

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

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**FORM 10-Q**

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

For the quarterly period ended June 30, 2001

OR

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

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Commission File Number 0-18550

**NTS MORTGAGE INCOME FUND**

Incorporated pursuant to the Laws of the State of Delaware

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Internal Revenue Service - Employer Identification No. 61-1146077

10172 Linn Station Road, Louisville, Kentucky 40223

(502) 426-4800

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

As of August 6, 2001 there were approximately 3,187,000 shares of common stock outstanding.

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## PART I - FINANCIAL INFORMATION

### Item 1 - Financial Statements

#### NTS MORTGAGE INCOME FUND CONSOLIDATED BALANCE SHEETS

	As of June 30, 2001 <u>(UNAUDITED)</u>	As of December 31, 2000*
<u>ASSETS</u>		
Cash and equivalents	\$ 458,344	\$ 570,465
Membership initiation fees and other accounts receivable, net of allowance of approximately \$82,000 and \$88,000, respectively	1,783,841	1,312,448
Notes receivable	1,356,778	1,213,191
Inventory	50,342,781	52,206,560
Property and equipment, net of accumulated depreciation of approximately \$869,000 and \$745,000	638,403	566,008
Investment in unconsolidated affiliate	1,391,685	1,329,427
Advances to affiliates	6,000	20,252
Other assets	<u>712,006</u>	<u>562,225</u>
 TOTAL ASSETS	 <u>\$ 56,689,838</u>	 <u>\$ 57,780,576</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Accounts payable and accrued expenses	\$ 2,828,792	\$ 3,195,691
Accounts payable - affiliates	4,612,900	3,809,658
Mortgages and notes payable	25,832,959	25,910,622
Notes payable - affiliate	123,286	418,657
Lot deposits	234,469	185,257
Deferred revenues	<u>44,186</u>	<u>28,885</u>
 TOTAL LIABILITIES	 <u>33,676,592</u>	 <u>33,548,770</u>
 COMMITMENTS AND CONTINGENCIES (Note 14)		
<u>STOCKHOLDERS' EQUITY</u>		
Comm on stock, \$0.001 par value, 6,000,000 shares authorized; 3,187,333 shares issued and outstanding	\$ 3,187	\$ 3,187
Additional paid-in-capital	54,163,397	54,163,397
Accumulated deficit	<u>(31,153,338)</u>	<u>(29,934,778)</u>
 TOTAL STOCKHOLDERS' EQUITY	 <u>23,013,246</u>	 <u>24,231,806</u>
 TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	 <u>\$ 56,689,838</u>	 <u>\$ 57,780,576</u>

\* Reference is made to the Fund's audited financial statements in the Form 10-K as filed with the Securities and Exchange Commission on April 3, 2001.

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

**NTS MORTGAGE INCOME FUND**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
<b><u>REVENUES</u></b>				
Lot sales, net of discounts	\$ 3,263,310	\$ 3,710,222	\$ 7,468,164	\$ 6,209,671
Cost of sales	2,501,646	2,753,605	6,110,524	4,796,824
Gross profit	761,664	956,617	1,357,640	1,412,847
Country Club income	340,576	--	340,576	--
Interest and miscellaneous income	23,814	113,584	33,387	208,647
<b>TOTAL REVENUES</b>	<b>1,126,054</b>	<b>1,070,201</b>	<b>1,731,603</b>	<b>1,621,494</b>
<b><u>EXPENSES</u></b>				
Selling, general and administrative - affiliated	731,864	667,409	1,494,813	1,297,217
Selling, general and administrative Country Club expenses	431,216	683,869	870,191	1,036,778
Interest expense	527,511	--	527,511	--
Other taxes and licenses	15,833	40,483	30,979	93,116
Depreciation and amortization	(3,211)	47,733	37,804	59,749
(Income) loss from investment in unconsolidated affiliate	13,796	19,652	27,023	33,231
	(67,033)	98,575	(38,158)	197,108
<b>TOTAL EXPENSES</b>	<b>1,649,976</b>	<b>1,557,721</b>	<b>2,950,163</b>	<b>2,717,199</b>
Net loss before federal income tax	(523,922)	(487,520)	(1,218,560)	(1,095,705)
Federal income tax expense	--	--	--	--
Net loss	<u>\$ (523,922)</u>	<u>\$ (487,520)</u>	<u>\$ (1,218,560)</u>	<u>\$ (1,095,705)</u>
Net loss per share of common stock	<u>\$ (0.16)</u>	<u>\$ (0.15)</u>	<u>\$ (0.38)</u>	<u>\$ (0.34)</u>
Weighted average number of shares	<u>3,187,333</u>	<u>3,187,333</u>	<u>3,187,333</u>	<u>3,187,333</u>

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

**NTS MORTGAGE INCOME FUND**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Six Months Ended	
	June 30,	
	2001	2000
<b><u>CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</u></b>		
Net loss	\$ (1,218,560)	\$ (1,095,705)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	27,023	33,231
(Income) loss from investment in unconsolidated affiliate	(38,158)	197,108
Changes in assets and liabilities:		
Membership initiation fees and other accounts receivable	(471,393)	(208,430)
Notes receivable	(143,587)	455,138
Inventory	1,989,699	(828,221)
Accounts payable and accrued expenses	(366,899)	1,838,131
Accounts payable - affiliates	803,242	1,525,248
Lot deposits	49,212	168,417
Deferred revenues	15,301	(32,679)
Other assets	(159,190)	(105,149)
	486,690	1,947,089
<b><u>CASH FLOW USED IN INVESTING ACTIVITIES</u></b>		
Purchase of property and equipment	(195,929)	(214,078)
Capital contribution to unconsolidated affiliate	(24,100)	(25,000)
	(220,029)	(239,078)
<b><u>CASH FLOWS USED IN FINANCING ACTIVITIES</u></b>		
Advances to/from affiliates	14,252	--
Proceeds from mortgage and notes payable	6,835,000	4,769,916
Proceeds from notes payable - affiliated	50,581	--
Payments on mortgages and notes payable	(6,912,663)	(6,173,592)
Payments on notes payable - affiliated	(345,952)	--
Other assets	(20,000)	(22,779)
	(378,782)	(1,426,455)
Net cash used in financing activities		
Net increase (decrease) in cash and equivalents	(112,121)	281,556
CASH AND EQUIVALENTS, beginning of period	570,465	619,022
CASH AND EQUIVALENTS, end of period	\$ 458,344	\$ 900,578
Cash paid for interest, net of amounts capitalized	\$ 33,533	\$ 91,921

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

**NTS MORTGAGE INCOME FUND**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The unaudited financial statements and schedules included herein should be read in conjunction with the Fund's 2000 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on April 3, 2001. In the opinion of the Fund's management, all adjustments (only consisting 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, 2001 and 2000.

**Note 1 - Organization**

NTS Mortgage Income Fund (the "Fund"), a Delaware corporation, was formed on September 26, 1988. The Fund operated as a Real Estate Investment Trust ("REIT") under the Internal Revenue Code of 1986 (the "Code"), as amended, from its inception through December 31, 1996. The Fund began operating as a "C" corporation under the Code for tax purposes effective January 1, 1997. NTS Corporation is the sponsor of the Fund (the "Sponsor"). NTS Advisory Corporation is the advisor to the Fund (the "Advisor"), and NTS Residential Management Company is the manager of the Fund ("NTS Management"). The Advisor and NTS Management are affiliates of and are under common control with NTS Corporation.

The Fund's subsidiaries are NTS/Lake Forest II Residential Corporation ("NTS/LFII") and NTS/Virginia Development Company ("NTS/VA"). These subsidiaries were acquired effective October 1, 1997. The acquisitions were accounted for under the purchase method of accounting. Prior to making the acquisitions, the Fund had been the primary creditor of these entities.

NTS/LFII is the owner and developer of the Lake Forest North, single-family residential community located in Louisville, Kentucky, and will continue to own and develop the Lake Forest North project to completion and orderly sale as wholly-owned subsidiary of the Fund. NTS Residential Realty, Inc., a Kentucky corporation and an Affiliate of the Sponsor of the Fund, was formed on April 6, 1999, to act as a broker and agent for NTS/LFII for the sale of lots within the Lake Forest North project, and as a broker and agent for the sale of new homes within the Lake Forest North project.

NTS/VA is the owner and developer of the Fawn Lake, single-family residential community located near Fredericksburg, Virginia, and will continue to own and develop the Fawn Lake project to completion and orderly sale as wholly-owned subsidiary of the Fund. Fawn Lake Realty, Inc., a division of NTS/Residential Properties, Inc.-Virginia, a Virginia corporation and an Affiliate of the Sponsor of the Fund, will continue to act as a broker and agent for NTS/VA for the sale of lots within the Fawn Lake project, and as a broker and agent for approved builders in the Fawn Lake project for the sale of new homes.

The Fund purchased a 50% interest in the Orlando Lake Forest Joint Venture (the “Joint Venture”) effective August 16, 1997. Prior to becoming a Joint Venture partner, the Fund had been the Joint Venture’s primary creditor. The Joint Venture owns the Orlando Lake Forest Project, a single-family residential community located in Seminole County, Florida (near Orlando). The Joint Venture will continue to own and develop the Orlando Lake Forest project. Lake Forest Realty, Inc., an Affiliate of and under common control with the Fund’s Sponsor, will continue to act as a broker and agent for the Joint Venture for the sale of lots within the Orlando Lake Forest project.

## **Note 2 - Basis of Accounting**

The Fund’s records are maintained on the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (“GAAP”) in the United States.

## **Note 3 - Principles of Consolidation and Basis of Presentation**

The consolidated financial statements of the Fund include the assets, liabilities, revenues and expenses of its 100% owned subsidiaries. The consolidated statements of operations include the results of acquired businesses accounted for under the purchase method of accounting from the date of acquisition. Investments of 50% or less in affiliated companies are accounted for under the equity method. All significant intercompany transactions have been eliminated.

## **Note 4 - Use of Estimates in Preparation of Financial Statements**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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 5 - Revenue Recognition**

The Fund and its subsidiaries recognize revenue and related costs from lot sales using the accrual method in accordance with GAAP, which is when payment has been received and title, possession and other attributes of ownership have been transferred to the buyer, and the Fund and its subsidiaries are not obligated to perform significant activities after the sale. The Fund and its subsidiaries generally require a minimum down payment of at least 10% of the sales price of the lot. Please see Note 10 for a discussion of the Sale of Undeveloped Land and the use of the cost recovery method of accounting.

## **Note 6 - Reclassifications**

Certain reclassifications have been made to the 2000 financial statements to be in conformity with the 2001 presentation. These reclassifications have no effect on previously reported operations.

## Note 7 - Inventory

Inventory is stated at the lower of cost or net realizable value. Inventory includes all direct costs of land, land development, and amenities, including interest, real estate taxes, and certain other costs incurred during the development period, less amounts charged to cost of sales. Inventory costs are allocated to individual lots sold using their relative sales values. The use of the relative sales value method to record cost of sales requires the use of estimates of sales values, development costs and absorption periods over the life of the project. Given the long-term nature of the projects and inherent economic volatility of residential real estate and the use of estimates to determine sales values, development costs and absorption periods, it is reasonably possible that any one component used in estimating could change in the near term. Any changes in estimates are accounted for prospectively over the life of the project.

Inventory consists of approximately the following as of June 30, 2001:

	<u>NTS/LFII</u>	<u>NTS/VA</u>	<u>Consolidated</u>
Land held for future development, under development, and completed lots	\$ 1,063,000	\$ 22,208,000	\$ 23,271,000
Country club (net of membership initiation fees)	5,525,000	12,053,000	17,578,000
Amenities	<u>1,214,000</u>	<u>8,280,000</u>	<u>9,494,000</u>
	<u>\$ 7,802,000</u>	<u>\$ 42,541,000</u>	<u>\$ 50,343,000</u>

Inventory consists of the following as of December 31, 2000:

	<u>NTS/LFII</u>	<u>NTS/VA</u>	<u>Consolidated</u>
Land held for future development, under development, and completed lots	\$ 672,000	\$ 23,023,000	\$ 23,695,000
Country club (net of membership initiation fees)	7,720,000	11,066,000	18,786,000
Amenities	<u>1,663,000</u>	<u>8,063,000</u>	<u>9,726,000</u>
	<u>\$ 10,055,000</u>	<u>\$ 42,152,000</u>	<u>\$ 52,207,000</u>

NTS/LFII and NTS/VA capitalized in inventory approximately \$1,063,000 of interest and real estate taxes for the six months ended June 30, 2001. Interest and real estate taxes incurred were approximately \$1,127,000.

NTS/LFII and NTS/VA capitalized in inventory approximately \$1,463,000 of interest and real estate taxes for the six months ended June 30, 2000. Interest and real estate taxes incurred were approximately \$1,583,000.

Inventory for 2001, as reflected above, includes approximately \$27,682,000, net of \$10,104,000 of country club membership initiation fees, of costs incurred to date for the development of the Fawn Lake Country Club and the Lake Forest Country Club.

Inventory for 2000, as reflected above, includes approximately \$28,413,000, net of \$9,627,000 of country club membership initiation fees, of costs incurred to date for the development of the Fawn Lake Country Club and the Lake Forest Country Club.

Pursuant to an agreement between NTS/LFII and the Lake Forest Country Club regarding the cost to develop the Country Club, NTS/LFII is to receive all initiation fees from membership sales for a period not to exceed 12 years from the date of the agreement (ending 2003). The remaining cost to be incurred for the current projected Country Club operating deficit for the period covered by the agreement is approximately \$1,458,000, which is expected to be offset by member initiation fees. During the six months ended June 30, 2001, approximately \$274,000 of the Fawn Lake Country Club deficit and \$406,000 of the Lake Forest Country Club deficit was capitalized as a cost of inventory. During the six months ended June 30, 2000, approximately \$459,000 of the Fawn Lake Country Club deficit and \$164,000 of the Lake Forest Country Club deficit was capitalized as a cost of inventory.

During the three months ended June 30, 2001, the Fawn Lake Country Club was substantially completed. As a result of the Fund's intention to sell the Club as a single asset, SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects" requires that the Club be reported separately from inventory on the Fund's balance sheet as an asset available for sale. The assets stated value on the balance sheet is to be its fair value. The Fund expects to have determined the Club's fair value during the third quarter and will reclassify the asset available for sale accordingly.

#### **Note 8 - Investment in Unconsolidated Affiliate**

Effective as of August 16, 1997, the Fund became a partner in the Joint Venture. The other partners in the Joint Venture are Orlando Lake Forest, Inc., Orlando Capital Corporation and OLF II Corporation, all of whom are Affiliates of and are under common control with the Fund's Sponsor. The Joint Venture will continue to operate under its current legal name as the Orlando Lake Forest Joint Venture.

The Joint Venture owns the Orlando Lake Forest project, a single-family residential community located in Seminole County, Florida (near Orlando). The Joint Venture will continue to own and develop the Orlando Lake Forest project.

The Fund contributed to the Joint Venture as a capital contribution its interest in the principal and interest of the first mortgage loan on the Orlando Lake Forest project, and obtained a 50% interest in the Joint Venture. The NTS entities named above hold cumulatively the remaining 50% interest in the Joint Venture.

The net income or net loss of the Joint Venture is allocated based on the respective Partner's percentage interest, as defined in the Joint Venture agreement. As of June 30, 2001, the Fund's percentage interest was 50%, and the Fund's investment balance in the Joint Venture was approximately \$1,392,000 and \$1,329,000 as of June 30, 2001 and December 31, 2000, respectively. The Fund's share of the Joint Venture's net income for the three and six months ended June 30, 2001, was approximately \$67,000 and \$38,000. The Fund's share of the Joint Venture's net loss for the three and six months ended June 30, 2000, was approximately \$99,000 and \$197,000.

Presented below are condensed balance sheets for the Joint Venture as of June 30, 2001 and December 31, 2000, and statements of operations for the three and six months ended June 30, 2001 and 2000:

	June 30, 2001	December 31, 2000
<u>Balance Sheets</u>		
Notes receivable	\$ 45,000	\$ 84,000
Inventory	7,149,000	8,805,000
Other, net	301,000	242,000
	<u>7,495,000</u>	<u>9,131,000</u>
Total assets	<u>\$ 7,495,000</u>	<u>\$ 9,131,000</u>
Mortgages and notes payable	2,451,000	4,401,000
Other liabilities	2,261,000	2,071,000
Equity	2,783,000	2,659,000
	<u>2,783,000</u>	<u>2,659,000</u>
Total liabilities and equity	<u>\$ 7,495,000</u>	<u>\$ 9,131,000</u>

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	2001	2000	2001	2000
<u>Statements of Operations</u>				
Lot sales, net of discounts	\$ 1,730,000	\$ 1,067,000	\$ 2,996,000	\$ 1,877,000
Cost of sales	(1,177,000)	(822,000)	(2,002,000)	(1,454,000)
Other expenses, net	(419,000)	(442,000)	(918,000)	(817,000)
	<u>(419,000)</u>	<u>(442,000)</u>	<u>(918,000)</u>	<u>(817,000)</u>
Net income (loss)	<u>\$ 134,000</u>	<u>\$ (197,000)</u>	<u>\$ 76,000</u>	<u>\$ (394,000)</u>

## Note 9 - Mortgages and Notes Payable

Mortgages and notes payable consist of the following:

	June 30, 2001	December 31, 2000
Mortgage loan payable to a bank in the amount of \$18,000,000, bearing interest at the Prime Rate + 1.0%, payable monthly, due October 31, 2005, secured by inventory of NTS/VA and NTS/LFIL, generally principal payments consist of approximately 91% of the Gross Receipts from lot sales, personally guaranteed by Mr. J. D. Nichols, Chairman of the Board of the Fund's Sponsor, for 50% of the outstanding loan balance and a \$2 million letter of credit from a third party lender with the beneficiary being the bank.	\$ 15,395,120	\$ 15,630,107
Note payable to a bank in the amount of \$9,000,000, bearing interest at 3.0%, payable monthly, due October 30, 2003, secured by a Certificate of Deposit owned by NTS Financial Partnership, an affiliate of the Fund.	6,696,959	6,696,959
Mortgage loan payable to a bank in the amount of \$4,000,000, bearing interest at the Prime Rate + .5%, payable monthly, due July 31, 2002, secured by the Lake Forest Country Club and golf course, principal reductions of \$300,000 every six months, guaranteed by NTS Corporation, the Fund's Sponsor.	2,160,000	2,490,000
Warehouse Line of Credit Agreements with two banks bearing interest at the Prime Rate + 1% and the Prime Rate + .75%, due December 15, 2001, \$(105,534) and September 18, 2001 \$(628,548), secured by notes receivable, principal payments consist of payments received from notes receivable securing the obligation. The \$105,534 Warehouse Line of Credit agreement is guaranteed by NTS Corporation.	734,082	223,871
Note payable in the amount of \$1,174,800, bearing interest at a Prime Rate + .5%, secured by a note receivable, due in monthly installments of \$5,000, with any outstanding principal and accrued interest due and payable in full on December 29, 2001.	594,778	680,925
Other	252,020	188,760
	<u>\$ 25,832,959</u>	<u>\$ 25,910,622</u>

The Prime Rate was 6.75% and 9.5% at June 30, 2001 and December 31, 2000, respectively.

On October 31, 2000, NTS/VA and NTS/LFII entered into a loan agreement with a financial institution for a combined principal sum of up to \$18,000,000 and used approximately \$5,930,000 and \$10,494,000 to pay the entire principal balance of the NTS/LFII and NTS/VA loans, respectively. The loan is secured by the NTS/LFII and NTS/VA projects, a \$2 million letter of credit issued by a third party lender with the NTS/VA and NTS/LFII lender stated as the beneficiary, a guarantee by the Fund for the full \$18,000,000, and a personal guarantee by J.D. Nichols for 50% of the outstanding loan balance. Additionally, the Joint Venture will be required to apply 50% of the net sales proceeds against the outstanding loan balance from the lot sales in the Joint Venture's project once its present loan is paid in full. The lender requires contracts on lots with gross proceeds exceeding 80% of a section's development costs before advancing funds for a newly developed section at NTS/VA. The loan is a reducing revolver and the maximum amount outstanding at the end of each year shall be as follows:

December 31, 2001	\$ 16,500,000
December 31, 2002	\$ 11,000,000
December 31, 2003	\$ 7,000,000
December 31, 2004	\$ 4,000,000

The Fund's projections indicate that it will meet the minimum principal payment requirement at December 31, 2001.

#### **Note 10 - Related Party Transactions**

As of June 30, 2001, the Sponsor and an Affiliate owned 132,616 shares of the Fund, collectively. The Fund has entered into, or had been subject to in prior periods, the following agreements with various Affiliates of the Sponsor regarding the ongoing operation of the Fund.

##### ***Property Management Agreements***

The ongoing operation and management of the Lake Forest North and Fawn Lake projects will be conducted by NTS Management under the terms of (i) a property management agreement executed on December 30, 1997, and dated as of October 1, 1997, by and among the Fund, NTS/LFII and NTS Management for the Lake Forest North project, and (ii) a property management agreement executed on December 30, 1997, and dated as of October 1, 1997, by and among the Fund, NTS/VA and NTS Management for the Fawn Lake project (collectively, the "Management Agreements"). NTS Management is a wholly-owned subsidiary of NTS Development Company. NTS Development Company is a wholly-owned subsidiary of the Fund's Sponsor. The Management Agreements have an initial term through December 31, 2003, subject to extension under certain conditions, and are renewable for successive six (6) year terms thereafter. Under the Management Agreements, NTS Management will be reimbursed for costs incurred in the operation and management of NTS/LFII and NTS/VA, will be entitled to an overhead recovery, and will accrue an incentive payment payable, all as provided therein.

These expense reimbursements include direct and pro-rated costs incurred in the management and operation of NTS/LFII and NTS/VA. Such costs include compensation costs of management, accounting, professional, engineering and development, marketing and office personnel employed by NTS Management and/or certain of its affiliates, as well as various non-payroll related operating expenses. Compensation costs are for those individuals who rendered services full time on and off site of the residential projects and with respect to the residential projects, but who have multiple residential projects responsibilities, some of which may be affiliated entities of NTS Management. For services provided by individuals not on site, or those with multiple residential projects responsibilities, costs are pro-rated by NTS Management and allocated to the appropriate residential project. As permitted by the Property Management Agreements, the Fund was charged the following amounts for the three and six months ended June 30, 2001 and 2000. These amounts are reflected in selling, general and administrative - affiliated on the accompanying consolidated statements of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
<u>Personnel related costs:</u>				
Financing and accounting	\$ 63,000	\$ 63,000	\$ 125,000	\$ 134,000
Data Processing	17,000	20,000	35,000	41,000
Human Resources	11,000	10,000	22,000	21,000
Executive and administrative services	38,000	31,000	77,000	66,000
Construction Management	30,000	7,000	59,000	10,000
Sales and Marketing	350,000	315,000	739,000	616,000
Legal	15,000	7,000	28,000	14,000
	<u>524,000</u>	<u>453,000</u>	<u>1,085,000</u>	<u>902,000</u>
Total personnel related costs				
Marketing	46,000	39,000	98,000	79,000
Rent	16,000	14,000	29,000	29,000
Other general and administrative	<u>6,000</u>	<u>10,000</u>	<u>12,000</u>	<u>33,000</u>
Total expense reimbursements	<u>\$ 592,000</u>	<u>\$ 516,000</u>	<u>\$ 1,224,000</u>	<u>\$ 1,043,000</u>

Additionally, NTS Management is entitled to an overhead recovery, which is a reimbursement for overhead expenses attributable to the employees and the efforts of NTS Management under the Management Agreements, in an amount equal to 3.75% of the projects' gross cash receipts, as defined in the Management Agreements. Overhead recovery for the three and six months ended June 30, 2001, was approximately \$140,000 and \$271,000, respectively. Overhead recovery for the three and six months ended June 30, 2000, was approximately \$151,000 and \$254,000, respectively. These amounts are classified with selling, general and administrative - affiliated in the accompanying consolidated statements of operations.

The Management Agreements also provide the opportunity for NTS Management to receive an incentive payment, as defined in the Management Agreements, equal to 10% of the net cash flows of the projects if certain financial obligations are met. The incentive payment will not begin accruing until after the cumulative cash flows of NTS/LFII, NTS/VA and the Fund's share of the cash flow of the Joint Venture would have been sufficient to enable the Fund to return to the shareholders of the Fund an amount which, after adding thereto all other payments previously distributed to such shareholders of the Fund, is at least equal to the shareholders' original capital contribution. As of June 30, 2001, the Fund had raised approximately \$63,690,000 and had paid distributions of approximately \$23,141,000. As of June 30, 2001, no amount had been accrued as an incentive payment in the Fund's consolidated financial statements.

### ***Advances and Notes Payable Affiliates***

The Fund has received advances from an affiliate of the Fund's Sponsor, net of repayments, totaling approximately \$123,000 and \$419,000 as of June 30, 2001 and December 31, 2000, respectively. As of June 30, 2001 and December 31, 2000, the advances bear interest at the Prime Rate.

As presented in the accompanying consolidated balance sheet as of June 30, 2001 accounts payable - affiliates of approximately \$4,613,000 is owed to NTS Development Company and NTS Residential Management Company for salary and overhead reimbursements. NTS Development Company and NTS Residential Management Company have agreed to defer amounts owed to them by the Fund as of June 30, 2001 and those amounts that will accrue during fiscal 2001 through the period ending March 31, 2002, other than as permitted by cash flows of the Fund. Management of the Fund believes that NTS Development Company and NTS Residential Management have the financial ability to defer amounts owed them by the Fund. There can be no assurances that this level of support will continue past March 31, 2002.

### ***Sale of Undeveloped Land***

On March 6, 2001, the NTS/LFII sold 26.5 acres of land to Lake Forest Fairways, LLC ("Fairways"), a limited liability company which was formed between NTS Development Company and Fairway Development, LLC (an unaffiliated third party). The initial payment was made on March 6, 2001 for \$30,000 per acre for a total of \$795,000. Fairways will also pay NTS/LFII at each closing of the sale of the first 100 home units, as an additional component of the purchase price for the property, the sum of \$14,500 per home unit sold. The sale has been recorded using the cost recovery method and the transaction has been recorded for a total sales value of \$1,715,000, consisting of the initial payment at closing for \$795,000 and the gross future proceeds of \$1,450,000 which are discounted to a net present value \$920,000. Under the cost recovery method, no profit is recognized until cash payments by the buyer (Fairways) exceed the seller's (NTS/LFII) cost of the property sold. This unrecognized profit is offset against the receivable on the balance sheet. At June 30, 2001, the receivable balance related to this sale was approximately \$442,000. The transactional values were derived from an independent appraisal performed by Integra Chapman & Bell dated January 4, 2000.

### **Note 11 - Country Club Accounting**

During the three months ended June 30, 2001, the Fawn Lake Country Club was substantially completed. As a result of the Fund's intention to sell the Club as a single asset, SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects" requires that the Club's operations no longer be capitalized to inventory costs upon substantial completion. Instead, the Club's results of operations have been included in the Fund's statement of operations beginning with the three months ended June 30, 2001.

### **Note 12 - Income Taxes**

The Fund adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"), effective January 1, 1997. SFAS 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequence of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the Fund's book and tax bases of assets and liabilities and tax carry forwards using enacted tax rates in effect for the year in which the differences are expected to reverse. The principal differences giving rise to the Fund's deferred taxes, consist of tax net operating loss carry forwards, valuation allowances and differences in inventory basis for book and tax.

A valuation allowance is provided when the probability that the deferred tax asset to be realized does not meet the criteria established by the Financial Accounting Standards Board. The Fund has determined, based on a history of operating losses by its subsidiaries and its expectations for the future, that it is more likely than not that the net deferred tax assets at June 30, 2001 and December 31, 2000, will not be realized.

As of December 31, 2000, the Fund had a federal net operating loss carry forward of approximately \$6,938,000 expiring during 2012, 2013, 2014 and 2015.

### **Note 13 - Financial Instruments**

The book values of cash and cash equivalents, trade receivables and trade payables are considered to be representative of their respective fair values because of the immediate or short-term maturity of these financial instruments. The fair value of the Fund's notes receivable and debt instruments approximated the book value because a substantial portion of the underlying instruments are variable rate notes.

### **Note 14 - Commitments and Contingencies**

The Fund, as an owner of real estate, is subject to various environmental laws of federal and local governments. Compliance by the Fund with existing laws has not had a material adverse effect on the Fund's financial condition and results of operations. However, the Fund cannot predict the

impact of new or changed laws or regulations on its current properties or on properties that it may acquire in the future.

The Fund does not believe there is any litigation threatened against the Fund 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 adverse effect on the consolidated financial statements of the Fund.

NTS/LFII and NTS/VA have various letters of credit outstanding to governmental agencies and utility companies totaling approximately \$2,603,000 and \$2,235,000 as of June 30, 2001 and December 31, 2000, respectively. The primary purpose of these documents is to ensure that the work at the developments is completed in accordance with the construction plans as approved by the appropriate governmental agency or utility company.

It is estimated that development of the remaining homeowner's association amenities at NTS/LFII will be substantially complete by November 2002. Based on engineering studies and projections, NTS/LFII will incur additional costs, excluding interest, of approximately \$400,000 during 2002 to complete the homeowner's association amenities. No costs are estimated to be incurred during 2001.

It is estimated that the amenities at NTS/VA will be substantially complete by December 2008. Based on engineering studies and projections, NTS/VA will incur additional costs, excluding interest, of approximately \$510,000 to complete the amenities for the project. These costs are estimated to be incurred as follows: \$10,000 for 2001, \$0 for 2002, \$50,000 for 2003, \$0 for 2004, \$50,000 for 2005, \$350,000 for 2006, \$0 for 2007, and \$50,000 for 2008.

#### **Note 15 - Guaranties to the Fund**

NTS Guaranty Corporation (the "Guarantor"), an Affiliate of the Sponsor, has guaranteed that investors of the Fund will receive, over the life of the Fund, aggregate distributions from the Fund (from all sources) in an amount at least equal to their original capital contributions, as defined in the Fund's Prospectus. As of June 30, 2001, the Fund has raised approximately \$63,690,000 and has paid distributions of \$23,141,000.

The liability of the Guarantor under the above guaranty is expressly limited to its assets and its ability to draw upon a \$10 million demand note receivable from Mr. J.D. Nichols, Chairman of the Board of Directors of the Sponsor. There can be no assurance that Mr. Nichols will, if called upon, be able to honor his obligation to the Guarantor. The total amounts guaranteed by the Guarantor are in excess of its net worth, and there is no assurance that the Guarantor will be able to satisfy its obligation under these guaranties. The Guarantor may in the future provide guaranties for other Affiliates of the Fund.

#### **Note 16 - Provisions for Write-down to Net Realizable Value**

Statement of Financial Accounting Standards (“SFAS”) No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of” 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. Application of this standard during the period ended June 30, 2001 did not result in an impairment loss.

## **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 ("MD&A") is structured in three major sections. The first section provides information related to liquidity and capital resources. The second section analyzes consolidated cash flows and financial conditions. The final section analyzes results of operations on a consolidated basis. A discussion of certain market risks also follows. MD&A should be read in conjunction with the Financial Statements in Item 1 and the Cautionary Statements below.

### **Cautionary Statements**

Some of the statements included in this Item 2 may be considered "forward-looking statements" since such statements relate to matters which have not yet occurred. For example, phrases such as "the Fund anticipates," "believes" or "expects" indicate that it is possible that the event anticipated, believed or expected may not occur. Should such event not occur, then the result which the Fund expected also may not occur or occur in a different manner, which may be more or less favorable to the Fund. The Fund does not undertake any obligations to publicly release the result of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances.

Any forward-looking statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations, or elsewhere in this report, which reflect management's best judgement based on factors known, involve risks and uncertainties. Readers are cautioned not to place undue reliance on any forward-looking statements, which reflect management's analysis only as of the date hereof. The Fund undertakes no obligation to publicly revise these forward-looking statements as a result of a number of factors, including but not limited to those discussed below. Any forward-looking information provided by the Fund pursuant to the safe harbor established by recent securities legislation should be evaluated in the context of these factors.

The Fund's subsidiaries, NTS/LFII and NTS/VA, and the Joint Venture, in which the Fund has a 50% interest, are engaged in the development and sale of residential subdivision lots, the pricing and sale of which are subject to risks generally associated with real estate development and applicable market forces beyond the control of the Fund and/or its subsidiaries, including general and local economic conditions, competition, interest rates, real estate tax rates, other operating expenses, the supply of and demand for properties, zoning laws, other governmental rules and fiscal policies, and acts of God. All of the properties owned by NTS/LFII, NTS/VA and the Joint Venture are encumbered by development loans from third party lenders which, given the nature of the risks incumbent in real estate investment and development activities as stated above, are inherently subject to default should the ability of NTS/LFII, NTS/VA, Joint Venture and/or the Fund to make principal and interest payments under such development loans become impaired.

There is the potential for occurrences which could affect the Fund's ability to control its professional and administrative expenses. Furthermore, the debt service regarding the Fund's borrowings is variable based on current interest rates, any fluctuations in which are beyond the control of the Fund. These variances could, for example, impact the Fund's projected cash and cash requirements as well as projected returns.

## **Liquidity and Capital Resources**

The Fund's current source of liquidity is primarily the ability of its subsidiaries to draw upon their respective development loans. Additional liquidity is provided by net proceeds retained from residential lot closings by the properties owned by the Fund's subsidiaries and Joint Venture in which the Fund has a 50% interest. The various development loans call for principal payments ranging from 72% to 91% of gross receipts from lot sales.

## **Consolidated Cash Flows and Financial Condition**

Key elements of the consolidated statements of cash flows:

	<u>Six Months Ended June 30,</u>	
	<u>2001</u>	<u>2000</u>
Net cash provided by operating activities	\$ 486,690	\$ 1,947,089
Net cash used for investing activities	<u>(220,029)</u>	<u>(239,078)</u>
Net cash flows from operating and investing activities	266,661	1,708,011
Net cash used for financing activities	<u>(378,782)</u>	<u>(1,426,455)</u>
Net increase (decrease) in cash and equivalents	<u>\$ (112,121)</u>	<u>\$ 281,556</u>

### ***Operating Activity***

Cash provided by operating activities was approximately \$487,000 for the six months ended June 30, 2001. The primary components of the cash provided by operating activities were the continued deferral of accounts payable to affiliates of approximately \$803,000 which is owed to NTS Development Company and NTS Residential Management Company for salary and overhead reimbursements, and a net reduction in inventory of approximately \$1,990,000. In addition, there was a decrease in accounts payable of approximately \$367,000 and an increase in the membership and accounts receivable of approximately \$471,000 of which \$442,000 was the receivable from Fairway Developments, LLC. NTS Management has agreed to defer amounts owed to them by the Fund as of June 30, 2001, and those amounts will accrue during the fiscal year 2001 through the period ending March 31, 2002, other than as permitted by cash flows of the Fund.

Cash provided by operating activities was approximately \$1,947,000 for the six months ended June 30, 2000. The primary components of the cash provided by operating activities were a net loss of approximately \$1,096,000 and net additions to inventory of approximately \$828,000, partially offset by an increase to accounts payable to affiliated of approximately \$1,525,000 owed to NTS Development Company and NTS Management for salary and overhead reimbursements, an increase in accounts payable and accrued expenses of approximately \$1,838,000, and collections of notes receivable of approximately \$455,000. The increase in accounts payable and accrued expenses was partially a result of costs incurred for a new development section at NTS/VA of approximately \$933,000.

### ***Investing Activity***

Cash used for investing activities was approximately \$220,000 for the six months ended June 30, 2001. The components of the use of cash for investing activities were additional capital contributions to an unconsolidated affiliate of approximately \$24,000 and capital additions, primarily at the NTS/LFII and NTS/VA golf operations, of approximately \$196,000.

Cash uses for investing activities was approximately \$239,000 for the six months ended June 30, 2000. The primary components of the use of cash for investing activities were an additional capital contribution to an unconsolidated affiliate of \$25,000 and capital additions, primarily at the NTS/LFII and NTS/VA golf operations, of approximately \$214,000.

### ***Financing Activity***

Cash used for financing activities was approximately \$379,000 for the six months ended June 30, 2001. The components of the cash used by financing activities were net payments on notes payable relating to the development loans for NTS/LFII and NTS/VA of approximately \$78,000 and net payments on notes payable to an affiliate of approximately \$295,000.

Cash used for financing activities was approximately \$1,426,000 for the six months ended June 30, 2000. The primary components of the use of cash for financing activities were net payments on mortgages and notes payable from gross receipts of lot sales relating to the development loans for NTS/LFII and NTS/VA of approximately \$1,404,000.

On October 31, 2000, NTS/VA and NTS/LFII entered into a loan agreement with a financial institution for a combined principal sum of up to \$18,000,000 and used approximately \$5,930,000 and \$10,494,000 to pay the entire principal balance of the NTS/LFII and NTS/VA loans, respectively. The loan is secured by the NTS/LFII and NTS/VA projects, a \$2 million letter of credit issued by a third party lender with the NTS/VA and NTS/LFII lender stated as the beneficiary, a guarantee by the Fund for the full \$18,000,000, and a personal guarantee by J.D. Nichols for 50% of the outstanding loan balance. Additionally, the Joint Venture will be required to apply 50% of the net sales proceeds against the outstanding loan balance from the lot sales in the Joint Venture's project once its present loan is paid in full. The lender requires contracts on lots with gross proceeds

exceeding 80% of a section's development costs before advancing funds for a newly developed section. The loan is a reducing revolver and the maximum amount outstanding at the end of each year shall be as follows:

December 31, 2001	\$16,500,000
December 31, 2002	\$11,000,000
December 31, 2003	\$ 7,000,000
December 31, 2004	\$ 4,000,000

The Fund's projections indicate that it will meet the minimum principal payment requirements at December 31, 2001.

The Fund's management believes that this loan will provide adequate liquidity for the operations and continued development of NTS/VA and NTS/LFII in accordance with the funding limits described in the table above.

## **Results of Operations**

### ***Revenues***

The following is an analysis of material changes in results of operations for the six months ended June 30, 2001 and 2000. Items that did not have a material impact on operations for the periods listed have been excluded from this discussion.

Revenue for the three months ended June 30, 2001, includes approximately \$3,263,000 in lot sales consisting of approximately \$1,422,000 and \$1,841,000 from NTS/LFII and NTS/VA, respectively. During this period 31 lots were sold for an average selling price of approximately \$105,000.

Revenue for the three months ended June 30, 2000, includes approximately \$3,634,000 in lot sales consisting of approximately \$2,223,000 and \$1,411,000 from NTS/LFII and NTS/VA, respectively. During this period 34 lots were sold for an average selling price of approximately \$107,000. Additionally, revenue for the three months ended June 30, 2000, includes approximately \$76,000 collected on an installment sale from NTS/VA.

Beginning with the three months ended June 30, 2001, the income and expenses of the Fawn Lake Country Club have been included in the Fund's statement of operations. This is a result of the substantial completion of the Club and the intention to sell the Club as a single asset. The Club's operations for the three and six months ended June 30, 2000, were capitalized to inventory costs. The net impact on the results of operations was a net operating deficit of approximately \$187,000.

Revenue for the six months ended June 30, 2001, includes approximately \$5,733,000 in lot sales consisting of approximately \$2,612,000 and \$3,121,000 from NTS/LFII and NTS/VA, respectively. During this period 57 lots were sold for an average selling price of approximately \$101,000.

Additionally, revenue for the six months ended June 30, 2001, includes approximately \$20,000 collected on an installment sale from NTS/VA.

On March 6, 2001, the NTS/LFII sold 26.5 acres of land to Lake Forest Fairways, LLC (“Fairways”), a limited liability company which was formed between NTS Development Company and Fairway Development, LLC (an unaffiliated third party). The initial payment was made on March 6, 2001 for \$30,000 per acre for a total of \$795,000. Fairways will also pay NTS/LFII at each closing of the sale of the first 100 home units, as an additional component of the purchase price for the property, the sum of \$14,500 per home unit sold. The sale has been recorded using the cost recovery method and the transaction has been recorded for a total sales value of \$1,715,000, consisting of the initial payment at closing for \$795,000 and the gross future proceeds of \$1,450,000 which are discounted to a net present value \$920,000. Under the cost recovery method, no profit is recognized until cash payments by the buyer (Fairways) exceed the seller’s (NTS/LFII) cost of the property sold. The non-recognition of profit on this transaction primarily created a decrease in the gross profit margin of NTS/LFII by approximately 15% for the three months ended March 31, 2001 as compared to the same period in 2000. This unrecognized profit is offset against the receivable on the balance sheet. At June 30, 2001, the receivable balance related to this sale was approximately \$442,000. The transactional values were derived from an independent appraisal performed by Integra Chapman and Bell dated January 14, 2000.

Revenue for the six months ended June 30, 2000, includes approximately \$6,118,000 in lot sales consisting of approximately \$4,138,000 and \$1,980,000 from NTS/LFII and NTS/VA, respectively. During this period 58 lots were sold for an average selling price of approximately \$105,000. Additionally, revenue for the six months ended June 30, 2000 includes approximately \$92,000 collected on an installment sale from NTS/VA.

The decrease in the average selling price of lots closed for the six months ended June 30, 2001, compared to the same period in 2000, is a result of a premium lot which sold for \$325,000 in the first quarter of 2000 at NTS/VA.

Costs of sales for the three months ended June 30, 2001 and 2000, were approximately \$2,502,000 and \$2,754,000, respectively. Cost of sales for the six months ended June 30, 2001 and 2000, were approximately \$6,111,000 and \$4,797,000, respectively.

Presented below are the gross profit margins for the three months ended June 30, 2001 and 2000:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2001	2000	2001	2000
NTS/LF II (1)	27%	19%	16%	19%
NTS/VA	21%	29%	21%	29%
Combined gross profit margins	23%	26%	18%	23%

(1) Please see the preceding discussion of the impact of the Sale of Undeveloped Land on gross margin due to the use of the cost recovery method of accounting.

The difference in the cost of sales percentage of NTS/LFII compared to NTS/VA and the difference in the lot sales mix will create a proportionate change in the combined gross profit margin throughout a given year. The decrease in gross profit margin is a function of a change in the estimates of sales values, development costs and absorption periods over the life of the project. The estimates are performed at the end of each fiscal year and the resulting cost of sales percentages are applied prospectively. Management assesses the basis for these annual projections at the end of each quarter and if changes in facts and circumstances warrant, interim adjustments are made to the cost of sales percentages prospectively. In comparing the gross margin percentages for the six months ended June 30, 2001 and 2000, respectively, Management's estimates have changed relative to the ultimate sales values, development costs and absorption periods, and inherent economic volatility of residential real estate they now believe will be realized during the duration of the projects.

The Fund periodically reviews the value of land and inventories and determines whether any write-downs are needed to reflect declines in value. The Fund did not record any write-downs during the six months ended June 30, 2001 and 2000. The estimated net realizable value of real estate inventories represents Management's best estimate based on present plans and intentions, selling prices in the ordinary course of business and anticipated economic and market conditions. Accordingly, the realization of the value of the Fund's real estate inventories is dependent on future events and conditions that may cause actual results to differ from amounts presently estimated.

Interest income on cash equivalents and miscellaneous income includes interest income earned from short-term investments made by the Fund with cash reserves for the six months ended June 30, 2001 and 2000.

### *Expenses*

The ongoing operation and management of NTS/LFII and NTS/VA will be conducted by NTS Management under the terms of (i) a property management agreement executed on December 30, 1997, and dated as of October 1, 1997, by and among the Fund, NTS/LFII and NTS Management for the Lake Forest North project, and (ii) a property management agreement executed on December 30, 1997 and dated as of October 1, 1997, by and among the Fund, NTS/VA and NTS Management

for the Fawn Lake project (collectively, the “Management Agreements”). NTS Management is a wholly-owned subsidiary of NTS Development Company. NTS Development Company is a wholly-owned subsidiary of the Fund’s Sponsor. The Management Agreements have an initial term through December 31, 2003, subject to extension under certain conditions, and are renewable for successive six (6) year terms thereafter. Under the Management Agreements, NTS Management will be reimbursed for costs incurred in the operation and management of the Lake Forest North and Fawn Lake projects, will be entitled to an overhead recovery, and will accrue an incentive payment payable, all as provided therein.

The expenses related to the Management Agreements are presented as selling, general and administrative - affiliated on the accompanying consolidated statements of operations. As defined in the Management Agreements, the expenses are classified in two ways, expense recovery and overhead recovery. The expense recovery includes direct and pro-rated costs incurred in the management and operation of NTS/LFII and NTS/VA. Such costs include compensation costs of management, accounting, professional, engineering and development, marketing and office personnel employed by NTS management and/or certain of its affiliates as well as various non-payroll related operating expenses. Compensation costs are for those individuals who rendered services full time on and off site of the residential projects and with respect to the residential projects, but who have multiple residential projects responsibilities, some of which may be affiliated entities of NTS Management. For services provided by individuals not on site, or those with multiple residential projects responsibilities, costs are pro-rated by NTS Management and allocated to the appropriate residential project.

Reimbursements for expense recovery of approximately \$592,000 and \$516,000 were accrued to NTS Management or an Affiliate during the three months ended June 30, 2001 and 2000, respectively, for actual personnel, marketing and administrative costs as they relate to NTS/LFII, NTS/VA and the Fund. For the six months ended June 30, 2001 and 2000, the expense recovery accrued to NTS Management or an affiliate was approximately \$1,224,000 and \$1,043,000.

Reimbursements for expense recovery increased approximately \$76,000 for the three months ended June 30, 2001, as compared to the same period in 2000. Reimbursements for expense recovery increased approximately \$181,000 for the six months ended June 30, 2001, as compared to the same period in 2000. The increase is primarily a result of an increase in commissions paid to sales agents employed by NTS/VA for the three and six months ended June 30, 2001, as compared to the same period in 2000.

Additionally, NTS Management is entitled to an overhead recovery, which is a reimbursement for overhead expenses attributable to the employees and the efforts of NTS Management under the Management Agreements, in an amount equal to 3.75% of the projects’ gross cash receipts, as defined in the Management Agreements. For the three months ended June 30, 2001 and 2000, overhead recovery incurred was approximately \$140,000 and \$151,000, respectively. For the six months ended June 30, 2001 and 2000, overhead recovery incurred was approximately \$271,000 and \$254,000.

Selling, general and administrative expenses include directors' fees, legal, outside accounting, other investor related cost, repairs and maintenance cost. Selling, general and administrative expenses also include those costs incurred directly by NTS/VA for marketing related activities.

For the three months ended June 30, 2001 and 2000, the amounts incurred for selling, general and administrative expenses were approximately \$431,000 and \$684,000. For the six months ended June 30, 2001 and 2000, the amounts incurred for selling, general and administrative expenses were approximately \$870,000 and \$1,037,000, respectively. The decrease in the selling, general and administrative expenses is primarily a result of a decrease in advertising costs at NTS/VA for the three and six months ended June 30, 2001 as well as a decrease in administrative, legal, and property tax for the six months ended June 30, 2001 compared to the same period in 2000.

Increases and decreases in interest expense generally correspond directly to increases and decreases in the outstanding balances of the Fund's borrowings and its subsidiaries borrowings as well as in the capitalization percentage. For the three months ended June 30, 2001 and 2000, approximately \$493,000 and \$695,000, respectively, was capitalized in inventory and approximately \$16,000 and \$40,000, respectively, was expensed. For the six months ended June 30, 2001 and 2000, approximately \$997,000 and \$1,376,000, was capitalized in inventory and approximately \$31,000 and \$93,000, respectively, was expensed. The decrease in total interest is primarily due to decreases in the Fund's interest rate on its variable rate mortgage loans.

Depreciation expense relates to equipment used for development activity which is being depreciated over five to seven years.

No benefit for income taxes was provided during the six months ended June 30, 2001 and 2000, as the Fund has recorded a valuation allowance equal to the amount of the recorded benefit. The Fund has determined that it is more likely than not that the net deferred tax asset will not be realized.

#### ***Provisions for Write-down to Net Realizable Value***

The Fund periodically reviews the value of land and inventories and determines whether any write-downs need to be recorded to reflect declines in value. The estimated net realizable value of real estate inventories represents management's estimate based on present plans and intentions, selling prices in the ordinary course of business and anticipated economic and market conditions. Accordingly, the realization of the value of the Fund's real estate inventories is dependent on future events and conditions that may cause actual results to differ from amounts presently estimated. The Fund did not record any write-downs during the period ended June 30, 2001.

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

Our primary market risk exposure with regard to financial instruments is changes in interest rates. The Fund's debt instruments bear interest at both variable and fixed rates as discussed in Note 9 of the Fund's financial statements. At June 30, 2001, a hypothetical 100 basis point increase in interest rates would result in an approximate \$64,000 increase in interest expense and an approximate \$64,000 decrease in the fair value of debt for the six months then ended. During the six months ended June 30, 2001, the majority of interest expense incurred was capitalized in inventory.

## **PART II - OTHER INFORMATION**

### **Item 1 - Legal Proceedings**

None.

### **Item 2 - Changes in Securities**

None.

### **Item 3 - Defaults upon Senior Securities**

None.

### **Item 4 - Submission of Matters to a Vote of Security Holders**

An annual meeting was held of June 5, 2001, which involved the election of the five directors and the designation of the auditors for 2001. Presented below are the votes cast for each of the elected directors and for the designated auditors.

<u>Directors</u>	<u>Votes For</u>	<u>Votes Against</u>	<u>Abstain</u>
Gerald B. Brenzel	1,529,213	148,933	-
Robert M. Day	1,526,696	151,450	-
Gerald B. Thomas	1,524,188	153,958	-
J.D. Nichols	1,497,280	180,866	-
Brian F. Lavin	1,513,326	164,820	-
<u>Auditors</u>			
Arthur Andersen	1,526,207	105,166	46,774

### **Item 5 - Other Information**

None.

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

Exhibits:

- Exhibit 99. Additional Exhibits - Pages from the Fund's Prospectus which have been specifically incorporated by, reference and copies of which are attached hereto which includes pages 75 to 81.

## SIGNATURES

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

NTS Mortgage Income Fund

/s/ Brian F. Lavin

Brian F. Lavin  
President and Director of the  
Mortgage Income Fund

Date: August 13, 2001