with the Securities and Exchange Commission. Both amendments are in response to comments made by the Securities and Exchange Commission.

### **Website Information**

Our website address is [www.ntsdevelopment.com](http://www.ntsdevelopment.com). Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are available and may be accessed free of charge through the “About NTS” section of our website as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. Our website and the information contained therein or connected thereto are not incorporated into this quarterly report on Form 10-Q.

### **Item 3 - Quantitative and Qualitative Disclosures About Market Risk**

Our primary market risk exposure with regard to financial instruments stems from changes in interest rates. Our debt bears interest at a fixed rate with the exception of the \$3,500,000 mortgage payable obtained on May 9, 2000, which had a balance of \$910,000 as of June 30, 2004. On June 30, 2004, a hypothetical 100 basis point increase in interest rates would result in an approximate \$236,000 decrease in the fair value of the debt and would increase interest expense on the variable rate mortgage by approximately \$9,000 annually.

### **Item 4 - Controls and Procedures**

Our General Partner, with the participation of the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2004. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2004. There were no material changes in our internal controls over financial reporting during the six months ended June 30, 2004.

## PART II - OTHER INFORMATION

### Item 1 - Legal Proceedings

On May 6, 2004, the Superior Court of the State of California for the County of Contra Costa granted its final approval of the Stipulation and Agreement of Settlement (the "Settlement Agreement") jointly filed by the general partners (the "General Partners") of NTS-Properties III, NTS-Properties IV, NTS-Properties V, NTS-Properties VI and NTS-Properties VII, Ltd. (the "Partnerships"), along with certain of their affiliates, with the class of plaintiffs in the action originally captioned *Buchanan, et al. v. NTS-Properties Associates, et al.* (Case No. C 01-05090) on December 5, 2003. At the final hearing, any member of the class of plaintiffs was given the opportunity to object to the final approval of the Settlement Agreement, the entry of a final judgment dismissing with prejudice the *Buchanan* litigation, or an application of an award for attorneys' fees and expenses to plaintiffs' counsel. The Superior Court's order provides, among other things, that: (1) the Settlement Agreement, and all transactions contemplated thereby, including the proposed merger of the Partnerships into NTS Realty Holdings Limited Partnership, are fair, reasonable and adequate, and in the best interests of the class of plaintiffs; (2) the plaintiffs' complaint and each and every cause of action and claim set forth therein is dismissed with prejudice; (3) each class member is barred from (a) transferring, selling or otherwise disposing of (other than by operation of law) their interests until the earlier of the closing date of the merger, the termination of the settlement or June 30, 2004; and (4) each class member who requested to be excluded from the settlement released their claims in the *Bohm* litigation.

On June 11, 2004, Joseph Bohm and David Duval, class members who objected to the Settlement Agreement but were overruled by the Superior Court, filed an appeal in the Court of Appeals of the State of California, first Appellate District.

**Items 2 through 5 are omitted because these items are inapplicable or the answers to the items are negative.**

### Item 6 - Exhibits and Reports on Form 8-K

#### Exhibit No.

3	Amended and Restated Agreement and Certificate of Limited Partnership of NTS-Properties III.	*
10	Management Agreement between NTS Development Company and NTS-Properties III.	*
14	Code of Ethics.	**

- |      |   |     |
|------|---|-----|
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.  | *** |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.  | *** |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  | *** |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  | *** |
| *    | Incorporated by reference to documents filed with the Securities and Exchange Commission in connection with the filing of the Registration Statements on Form S-11 on June 25, 1982 (effective October 13, 1982) under Commission File No. 2-78152. |     |
| **   | See <a href="http://www.ntsdevelopment.com">www.ntsdevelopment.com</a> for our code of ethics.  |     |
| ***  | Attached as an exhibit with this Form 10-Q.   |     |

### **Reports on Form 8-K**

We filed a Form 8-K on June 24, 2004, to announce that NTS Realty Holdings Limited Partnership filed an amendment to Form S-4 with the Securities and Exchange Commission on June 18, 2004. The original Form S-4 was filed on February 4, 2004.

We filed a Form 8-K on August 13, 2004, to announce that NTS Realty Holdings Limited Partnership filed a second amendment to Form S-4 with the Securities and Exchange Commission on August 13, 2004. The original Form S-4 was filed on February 4, 2004.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### NTS-PROPERTIES III

By: NTS-Properties Associates,  
General Partner  
By: NTS Capital Corporation,  
General Partner

/s/ Brian F. Lavin  
Brian F. Lavin  
President of NTS Capital Corporation

/s/ Gregory A. Wells  
Gregory A. Wells  
Chief Financial Officer of NTS Capital Corporation

Date: August 16, 2004



## EXHIBIT 31.1

### CERTIFICATION

I, Brian F. Lavin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NTS-Properties III;
2. Based on my knowledge, this report 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 such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the registrant's general partner:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 16, 2004

/s/ Brian F. Lavin

President of NTS Capital Corporation,  
General Partner of NTS-Properties Associates,  
General Partner of NTS-Properties III

## EXHIBIT 31.2

### CERTIFICATION

I, Gregory A. Wells, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NTS-Properties III;
2. Based on my knowledge, this report 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 such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the registrant's general partner:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 16, 2004

/s/ Gregory A. Wells

Chief Financial Officer of NTS Capital Corporation,  
General Partner of NTS-Properties Associates,  
General Partner of NTS-Properties III

## **EXHIBIT 32.1**

### **CERTIFICATION**

I, Brian F. Lavin, President of NTS Capital Corporation, the general partner of NTS-Properties Associates, the general partner of NTS-Properties III (the “Partnership”), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The quarterly report on Form 10-Q of the Partnership for the period ended June 30, 2004 (the “Report”) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Partnership.

Dated: August 16, 2004

/s/ Brian F. Lavin  
President of NTS Capital Corporation,  
General Partner of NTS-Properties Associates,  
General Partner of NTS-Properties III

A signed original of this written statement required by Section 906 has been provided to the Partnership and will be retained by the Partnership and furnished to the Securities and Exchange Commission or its staff upon request.

## **EXHIBIT 32.2**

### **CERTIFICATION**

I, Gregory A. Wells, Chief Financial Officer of NTS Capital Corporation, the general partner of NTS-Properties Associates, the general partner of NTS-Properties III (the “Partnership”), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The quarterly report on Form 10-Q of the Partnership for the period ended June 30, 2004 (the “Report”) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Partnership.

Dated: August 16, 2004

/s/ Gregory A. Wells  
Chief Financial Officer of NTS Capital Corporation,  
General Partner of NTS-Properties Associates,  
General Partner of NTS-Properties III

A signed original of this written statement required by Section 906 has been provided to the Partnership and will be retained by the Partnership and furnished to the Securities and Exchange Commission or its staff upon request.