

**FORM 10-K**  
**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

*(Mark One)*

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number **0-17686**

**DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**

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

**Wisconsin**

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

**39-1606834**

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

**1100 Main Street, Suite 1830 Kansas City, Missouri 64105**

*(Address of principal executive offices, including zip code)*

**(816) 421-7444**

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Limited Partnership Interests

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 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 the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting securities held by non-affiliates of the Registrant: The aggregate market value of limited partnership interests held by non-affiliates is not determinable since there is no public trading market for the limited partnership interests.

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## PART I

### **Item 1. Business**

#### **Background**

The Registrant, DiVall Insured Income Properties 2 Limited Partnership (the "Partnership"), is a limited partnership organized under the Wisconsin Uniform Limited Partnership Act pursuant to a Certificate of Limited Partnership dated as of November 20, 1987, and governed by a Limited Partnership Agreement, as amended from time to time (collectively, the "Partnership Agreement"). The Partnership is managed by its general partner, The Provo Group, Inc. (the "General Partner", "TPG", and "Management"). As of December 31, 2011, the Partnership had 1,757 Limited Partners owning an aggregate of 46,280.3 Limited Partnership Interests (the "Interests").

The Partnership is engaged in the business of owning and operating its investment portfolio of commercial real estate properties (the "Properties"). At December 31, 2011, the Partnership owned thirteen properties, located in a total of six states. The Properties, except for the vacant Phoenix, AZ property, which formerly operated as China Super Buffet ("China Buffet"), are leased on a triple net basis primarily to, and operated by, primarily franchisees of national, regional and local retail chains under long-term leases. The lessees are predominantly fast food, family style, and casual/theme restaurants.

At December 31, 2011 nine of the thirteen Properties were and continue to be leased to three Wendy's Franchisee's, with six of the Properties being leased to Wendgusta, LLC ("Wendgusta"), two of the Properties being leased to Wendcharles I, LLC ("Wendcharles I"), and one of the Properties being leased to Wendcharles II, LLC ("Wendcharles II"). Operating base rents from these nine leases comprised approximately 75% of the total 2011 operating base rents. During 2011, additional percentage rents were also generated from these nine Wendy's properties and totaled approximately \$419,000. Additionally, the nine properties exceeded 69% of the Partnership's total Properties, both by historical asset value and number. Eight of the nine Wendy's leases are set to expire in November of 2021, with the remaining Wendy's lease set to expire in November of 2016. See Properties under Item 2 below for the table of all Properties and lease expirations and a discussion of Properties with significant developments.

During the process of leasing the Properties, the Partnership may experience competition from owners and managers of other properties. As a result, in connection with negotiating tenant leases, along with recognizing market conditions, Management may offer rental concessions, or other inducements, which may have an adverse impact on the results of the Partnership's operations. The Partnership is also in competition with sellers of similar properties to locate suitable purchasers for its Properties.

The Partnership will be dissolved on November 30, 2020 (extended ten years per the results of the 2009 Consent, as defined below), or earlier upon the prior occurrence of any of the following events: (a) the disposition of all properties of the Partnership; (b) the written determination by the General Partner that the Partnership's assets may constitute "plan assets" for purposes of ERISA; (c) the agreement of Limited Partners owning a majority of the outstanding interests to dissolve the Partnership; or (d) the dissolution, bankruptcy, death, withdrawal, or incapacity of the last remaining General Partner, unless an additional general partner is elected previously by a majority of the Limited Partners. During the second quarters of 2001, 2003, 2005 and 2007, Consent solicitations were circulated (the "2001, 2003, 2005 and 2007 Consents, respectively"), which if approved would have authorized the sale of all of the Partnership's Properties and the dissolution of the Partnership. A majority of the Limited Partners did not vote in favor of any of the Consents. Therefore, the Partnership had continued to operate as a going concern. On July 31, 2009, the Partnership mailed a Consent solicitation (the "2009 Consent") to Limited Partners to determine whether the Limited Partners wished to extend the term of the Partnership for ten years to

November 30, 2020 (the “Extension Proposition”), or wished the Partnership to sell its assets, liquidate, and dissolve by November 30, 2010. A majority of the Partnership Interests voted “FOR” the Extension Proposition and therefore, the Partnership continued to operate as a going concern. During the second quarter of 2011, Consent solicitations were circulated (“2011 Consent”), which if approved would have authorized the sale of all of the Partnership’s Properties and the dissolution of the Partnership. A majority of the Limited Partners did not vote in favor of the 2011 Consent, and the General Partner declared the 2011 Consent solicitation process concluded on June 30, 2011. Therefore, the Partnership continues to operate as a going concern.

### **The Permanent Manager Agreement**

The Permanent Manager Agreement (“PMA”) was entered into on February 8, 1993, between the Partnership, DiVall 1 (which was dissolved in December 1998), DiVall 3 (which was dissolved in December 2003), the now former general partners, Gary J. DiVall and Paul E. Magnuson, their controlled affiliates, and TPG, naming TPG as the Permanent Manager. The PMA contains provisions allowing TPG to submit the PMA, the issue of electing TPG as General Partner, and the issue of acceptance of the resignations of the former general partners to a vote of the Limited Partners through a solicitation of written consents.

TPG, as the General Partner, has been operating and managing the affairs of the Partnership in accordance with the provisions of the PMA and the Partnership Agreement.

The PMA had an original expiration date of December 31, 2002. At the end of the original term, it was extended three years by TPG to an expiration date of December 31, 2005, then an additional three years to an expiration date of December 31, 2008, and then an additional two years to an expiration date of December 31, 2010. Effective January 1, 2011, the PMA was renewed by TPG for the two-year period ending December 31, 2012. The PMA can be terminated earlier (a) by a vote at any time by a majority interest of the Limited Partners, (b) upon the dissolution and winding up of the Partnership, (c) upon the entry of an order of a court finding that TPG has engaged in fraud or other like misconduct or has shown itself to be incompetent in carrying out its duties under the Partnership Agreement, or (d) upon sixty days written notice from TPG to the Limited Partners of the Partnership.

### **Advisory Board**

The concept of the Advisory Board was first introduced by TPG during the solicitation of written consents seeking to elect TPG as the General Partner. The first Advisory Board was appointed in October 1993, and held its first meeting in November 1993. Among other functions, the three person Advisory Board has the following rights: to review operational policies and practices; to review extraordinary transactions; to review internal financial controls and practices; and to review the performance of the independent auditors of the Partnership. The Advisory Board powers are advisory only and the Advisory Board does not have the authority to direct management decisions or policies of the Partnership or remove the General Partner. The Advisory Board has full and free access to the Partnership's books and records, and individual Advisory Board members have the right to communicate directly with the Limited Partners concerning Partnership business. Members of the Advisory Board are compensated \$1,500 annually and \$500 for each quarterly meeting attended.

The Advisory Board currently consists of a broker dealer representative, William Arnold; and Limited Partners from the Partnership: Jesse Small and Albert Kramer. For a brief description of each Advisory Board member, refer to Item 10, Directors and Executive Officers of the Registrant.

The Partnership has no employees.

All of the Partnership's business is conducted in the United States.

### **Available Information**

The Partnership is required to file with the SEC annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, along with any related amendments and supplements to these periodic and current reports. The SEC maintains a website containing these reports and other information regarding our electronic filings at [www.sec.gov](http://www.sec.gov). These reports may also be read and copied at the SEC's Public Reference Room at 100 F Street, NE Washington, DC 20549. Further information about the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

We also make these reports and other information available either on or through our Internet Website at [www.divallproperties.com](http://www.divallproperties.com) as soon as reasonably practicable after such reports are available. Please note that any internet addresses provided in this Form 10-K are for information purposes only and are not intended to be hyperlinks. Accordingly, no information found and/or provided at such internet addresses is intended or deemed to be incorporated by reference herein.

### **Item 1A. Risk Factors**

Not Applicable.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

All of the Properties are leased to franchisees of national, regional and local fast food, family style and casual/theme restaurants.

Original lease terms for the majority of the Properties are generally five to twenty years from their inception. All leases are triple-net which require the tenant to pay all property operating costs including maintenance, repairs, utilities, property taxes, and insurance. A majority of the leases contain percentage rent provisions, which require the tenant to pay a specified percentage (five percent to eight percent) of gross sales above a threshold amount. None of the Properties are mortgaged. The Partnership owns the buildings and land and all improvements for all the Properties, except for the property leased to the franchisee of a Kentucky Fried Chicken restaurant ("KFC") in Santa Fe, New Mexico. KFC is located on land, where the Partnership has entered into a long-term ground lease, as lessee, which is set to expire in 2018. The Partnership has the option to extend the lease for two additional ten year periods. The Partnership owns all improvements constructed on the land (including the building and improvements) until the termination of the ground lease, at which time all constructed improvements will become the land owner's property.

The Partnership owned the following Properties as of December 31, 2011:

<u>Acquisition Date</u>	<u>Property Name &amp; Address</u>	<u>Lessee</u>	<u>Purchase Price (1)</u>	<u>Operating Rental Per Annum</u>	<u>Lease Expiration Date</u>	<u>Renewal Options</u>
06/15/88	Vacant 8801 N 7th St Phoenix, AZ	NA	\$1,087,137	NA	NA	NA

10/10/88	Kentucky Fried Chicken (5) 1014 S St Francis Dr Santa Fe, NM	Palo Alto, Inc,	451,230	60,000	06-30-2018	None
12/22/88	Wendy's (6) 1721 Sam Rittenburg Blvd Charleston, SC	Wendcharles II, LLC	596,781	76,920	11-6-2021	(2)
12/22/88	Wendy's (7) 3013 Peach Orchard Rd Augusta, GA	Wendgusta, LLC	649,594	86,160	11-6-2021	(3)
02/21/89	Wendy's (7) 1901 Whiskey Rd Aiken, SC	Wendgusta, LLC	776,344	96,780	11-6-2021	(3)
02/21/89	Wendy's (7) 1730 Walton Way Augusta, GA	Wendgusta, LLC	728,813	96,780	11-6-2021	(3)
02/21/89	Wendy's (8) 343 Foley Rd Charleston, SC	Wendcharles I, LLC	528,125	70,200	11-6-2021	(2)
02/21/89	Wendy's (8) 361 Hwy 17 Bypass Mount Pleasant, SC	Wendcharles I, LLC	580,938	77,280	11-6-2021	(2)
03/14/89	Wendy's (7) 1004 Richland Ave Aiken, SC	Wendgusta, LLC	633,750	90,480	11-6-2021	(3)
04/20/89	Daytona's All Sports Café 4875 Merle Hay Des Moines, IA	Karl Shaen Valderrama	897,813	30,000	05-31-14	None
12/29/89	Wendy's (7) 517 Martintown Rd N Augusta, SC	Wendgusta, LLC	660,156	87,780	11-6-2021	(3)
12/29/89	Wendy's (7) 3869 Washington Rd Martinez, GA	Wendgusta, LLC	633,750	84,120	11-6-2016	None
05/31/90	Applebee's (9) 2770 Brice Rd Columbus, OH	Thomas & King, Inc.	<u>1,434,434</u>	<u>113,330</u>	10-31-2012	(4)
			<u>\$9,658,865</u>	<u>\$969,830</u>		

Footnotes:

- (1) Purchase price includes all costs incurred by the Partnership to acquire the property.
- (2) The tenant has the option to extend the lease two additional periods of five years each.
- (3) The tenant has the option to extend the lease an additional period of five years.
- (4) The tenant has the option to extend the lease five additional periods of two years each.
- (5) Ownership of lessee's interest is under a ground lease. The tenant is responsible for payment of all rent obligations under the ground lease.
- (6) One of the thirteen Properties owned as of December 31, 2011 was leased to Wendcharles II. Since more than 69% of the Partnership's Properties, both by historical asset value and number,

are leased to Wendy's franchisees the financial status of the tenant may be considered relevant to investors. At the request of the Partnership, Wendcharles II provided it with a copy of its reviewed financial statements for the fiscal years ended December 25, 2011 and December 26, 2010. Those reviewed financial statements are attached to this Annual Report 10-K as Exhibit 99.2.

- (7) Six of the thirteen Properties owned as of December 31, 2011 were leased to Wendgusta. Since more than 69% of the Partnership's Properties, both by historical asset value and number, are leased to Wendy's franchisees, the financial status of the tenant may be considered relevant to investors. At the request of the Partnership, Wendgusta provided it with a copy of its reviewed financial statements for the fiscal years ended December 25, 2011 and December 26, 2010. Those reviewed financial statements are attached to this Annual Report 10-K as Exhibit 99.0.
- (8) Two of the thirteen Properties owned by the Partnership as of December 31, 2011 were leased to Wendcharles I. Since more than 69% of the Partnership's Properties, both by historical asset value and number, are leased to Wendy's franchisees, the financial status of the tenant may be considered relevant to investors. At the request of the Partnership, Wendcharles I provided it with a copy of its reviewed financial statements for the fiscal years ended December 25, 2011 and December 26, 2010. Those reviewed financial statements are attached to this Annual Report 10-K as Exhibit 99.1.
- (9) The lease on the property is set to expire on October 31, 2012. Management anticipates that the tenant will exercise its first of five options to renew the lease for an additional two years (base rent is to increase by 2% percent for each year of each option).

The following summarizes significant developments, by property, for properties with such developments.

#### Vacant Phoenix, AZ Property

The China Super Buffet restaurant ceased operations and vacated the Phoenix, AZ property in late June of 2011. Management had sent a letter of default to the former tenant in June, due to its delinquent May and June of 2011 lease obligations totaling \$12,312. Management regained possession of the property in July, and although the former tenant is responsible for lease obligations through its lease end date of January 20, 2013, Management does not anticipate any further rent collections and, therefore, monthly base rent charges of \$6,000 per month ceased as of June 30, 2011. As of June 30, 2011, the former tenant's \$18,000 security deposit was applied to the past due amounts and the remaining balance of approximately \$5,700 was held by the Partnership as property tax cash escrow. In addition, as of June 30, 2011, the former tenant's remaining long-term rent receivable balance of \$9,000 was removed from the balance sheet as an additional straight-line rent adjustment and its remaining deferred lease commission balance of approximately \$7,000 was fully amortized.

The Partnership had been unsuccessful in finding a new tenant for the vacant Phoenix, AZ property, and during the third quarter of 2011, the property was reclassified to properties held for sale upon the late September of 2011 execution of an Agency and Marketing Agreement ("Agreement") with an unaffiliated Agent. The Agreement gave the Agent the exclusive right to sell the vacant Phoenix, AZ property and the Denny's, Phoenix, AZ property through auction, sealed bid, hybrid sealed bid, on-line bid or through private negotiations. The vacant, Phoenix, AZ property did not sell at the October 18, 2011 auction. Per the Agreement, the Agent had the right to continue to market the property to potential buyers until the Agreement was set to terminate upon the later of 30 days after the Live Outcry Auction date, or a closing or settlement, if applicable. A marketing fee of approximately \$7,700 was paid to the Agent in September of 2011 for the purpose of advertising, marketing and promoting the properties to the buying public. Management continued to market the property to potential buyers.

The carrying amount of the vacant Phoenix, AZ property was reduced by \$390,117 during the fiscal year 2011, to its estimated fair value of \$150,000. The net book value of the vacant Phoenix, AZ property at

December 31, 2011, classified as property held for sale in the condensed financial statements, was approximately \$151,700 which included \$123,369 related to land, \$26,631 related to building, net of accumulated depreciation, \$700 related rents and other receivables, \$9,300 related to utilities security deposit, \$1,600 related to prepaid insurance, \$2,300 related to accounts payable and accrued expenses and \$7,600 related to property tax payable.

A contract ("Contract") to sell the vacant Phoenix, AZ property to an unaffiliated party was executed on February 14, 2012 for the sale price of \$325,000. The potential buyer provided an earnest money deposit of \$25,000, which is held by an independent escrow company. Per the Contract, closing is anticipated to occur prior to and up to 210 days out from the contract execution date. Closing costs are estimated to be approximately \$30,000, which includes commissions totaling approximately \$23,000 in the aggregate, which are anticipated to be paid to two unaffiliated brokers.

The \$325,000 sales contract has various due diligence and feasibility periods, as well as additional extensions and Management has no measure of certainty that the Contract will close or if a specific and unique re-use of the now vacant property will materialize. Therefore, the \$150,000 net book value for the vacant property at December 31, 2011, is its estimated fair value based on income capitalization calculations using historical capitalization rates (used by Management in relation to the property for annual Partnership Net Unit Valuations) applied to independently identified market rents, less known releasing costs such as estimated roof, parking lot and miscellaneous repairs, as well as leasing commissions. The estimated fair value is not necessarily what the Partnership will settle (sales price net of closing costs), within an actual arms length sales transaction of the vacant property.

At June 30, 2011, the Partnership had accrued six months of 2011 estimated property tax totaling \$9,000 based on the 2010 actual property tax bills, approximately \$3,300 of which was expensed by the Partnership as property tax. Monthly property tax expense and accruals of \$1,500 began in July of 2011 for the vacant property. The first installments of the 2011 property tax bills totaled \$7,600 in aggregate and were paid in September of 2011, of which \$5,700 was paid from the property tax cash escrow held by the Partnership. The second installments of the 2011 property tax bills total \$7,600 in aggregate and are due by March 1, 2012. The monthly property tax accrual for the vacant property was adjusted to approximately \$1,300 in September of 2011 due to the receipt of the actual 2011 property tax bills related to the property and therefore the property tax payable balance as of December 31, 2011 approximated \$7,600.

Due to the vacancy of the Phoenix, AZ property, the Partnership assumed property insurance and maintenance responsibility beginning in July of 2011. The Partnership purchased property insurance amounting to approximately \$3,000 for the 2011/2012 policy year during July of 2011, of which \$1,200 was expensed during 2011. Maintenance, security and utility expenditures totaling approximately \$10,000 were incurred during the third and fourth quarters of 2011. Management anticipates that the Partnership will continue to incur approximately \$1,500 per month in security patrol measures at the vacant property.

#### Formerly Owned Denny's Restaurant- Phoenix, AZ Property

The carrying amount of the Denny's, Phoenix, AZ property was reduced by \$104,705 to its estimated fair value less estimated costs to sell of \$445,000 during the fiscal year 2011.

During the third quarter of 2011, the property was reclassified to properties held for sale upon the late September of 2011 execution of an Agency and Marketing Agreement ("Agreement") with an unaffiliated Agent. The Agreement gave the Agent the exclusive right to sell the Denny's, Phoenix, AZ property and the vacant Phoenix, AZ property through auction, sealed bid, hybrid sealed bid, on-line bid or through private negotiations. The Agreement was set to terminate upon the later of 30 days after the Live Outcry

Auction, or a closing or settlement, if applicable. A marketing fee of approximately \$7,700 was paid to the Agent in September of 2011 for the purpose of advertising, marketing and promoting the properties to the buying public.

A contract to sell the Denny's, Phoenix, AZ property was executed at the October 18, 2011 auction by an unaffiliated party for the high bid price of \$475,000. A five percent buyer's premium totaling \$23,750, which was retained by the Agent per the Marketing Agreement at closing, was added to the high bid price for a total sales price of \$498,750 to be paid by the buyer. The buyer provided a ten percent earnest money deposit of \$49,870 which was held by an independent escrow company. The Purchase Agreement was accepted and executed by Management on October 20, 2011. Closing occurred on November 23, 2011 and resulted in a fourth quarter loss of approximately \$1,000. Closing and other sale related costs paid by the Partnership amounted to approximately \$26,000 and included a two percent commission (\$9,500) of the high bid price paid to the Agent and an advisory fee of three percent (\$14,250) of the high bid price paid to an affiliate of the Partnership.

A new twenty three month lease for the Denny's restaurant located in Phoenix, AZ was executed with the tenant, Denny's #6423, LLC ("Denny's") in June of 2009. The lease (which was effective as of June 1, 2009) provided for an annual base rent of \$72,000 (less a potential \$600 rent credit per month for both timely payment and sales reporting), and was set to expire on April 30, 2011. A commission of approximately \$4,000 was paid to a General Partner affiliate in the second quarter of 2009 in relation to the lease. Due to the lease modifications detailed below, approximately \$1,200 of the commission paid in 2009 was reimbursed to the Partnership in May of 2011 and is included in other income in the condensed statements of income.

In December of 2009, due to sluggish sales figures, Denny's notified the General Partner of its intent to terminate its lease early, pursuant to its lease rights, as of March 15, 2010. Responsive to the depressed Phoenix market, during January of 2010, Management and Denny's agreed to a six month temporary modification to the lease retroactive to January 1, 2010. The tenant's rent from January of 2010 through June of 2010 was strictly percentage rent at eight percent of monthly sales over \$50,000. In June of 2010, an additional temporary lease modification was agreed upon. Denny's rent from July of 2010 to September of 2010 was strictly percentage rent at eight percent of monthly sales over \$50,000 and the rent from October 1, 2010 to December 31, 2010 was strictly percentage rent at eight percent of monthly sales over \$37,500. During the fiscal year ended December 31, 2010, percentage rent income totaling approximately \$40,000 was recognized in relation to the property.

The January 1, 2011 third modification to Denny's lease, allowed for a month-to-month tenant lease as of May 1, 2011. In addition, Denny's rent, beginning January 1, 2011 and until the sale of the property in November of 2011, was strictly percentage rent at eight percent of monthly sales over \$37,500. During the fiscal year ended December 31, 2011, percentage rent income totaling approximately \$47,000 was recognized in relation to the property. In addition, eight percent of monthly sales between \$27,500 and \$37,500 (up to \$800) were held in a repair fund reserve by the Partnership, from which the tenant could withdraw for necessary property improvements upon proper proof of expenditures to the Partnership. The \$8,000 repair fund reserve balance was credited to the buyer upon the sale of the property on November 23, 2011.

#### Wendy's- 1721 Sam Rittenberg, Charleston, SC

The Sam Rittenberg property lease with tenant, Wencoast, was set to expire on November 6, 2016. On September 4, 2008 the lease was assumed and assigned to Wendcharles I. Per the Assumption and Assignment of Lease agreement, the monetary lease obligations and original lease expiration date remained the same. However, per a Lease Amendment agreement ("Amendment") with Wendcharles I, dated September 4, 2008, the original lease was extended five (5) years to November 6, 2021 and

provided for two options to renew for additional five (5) year periods. On November 17, 2011, per an Assumption and Assignment of Lease agreement, the lease was assumed and assigned to Wendcharles II.

#### Wendy's- 361 Highway 17 Bypass, Mt. Pleasant, SC Property

On November 30, 2010, the County of Charleston made a purchase offer ("Initial Offer") of approximately \$177,000 to the Partnership in connection with an eminent domain (condemnation) land acquisition of approximately 5,000 square feet of the approximately 44,000 square feet of the Wendy's-Mt. Pleasant, SC ("Wendy's- Mt. Pleasant") property. The proposed land purchase is for "Right of Way" for planned road improvements. Unfortunately, the plan provides for the relocation of ingress and egress that could make the operations of the Wendy's restaurant uneconomic.

In October of 2011, the Partnership received Notice ("Condemnation Notice") that the County of Charleston filed condemnation proceedings on October 12, 2011, which in effect permits the County of Charleston to take possession of approximately 5,000 square feet of the Wendy's- Mt. Pleasant property and to begin construction of the planned road improvements. The County of Charleston deposited the Initial Offer of \$177,000 with the Charleston County Clerk of Court as is required under South Carolina law. The Partnership had until November 11, 2011, to reject the Initial Offer ("Tender of Payment") for the purchase of the property. The Partnership rejected the Tender of Payment; however, the Initial Offer is still valid during the period the Partnership disputes the County of Charleston's position that the \$177,000 reflects just compensation for the taking of the property. By and through respective legal counsel, the Partnership and the lessee, Wendcharles, each filed a Notice of Court Appearance ("Notice of Appearance") and requested a jury trial in October. In addition, the Partnership and the lessee served one set of joint initial discovery requests ("Interrogatories" and "Requests for Production") with the County of Charleston requesting information about and access to up-to-date project plans and any and all other information pertaining to this matter. Management will continue to actively work with legal counsel and Wendcharles I to facilitate a settlement with the County of Charleston and the re-engineering of the County's plans to preserve the viability of the site for Wendy's operational use. The net book value of the land to be purchased is \$33,991 and was reclassified to a property held for sale during the fourth quarter of 2010.

#### Daytona's All Sports Café- Des Moines, IA Property

The second amendment to the lease for the Daytona's All Sports Café ("Daytona's) located in Des Moines, IA expired on May 31, 2011. In April of 2011, Management and Daytona's signed a letter of intent ("LOI") which agreed to a three year lease amendment and extension which was to begin on June 1, 2011 and expire on May 31, 2014. The third amendment to the lease was executed in early May of 2011 and provides for an annual base rent of \$72,000, rent abatement for June for each of the three years, and a continued potential \$600 rent credit per month for both timely payment and sales reporting. In addition, Daytona's is to pay as percentage rent 8% of its annual sales over \$850,000. During 2010, Daytona's reported sales to the Partnership of approximately \$820,000 (percentage rents were to be charged at six percent over a sales breakpoint of \$900,000). A leasing commission of approximately \$5,000 was paid in May of 2011 to a General Partner affiliate upon the execution of the third lease amendment and extension.

Beginning in December of 2005, Management requested that Daytona's escrow its future property tax liabilities with the Partnership on a monthly basis. As of December 31, 2011, Daytona's was current on its monthly rent and property tax escrow obligations. The escrow payments held by the Partnership totaled approximately \$26,000 and were included in property tax payable in the Partnership's condensed balance sheets.

#### Applebee's- Columbus, OH Property

An Amendment and Extension of Lease (“Amendment”) was executed with the Applebee’s restaurant occupying the property located in Columbus, OH on November 4, 2009. The Amendment, effective as of November 1, 2009, provides for an annual base rent of \$135,996 and is set to expire on October 31, 2012. The Amendment also provides Applebee’s five options to renew the lease for an additional two years (base rent is to increase by 2% percent for each year of each option). The Amendment also increased the percentage rent sales breakpoint from \$1,500,000 to \$2,300,000 and decreased the additional percentage rent from 7% to 5%.

#### Formerly Owned and Vacant Park Forest, IL Property

The Partnership had been unsuccessful in finding a new tenant for the vacant Park Forest, IL (“Park Forest”) property and, as of December 31, 2009, the carrying value of this property was written down to \$0.

In November of 2010, a Purchase Contract was executed for the sale of the Park Forest property to an unaffiliated party for a selling price of \$10,000. The closing date of the sale was December 2, 2010, and a net gain on the sale of approximately \$7,000 was recognized in the fourth quarter of 2010. Closing and other sale related costs amounted to approximately \$3,000 and included a \$1,000 sales commission paid to an unaffiliated Broker Agent. In addition, the Partnership paid approximately \$2,000 at the closing for past due water bills related to the former tenant of the Park Forest property. Per the terms of the Purchase Contract, the Partnership was responsible for paying the 2010 property tax for the Park Forest property which will be due in 2011 to the Cook County taxing authority. At the closing, the buyer paid approximately \$2,000 to the Partnership for its one month share of the 2010 property tax.

As of December 31, 2010, the Partnership had accrued and expensed eleven months of estimated 2010 property tax totaling approximately \$20,000 and held one month property tax cash escrow of approximately \$2,000 from the buyer of the property. The first installment of 2010 property tax, totaling approximately \$12,000 was paid in February of 2011 and the second installment of 2010 property tax, totaling approximately \$10,000 was paid in October of 2011.

#### Formerly Owned Panda Buffet Restaurant- Grand Forks, ND Property

A sales contract was executed on September 30, 2009 for the installment sale of the Panda Buffet restaurant property (“Panda Buffet”) located in Grand Forks, ND to the owner tenant. The Partnership completed the sale of the Panda Buffet property on November 12, 2009 for \$450,000. The buyer paid \$150,000 at closing with the remaining balance of \$300,000 being delivered in the form of a Promissory note (“Buyers Note”) to the Partnership. The Buyers Note reflects a term of three years, an interest rate of 7.25%, and principal and interest payments paid monthly. Principal is amortized over a period of ten years beginning December 1, 2009 with a balloon payment due on November 1, 2012. Pursuant to the Buyers Note, there will be no penalty for early payment of principal. The Buyers Note also requires the buyer to escrow property taxes with the Partnership beginning January of 2010 at \$1,050 per month (lowered to \$900 beginning February 1, 2011 and \$700 beginning January 1, 2012). As of December 31, 2011, the buyer was current on its 2011 monthly property tax escrow obligations and escrow payments. The property tax escrow cash balance held by the Partnership amounted to \$12,600 at December 31, 2010, and in January of 2011, \$10,800 of the property tax escrow was relinquished to the Buyer upon proof of payment of the 2010 property tax to the taxing authority. The property tax escrow cash balance held by the Partnership amounted to approximately \$2,000 at December 31, 2011, after the \$10,800 payment of the 2011 property tax to the taxing authority by the Partnership in October of 2011, and is included in the property tax payable in the condensed balance sheets.

Per the Buyer's Note amortization schedule, the monthly payments are to total approximately \$3,522 per month. The amortized principal payments yet to be received under the Buyer's Note amounted to \$253,247 as of December 31, 2011. During the year ended December 31, 2011, twelve note payments were received by the Partnership and totaled \$22,991 in principal and \$19,273 in interest.

#### Other Property Information

Property taxes, general maintenance, insurance and ground rent on the Partnership's Properties are the responsibility of the tenant. However, when a tenant fails to make the required tax payments or when a property becomes vacant (such as Phoenix, AZ property, formerly operated as China Buffet, or the formerly owned vacant Park Forest, IL property), the Partnership makes the appropriate property tax payments to avoid possible foreclosure of the property. In a property vacancy the Partnership pays for insurance and maintenance related to the vacant property.

Such taxes, insurance and ground rent are accrued in the period in which the liability is incurred. The Partnership owns one restaurant, which is located on a parcel of land where it has entered into a long-term ground lease, as lessee, which is set to expire in 2018. The Partnership has the option to extend the lease for two additional ten year periods. The Partnership owns all improvements constructed on the land (including the building and improvements) until the termination of the ground lease, at which time all constructed improvements will become the land owner's property. The tenant, KFC, is responsible for the \$3,400 per month ground lease payment per the terms of its lease with the Partnership.

#### **Item 3. Legal Proceedings**

None.

#### **Item 4. Mine Safety Disclosures**

Not applicable.

## PART II

### **Item 5. Market Price and Dividends on the Registrant's Common Equity and Related Stockholder Matters**

- (a) Although some Interests have been traded, there is no active public market for the Interests, and it is not anticipated that an active public market for the Interests will develop.
- (b) As of December 31, 2011, there were 1,757 record holders of Interests in the Partnership.
- (c) The Partnership does not pay dividends. However, the Partnership Agreement provides for net income and loss of the Partnership to be allocated on a quarterly basis, 99% to the Limited Partners and 1% to the General Partner. The Partnership Agreement provides for the distribution of net cash receipts and net proceeds to the Limited Partners and General Partner on a quarterly basis, subject to the limitations on distributions to the General Partner described in the Partnership Agreement. See Note 4 to the financial statements for further information. During 2011 and 2010, \$1,030,000 and \$1,175,000, respectively, were distributed in the aggregate to the Limited Partners. The General Partner received aggregate distributions of \$3,081 and \$3,260 in 2011 and 2010, respectively.

### **Item 6. Selected Financial Data**

Not Applicable.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **CAUTIONARY STATEMENT**

Item 7 of this Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included in this section and located elsewhere in this Annual Report Form 10-K regarding the prospects of our industry as well as the Partnership's prospects, plans, financial position and business strategy may constitute forward-looking statements. These forward-looking statements are not historical facts but are the intent, belief or current expectations of Management based on its knowledge and understanding of the business and industry. Words such as "may," "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," "would," "could," "should" and variations of these words and similar expressions are intended to identify forward-looking statements. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these expectations will prove to have been correct. These statements are not guarantees of the future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. The Partnership cautions readers not to place undue reliance on forward-looking statements, which reflect Management's view only as of the date of this Form 10-K. All subsequent written and oral forward-looking statements attributable to the Partnership, or persons acting on the Partnership's behalf, are expressly qualified in their entirety by this cautionary statement. Management undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. Factors that could cause actual results to differ materially from any forward-looking statements made in this Form 10-K include, without limitation, changes in general economic conditions, changes in real estate conditions, including without limitation, decreases in valuations of real properties, increases in property taxes and lack of buyers should the Partnership want to dispose of a property, lease-up risks, ability of tenants to fulfill their obligations to the Partnership under existing leases, sales levels of tenants whose leases include a percentage rent component, adverse changes to the restaurant market, entrance of competitors to the Partnership's lessees in markets in which the Properties are located, inability to obtain new tenants upon the expiration of existing leases, the potential need to fund tenant improvements or other capital expenditures out of operating cash flows and our inability to realize value for Limited Partners upon disposition of the Partnership's assets.

### **Critical Accounting Policies and Estimates**

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate these estimates, including investment impairment. These estimates are based on Management's historical industry experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The Partnership believes that its most significant accounting policies deal with:

Depreciation methods and lives- Depreciation of the properties is provided on a straight-line basis over the estimated useful life of the buildings and improvements. While the Partnership believes these are the

appropriate lives and methods, use of different lives and methods could result in different impacts on net income. Additionally, the value of real estate is typically based on market conditions and property performance, so depreciated book value of real estate may not reflect the market value of real estate assets.

Revenue recognition- Rental revenue from investment properties is recognized on the straight-line basis over the life of the respective lease when collectability is assured. Percentage rents are accrued only when the tenant has reached the sales breakpoint stipulated in the lease.

Impairment-The Partnership periodically reviews its long-lived assets, primarily real estate, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The Partnership's review involves comparing current and future operating performance of the assets, the most significant of which is undiscounted operating cash flows, to the carrying value of the assets. Based on this analysis, if deemed necessary, a provision for possible loss is recognized.

### **Investment Properties**

As of December 31, 2011, the Partnership owned thirteen fully constructed fast-food restaurants, which includes one vacant property in Phoenix, AZ that was reclassified to properties held for sale during the third quarter of 2011 (formerly operated as a China Super Buffet restaurant ("China Buffet")). In addition, one property is located on a parcel of land which is subject to a ground lease (see paragraph below). The twelve tenants are composed of the following: nine Wendy's restaurants, an Applebee's restaurant, a KFC restaurant, and a Daytona's All Sports Café ("Daytona's"). The thirteen properties are located in a total of six states.

Property taxes, general maintenance, insurance and ground rent on the Partnership's Properties are the responsibility of the tenant. However, when a tenant fails to make the required tax payments or when a property becomes vacant (such as Phoenix, AZ property, formerly operated as China Buffet, or the formerly owned vacant Park Forest, IL property), the Partnership makes the appropriate property tax payments to avoid possible foreclosure of the property. In a property vacancy the Partnership pays for insurance and maintenance related to the vacant property.

Such taxes, insurance and ground rent are accrued in the period in which the liability is incurred. The Partnership owns one restaurant, which is located on a parcel of land where it has entered into a long-term ground lease, as lessee, which is set to expire in 2018. The Partnership has the option to extend the lease for two additional ten year periods. The Partnership owns all improvements constructed on the land (including the building and improvements) until the termination of the ground lease, at which time all constructed improvements will become the land owner's property. The tenant, KFC, is responsible for the \$3,400 per month ground lease payment per the terms of its lease with the Partnership.

There were no building improvements capitalized during 2011 or 2010.

In accordance with Financial Accounting Standards Board ("FASB") guidance for "Accounting for the Impairment or Disposal of Long-Lived Assets", current and historical results from operations for disposed properties and assets classified as held for sale are reclassified separately as discontinued operations. The guidance also requires the adjustment to carrying value of properties due to impairment in an attempt to reflect appropriate market values.

In late September of 2011 Management executed an Agency and Marketing Agreement ("Agreement") with an unaffiliated Agent. The Agreement gave the Agent the exclusive right to sell the vacant Phoenix, AZ property and the Denny's, Phoenix, AZ property through auction, sealed bid, hybrid sealed bid, on-

line bid or through private negotiations. The Agreement terminated upon the later of 30 days after the Live Outcry Auction date of October 18, 2011, or a closing or settlement, if applicable. A marketing fee of approximately \$7,700 was paid to the Agent in September of 2011 for the purpose of advertising, marketing and promoting the properties to the buying public.

#### Vacant Phoenix, AZ Property

The China Super Buffet restaurant ceased operations and vacated the Phoenix, AZ property in late June of 2011. Management regained possession of the property in July and lease obligation charges ceased as of June 30, 2011. The vacant property was reclassified to properties held for sale during the third quarter of 2011 upon the execution of the Agreement. The vacant Phoenix, AZ property did not sell at the October 18, 2011 auction; however, Management continued to market the property to potential buyers.

The carrying amount of the vacant Phoenix, AZ property was reduced by \$390,117 during the fiscal year 2011, to its estimated fair value of \$150,000. The net book value of the vacant, Phoenix, AZ property at December 31, 2011, classified as property held for sale in the condensed financial statements, was approximately \$151,700, which included \$123,369 related to land, \$26,631 related to building, net of accumulated depreciation, \$9,300 related to a utilities security deposit, \$700 related to rents and other receivables, \$1,600 related to prepaid insurance, \$2,300 related to accounts payable and accrued expenses and \$7,600 related to property tax payable.

A contract (“Contract”) to sell the vacant Phoenix, AZ property to an unaffiliated party was executed on February 14, 2012 for the sale price of \$325,000. The potential buyer provided an earnest money deposit of \$25,000, which is held by an independent escrow company. Per the Contract, closing is anticipated to occur prior to and up to 210 days out from the contract execution date. Closing costs are estimated to be approximately \$30,000, which includes commissions totaling approximately \$23,000 in the aggregate, which are anticipated to be paid to two unaffiliated brokers.

The \$325,000 sales contract has various due diligence and feasibility periods, as well as additional extensions and Management has no measure of certainty that the Contract will close or if a specific and unique re-use of the now vacant property will materialize. Therefore, the \$150,000 net book value for the vacant property at December 31, 2011, is its estimated fair value based on income capitalization calculations using historical capitalization rates (used by Management in relation to the property for annual Partnership Net Unit Valuations) applied to independently identified market rents, less known re-leasing costs such as estimated roof, parking lot and miscellaneous repairs, as well as leasing commissions. The estimated fair value is not necessarily what the Partnership will settle (sales price net of closing costs), within an actual arms length sales transaction of the vacant property.

The vacated use (China Buffet) was already deemed the lowest use remaining to occupy the space originally occupied by a national chain. Based on Management’s prior experience incurring significant carrying costs on vacant properties, the current strategy for distressed property is cost containment with an accelerated disposition motivation being the elimination of future carrying costs of uncertain duration and amounts. Management does recognize the exposures of continuing carrying costs of a vacant property to operations. Management does not believe it is in the best interest of the Limited Partners to hold the property and incur carrying costs, such as property tax, utilities, maintenance and repair, security, and other unknown liabilities for an uncertain and prolonged period. Management believes the greatest benefit to the overall value of the remaining portfolio would be the elimination of uncertainties surrounding a troubled asset by aggressive disposition. Management’s primary objective is to limit the earnings impairment from continued carrying costs related to the vacant property.

#### Formerly Owned Denny’s, Phoenix, AZ Property

The Denny's, Phoenix, AZ property was reclassified to properties held for sale during September of 2011 due to the execution of the Marketing Agreement. The carrying amount of the property was reduced by \$104,705, to its estimated fair value less estimated costs to sell of \$445,000, during the fiscal year 2011. A contract to sell the Denny's, Phoenix, AZ property was executed at the October 18, 2011 auction by an unaffiliated party and the property was then sold in November of 2011 for the high bid price of \$475,000.

#### Wendy's- 361 Highway 17 Bypass, Mt. Pleasant, SC Property

On November 30, 2010, the County of Charleston made a purchase offer ("Initial Offer") of approximately \$177,000 to the Partnership in connection with an eminent domain (condemnation) land acquisition of approximately 5,000 square feet of the approximately 44,000 square feet of the Wendy's-Mt. Pleasant, SC ("Wendy's- Mt. Pleasant") property. In October of 2011, the Partnership received Notice ("Condemnation Notice") that the County of Charleston filed condemnation proceedings on October 12, 2011, which in effect permits the County of Charleston to take possession of approximately 5,000 square feet of the Wendy's- Mt. Pleasant property and to begin construction of the planned road improvements. The Partnership had until November 11, 2011, to reject the Initial Offer ("Tender of Payment") for the purchase of the property. The Partnership rejected the Tender of Payment; however, the Initial Offer is still valid during the period the Partnership disputes the County of Charleston's position that the \$177,000 reflects just compensation for the taking of the property. Management will continue to actively work with legal counsel and Wendcharles I to facilitate a settlement with the County of Charleston and the re-engineering of the County's plans to preserve the viability of the site for Wendy's-Mt. Pleasant's operational use. The net book value of the land to be purchased is \$33,991 and was reclassified to a property held for sale during the fourth quarter of 2010.

#### Formerly Owned Park Forest, IL property

The Partnership had been unsuccessful in finding a new tenant for the vacant Park Forest property, and on December 31, 2009, the carrying value of this property had been written down to \$0. The property was then sold to an unaffiliated party in December of 2010 for a gross sales price of \$7,000.

#### Further Information

A summary of significant developments as of December 31, 2011, by property, for properties with such developments, can be found in Item 2, Properties.

#### Net Income

Net income for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$276,000, \$815,000, and \$772,000, respectively. Net income per Limited Partnership Interest for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$5.90, \$17.43 and \$16.52, respectively.

The variance is primarily due to the reclassification of the Panda Buffet, Grand Forks, ND property to properties held for sale in the third quarter of 2009 and its sale in the fourth quarter of 2009, the second quarter of 2011 vacancy of the former China Super Buffet, Phoenix, AZ property and its reclassification to properties held for sale during the third quarter of 2011, the 2010 and 2011 lease modifications related to the Denny's, Phoenix, AZ property, the third quarter of 2011 reclassification of the Denny's, Phoenix, AZ property to properties held for sale and the fourth quarter of 2011 sale of the property. The 2011 net income also includes the fiscal year 2011 property impairment write downs of \$390,117 related to the vacant Phoenix, AZ property and \$104,705 related to the Denny's, Phoenix, AZ property.

Net income for the fiscal years ended December 31, 2011, 2010 and 2009 included the results from both operations and discontinued operations. Assets disposed of or deemed to be classified as held for sale

require the reclassification of current and previous years' operations to discontinued operations in accordance with GAAP applicable to "Accounting for the Impairment or Disposal of Long Lived Assets". As such, prior year operating results for those properties considered as held for sale or properties no longer considered for sale have been reclassified to conform to the current year presentation without effecting total net income. When properties are considered held for sale, depreciation of the properties is discontinued, and the properties are valued at the lower of the depreciated cost or fair value, less costs to dispose.

### **Results of Operations**

Income from continuing operations for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$754,000, \$761,000, and \$691,000, respectively. See the paragraphs below for further information as to individual operating income and expense items and explanations as to 2011, 2010 and 2009 variances.

#### **Fiscal year ended December 31, 2011 as compared to fiscal years ended December 31, 2010 and 2009:**

*Operating Rental Income:* Operating rental income for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$1.46 million, \$1.43 million, and \$1.43 million, respectively. The rental income was comprised of monthly lease obligations per the tenant leases, percentage rents obligations related to operating tenants who had reached their sales breakpoint, and included adjustments for straight-line rent. The 2011 to 2010 and 2009 variance is due to an overall increase in reported 2011 sales for tenants who had reached their sales breakpoint.

Management expects total base operating rent revenues to be approximately \$1 million for the year 2012 based on operating leases currently in place. Total base operating revenue for 2012 may increase by approximately \$23,000 if Applebee's exercises its first of five options to renew its lease for an additional two years (base rent will increase by 2% percent for each year of each option). The fixed rent increases associated with Applebee's offsets some of the loss of potential percentage rents from the tenant due to an increase in its sales breakpoint. In addition, future operating rent revenues may decrease with tenant defaults and/or the reclassification of properties as properties held for sale. They may also increase with additional rents due from tenants, if those tenants experience increased sales levels, which require the payment of additional rent to the Partnership. Operating percentage rents included in operating rental income in 2011, 2010, and 2009 were approximately \$431,000, \$398,000, and \$399,000, respectively. Management expects the 2012 percentage rents to be comparable to 2011.

*Insurance Expense:* Insurance expense for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$6,000, \$29,000 and \$35,000, respectively. The 2011 insurance expense was comprised of general liability insurance and the 2010 and 2009 insurance expense was comprised of aggregate property insurance (back-up policies for unexpected vacancy or tenant lapses) and general liability insurance. The Partnership did not purchase additional property insurance in the fourth quarter of 2010 for the aggregate of the Properties for the 2010/2011 insurance year. Each tenant is responsible for insurance protection and beginning October 31, 2010 the Partnership only purchases property insurance for an individual property if the tenant cannot provide proof of insurance protection or due to a property vacancy. For 2012, Management expects operating insurance expense to be approximately \$6,000. This amount could increase upon a property insurance default or vacancy by a tenant or an increase in the general liability insurance premium for the 2012/2013 insurance year, which is expected to be paid in the fourth quarter of 2012.

*General and Administrative Expense:* General and administrative expenses for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$63,000, \$66,000 and \$103,000, respectively. General and administrative expenses were comprised of management expense, state/city

registration and annual report filing fees, office supplies and printing costs, outside storage expenses, copy/fax costs, postage and shipping expenses, long-distance telephone expenses, website fees, bank fees and state income tax expenses. The variance in general and administrative expenses is primarily due to the overpayment of 2009 and 2010 estimated state tax expenditures and the printing and mailing of the 2008 Annual Report on Form 10-K to investors in the second quarter of 2009 and the printing and mailing of the 2009 Consent Statement materials to investors in the third quarter of 2009. Lower printing and mailing expenditures were incurred in 2010 and 2011 as the 2009 and 2010 Annual Reports on Form 10-K were posted to the Partnership website for viewing and printing and hard copies were only mailed to an investor upon request. Also, the 2011 Consent Statement materials were posted to the Partnership website in the second quarter of 2011 and hard copies were only mailed upon request. Management expects the total 2012 operating general and administrative expenses to potentially be eight percent higher than the 2011 expenses, primarily due to increased postage rates, higher management and outsourced service fees and higher state and local income tax expenditures.

*Professional services:* Professional services expenses for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$226,000, \$178,000, and \$198,000, respectively. Professional services expenses were primarily comprised of investor relations data processing, investor mailings processing, website design, legal, auditing and tax preparation fees, electronic tax filings, and SEC report conversion and processing fees. The variance in professional services expenses is primarily due to the SEC mandated XBRL financial statement conversion and filing requirements for the Partnership beginning in the second quarter of 2011, the 2011 and 2009 Consents and related SEC filings, the design and implementation of the Partnership website in 2009, additional electronic state income tax filings in 2011, and the timing of annual audit installment billings. Management anticipates that the total 2012 operating professional services expenses will be approximately seven percent higher than 2011 due primarily to the additional SEC mandated XBRL financial statement footnotes conversion and filing requirements for the Partnership beginning in the second quarter of 2012.

*Note Receivable Interest Income:* Note receivable interest income for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$19,000, \$21,000 and \$1,000, respectively. The interest income was comprised of interest income associated with the Buyer's Note from the Panda Buffet property sale in November of 2009. Management expects 2012 note receivable interest income to approximate \$16,000 in 2012. See Item 2, Properties for further information.

*Recovery of Amounts Previously Written-off:* Recovery of amounts previously written-off for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$7,000, \$12,000, and \$11,000, respectively, and were comprised of unexpected small recoveries from former general partners in connection with the misappropriation of assets by the former general partners and their affiliates. Management anticipates that such revenue type may continue to be generated until Partnership dissolution; however, no significant recoveries are anticipated.

## **Results of Discontinued Operations**

In accordance with FASB guidance for "Accounting for the Impairment or Disposal of Long Lived Assets", discontinued operations represent the operations of properties disposed of or classified as held for sale as well as any gain or loss recognized in their disposition. During the fiscal years ended December 31, 2011, 2010 and 2009, the Partnership recognized (loss) income from discontinued operations of approximately \$(478,000), \$54,000 and \$81,000, respectively. The 2011, 2010 and 2009 (loss) income from discontinued operations was attributable to the third quarter of 2011 reclassifications of the vacant Phoenix, AZ property and the Denny's, Phoenix, AZ property to properties held for sale upon the execution of Agency and Marketing Agreements with an unaffiliated party in September of 2011 to sell both of the properties. The 2011 loss from discontinued operations also includes the fiscal year 2011 property impairment write downs of \$390,117 related to the vacant Phoenix, AZ property and

\$104,705 related to the Denny's, Phoenix, AZ property, and the fourth quarter of 2011 loss of approximately \$1,000 in relation to the sale of the Denny's, Phoenix, AZ property. The 2010 and 2009 income from discontinued operations was attributable to the fourth Quarter of 2010 reclassification of a small strip of the Wendy's- Mt. Pleasant land to a property held for sale due to the pending eminent domain acquisition of the land by the County of Charleston for Right of Way for planned road improvements and the third quarter of 2010 reclassification of the vacant Park Forest property to a property held for sale upon the execution of the Agency and Marketing Agreement in August. The 2010 income from discontinued operations includes the fourth quarter net gain of approximately \$7,000 on the sale of the Park Forest property. The 2009 income from discontinued operations was also attributable to the third quarter of 2009 reclassification of the Panda Buffet property to a property held for sale (executed sales contract dated September 30, 2009). The 2009 income from discontinued operations includes the \$50,000 fourth quarter property impairment write down of the vacant Park Forest, IL property, the fourth quarter net gain of approximately \$29,000 on the sale of the Panda Buffet property, and the second quarter revenue collection of a \$12,500 sales escrow deposit in relation to the termination of the Denny's property sales contract dated February 22, 2008. See the components of discontinued operations included in the statements of income for the years ended December 31, 2011, 2010 and 2009 in Note 3 Investment Properties and Properties Held for Sale.

Management anticipates that discontinued operating expenditures in 2012 may approximate at least \$3,000 per month in relation to security and patrol, property tax and insurance, maintenance, and utilities in relation to the vacant Phoenix, AZ property which is classified as property held for the sale in the balance sheets as of December 31, 2011. A summary of significant developments as of December 31, 2011, for the vacant Phoenix, AZ property can be found in Item 2, Properties.

### **Cash Flow Analysis**

Net cash flows provided by operating activities for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$907,000, \$1.01 million and \$964,000, respectively. The variance in cash provided by operating activities from 2011 to 2010 and 2009 is primarily due to: (i) lower monthly operating base rental collections beginning July of 2011 due to the China Buffet vacancy beginning July 1, 2011; (ii) Denny's 2010 lease modifications resulting in lower operating base rental collections in 2010 and 2011, but higher percentage rent collections in 2010 and 2011; (iii) lower monthly rent collections in 2011 and 2010 due to the sale of the Panda Buffet property in November of 2009; (iv) percentage rent collections higher in 2011 and 2010 than in 2009 due to variances in annual tenant sales reported; (v) the timing and the amount of annual audit fee installment billings and the timing of the payments thereof; (vi) the timing of property tax payments from property tax cash escrow related to the former Panda Buffet property; (vii) formerly owned Park Forest property tax payments; (viii) the Partnership not purchasing property insurance in 2010 or 2011 for the aggregate of the Properties; (ix) the 2009 Consent resulting in higher investor communication and professional service expenditures in 2009; (x) the 2010 and 2009 Annual Report and the 2011 Consent Statement materials being posted to the Partnership website and printed and mailed to investors in May of 2011 and 2010 only upon request, respectively; (xii) lower 2011 and 2010 estimated state and local income taxes being paid due to the overpayment of 2010 and 2009 tax liabilities, respectively.

Property impairment write-downs, depreciation and amortization are non-cash items and do not affect the current operating cash flow of the Partnership or distributions to the Limited Partners.

Cash flows from investing activities for the fiscal years ended December 31, 2011, 2010 and 2009 were approximately \$469,000, \$40,000, and \$112,000, respectively. The 2011 amount was comprised of \$444,000 in net proceeds from the sale of the Denny's, Phoenix, AZ property, small recoveries from former general partners, the receipt of approximately \$23,000 in note receivable principal payments from

the Buyer's Note, offset by a leasing commission payment in relation to the Daytona's, Des Moines, IA property. The 2010 amount was comprised of small recoveries from former general partners, the receipt of approximately \$21,000 in note receivable principal payments from the Buyer's Note, and approximately \$7,000 in net sale proceeds from the December of 2010 sale of the vacant Park Forest property. The 2009 amount was primarily comprised of small recoveries from former general partners, the receipt of approximately \$2,000 in note receivable principal payments from the Buyer's Note, and approximately \$128,000 in net sale proceeds from the November of 2009 installment sale of the Panda Buffet property. In addition, leasing commissions paid totaled approximately \$21,000 and building improvement expenditures totaled \$9,000 during 2009.

During 2012, principal payments to be received by the Partnership under the Buyer's Note amortization schedule total approximately \$253,000 and include a balloon payment due on November 1, 2012 of approximately \$233,000 (see Note 11 to financial statements.) In addition, it is anticipated that small recoveries from former general partners may continue in the future. A leasing commission of approximately \$8,000 is anticipated to be paid during 2012 in relation to the Applebee's anticipated 2012 exercise of its first of five two year lease options.

For the fiscal year ended December 31, 2011, cash flows used in financing activities were approximately \$1.033 million and consisted of aggregate Limited Partner distributions of \$1.03 million (included \$23,000 in Buyer's Note principal payments received), and General Partner distributions of \$3,081. For the fiscal year ended December 31, 2010, cash flows used in financing activities were approximately \$1.18 million and consisted of aggregate Limited Partner distributions of \$1.18 million (included net sale cash proceeds of approximately \$128,000 from the installment sale of the Panda Buffet property in November of 2009 and \$19,000 in Buyer's Note principal payments received), and General Partner distributions of \$3,260. For the fiscal year ended December 31, 2009, cash flows used in financing activities was approximately \$2.05 million and consisted of aggregate Limited Partner distributions of \$2.05 million (included net sale cash proceeds of approximately \$1 million from the sale of the Blockbuster property in December of 2008), and General Partner distributions of \$3,290. Both Limited Partner and General Partner distributions have been and will continue to be made in accordance with the Partnership Agreement. Management anticipates that aggregate Limited Partner distributions could be approximately \$1.27 million during 2012, which includes the \$444,000 in net sale proceeds from the sale of the Denny's, Phoenix, AZ property during the fourth quarter of 2011.

### **Liquidity and Capital Resources**

The Partnership's cash balance was approximately \$771,000 at December 31, 2011. Cash of \$640,000, which includes the approximately \$444,000 in net sale proceeds from the November of 2011 sale of the Denny's, Phoenix, AZ property and approximately \$11,000 in Buyer's Note principal and interest payments received, will be used to fund the fourth quarter of 2011 aggregate distribution to Limited Partners in February of 2012, and cash of approximately \$31,000 is anticipated to be used for the payment of quarter-end accrued liabilities, net of property tax cash escrow, which are included in the balance sheets. The remainder represents amounts deemed necessary to allow the Partnership to operate normally.

The Partnership's principal demands for funds are expected to be for the payment of operating expenses and distributions. Management anticipates that cash generated through the operations of the Partnership's Properties and sales of Properties will primarily provide the sources for future fund liquidity and Limited Partner distributions. During the process of leasing the Properties, the Partnership may experience competition from owners and managers of other properties. As a result, in connection with negotiating tenant leases, along with recognizing market conditions, Management may offer rental concessions, or other inducements, which may have an adverse impact on the results of the Partnership's operations. The Partnership is also in competition with sellers of similar properties to locate suitable purchasers for its

Properties. The two primary liquidity risks in the absence of mortgage debt are the Partnership's inability to collect rent receivables and near or chronic property vacancies. The amount of cash to be distributed to our Limited Partners is determined by the General Partner and is dependent on a number of factors, including funds available for payment of distributions, capital expenditures, and taxable income recognition matching, which is primarily attributable to percentage rents and property sales.

As of December 31, 2011 and 2010, the current twelve operating Properties were leased 100 percent. In addition, the Partnership collected 100% of its base rent from current operating tenants for the fiscal years ended December 31, 2011 and 2010, which we believe is a good indication of overall tenant quality and stability. Twelve of the Partnership's thirteen Properties are currently leased and only the Applebee's lease is due to expire within 2012. The vacant Phoenix, AZ property (China Buffet ceased operations and vacated the Phoenix, AZ property in late June of 2011) and rent charges ceased as of June 30, 2011. The property was reclassified to properties held for sale during the third quarter of 2011. See Item 2, Investment Properties for further information regarding properties with significant developments.

Nine of the Partnership's thirteen properties operate as Wendy's fast food restaurants and are franchises of the international Wendy's Company. Operating base rents from the nine Wendy's leases comprised approximately 75% of the total 2011 operating base rents included in operating rental income. As of December 31, 2011, additional 2011 percentage rents totaled approximately \$419,000, of which \$417,000 were unbilled and were accrued in relation to the Wendy's properties. Therefore, during 2011, the Partnership generated approximately 81% of its total operating revenues from the nine properties. During 2010, additional percentage rents were generated from these Wendy's properties and approximately \$382,000 was accrued as of December 31, 2010. The 2010 percentage rents were both billed and fully collected as of December 31, 2011. Additionally, as of December 31, 2011, the nine Properties exceeded 69% of the Partnership's total properties, both by asset value and number. Eight of the nine Wendy's leases are set to expire in November of 2021, with the remaining one lease set to expire in November of 2016.

Since more than 69% of the Partnership's Properties, both by historical asset value and number, are leased to Wendy's franchises, the financial status of the three tenant's may be considered relevant to investors. At the request of the Partnership, Wendgusta, Wendcharles I and Wendcharles II provided it with a copy of their reviewed financial statements for the fiscal years ended December 25, 2011 and December 26, 2010. Those reviewed financial statements prepared by Wendgusta's, Wendcharles I's and Wendcharles II's accountants are attached as Exhibit 99.0, 99.1 and 99.2, respectively, to the Partnership's December 31, 2011 Annual Report on Form 10-K. The Partnership has no rights to audit or review Wendgusta's or Wendcharles I's or Wendcharles II's financial statements and the Partnership's independent registered public accounting firm has not audited or reviewed the financial statements received from Wendgusta, Wendcharles I or Wendcharles II.

The Partnership's return on its investment will be derived principally from rental payments received from its lessees. Therefore, the Partnership's return on its investment is largely dependent upon the business success of its lessees. The business success of the Partnership's individual lessees can be adversely affected on three general levels. First, the tenants rely heavily on the management contributions of a few key entrepreneurial owners. The business operations of such entrepreneurial tenants can be adversely affected by death, disability or divorce of a key owner, or by such owner's poor business decisions such as an undercapitalized business expansion. Second, changes in a local market area can adversely affect a lessee's business operation. A local economy can suffer a downturn with high unemployment. Socioeconomic neighborhood changes can affect retail demand at specific sites and traffic patterns may change, or stronger competitors may enter a market. These and other local market factors can potentially adversely affect the lessees of the Partnership Properties. Finally, despite an individual lessee's solid business plans in a strong local market, the franchise concept itself can suffer reversals or changes in management policy, which in turn can affect the profitability of operations. An overall economic

recession is another factor that could affect the relative success of a lessee's business. Therefore, there can be no assurance that any specific lessee will have the ability to pay its rent over the entire term of its lease with the Partnership.

Since the Partnership's Properties involve restaurant tenants, the restaurant market is the major market segment with a material impact on Partnership operations. The success of customer marketing and the operating effectiveness of the Partnership's lessee's, will impact the Partnership's future operating success in a very competitive restaurant and food service marketplace.

There is no way to determine, with any certainty, which, if any, tenants will succeed or fail in their business operations over the term of their respective leases with the Partnership. The nationwide economic downturn may affect a lessee's operational activity and its ability to meet lease obligations. Based on past experience, it can be reasonably anticipated that some lessees will default on future lease payments to the Partnership, which will result in the loss of expected lease income for the Partnership. Management will use its best efforts to vigorously pursue collection of any defaulted amounts and to protect the Partnership's assets and future rental income potential by trying to re-lease any properties with rental defaults. External events, which could impact the Partnership's liquidity, are the entrance of other competitors into the market areas of our tenants; the relocation of the market area itself to another traffic area; liquidity and working capital needs of the lessees; and failure or withdrawal of any of the national franchises held by the Partnership's tenants. Each of these events, alone or in combination, would affect the liquidity level of the lessees resulting in possible default by a tenant. Since the information regarding plans for future liquidity and expansion of closely held organizations, which are tenants of the Partnership, tend to be of a private and proprietary nature, anticipation of individual liquidity problems is difficult.

The continuing nationwide economic downturn has created a difficult credit environment. Fortunately, the Partnership has limited exposure to the credit markets, as the Partnership has no mortgage debt. Management monitors the depository institutions that hold the Partnership's cash on a regular basis and believes that funds have been deposited with creditworthy financial institutions. In addition, the Partnership has no outstanding mortgage debt. However, the continued economic downturn and lack of available credit could delay or inhibit Management's ability to dispose of the Partnership's Properties, or cause Management to have to dispose of the Partnership's Properties for a lower than anticipated return. As a result, Management continues to maintain an objective to preserve capital and sustain property values while selectively disposing of the Properties as appropriate.

### **Off-Balance Sheet Arrangements**

The Partnership does not have any off-balance sheet arrangements that are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### **Disposition Policies**

Management intends to hold the Partnership Properties until such time as sale or other disposition appears to be advantageous to achieve the Partnership's investment objectives or until it appears that such objectives will either currently not be met or not be met in the future. In deciding whether to sell properties, Management considers factors such as potential capital appreciation or depreciation, cash flow and federal income tax considerations, including possible adverse federal income tax consequences to the Limited Partners. The General Partner may exercise its discretion as to whether and when to sell a property, and there is no obligation to sell properties at any particular time, except upon Partnership termination on November 30, 2020 or if Limited Partners holding a majority of the units vote to liquidate and dissolve the Partnership in response to a formal consent solicitation to liquidate the Partnership.

## **Inflation**

To the extent that tenants can pass through commodity inflation in their sales prices, the Partnership will benefit from additional percentage rent from increased sales. The majority of the Partnership's leases have percentage rental clauses. Revenues from operating percentage rentals represented 30% of operating rental income for the fiscal year ended December 31, 2011, 29% of operating rental income for the fiscal year ended December 31, 2010, and 26% for the fiscal year ended December 31, 2009. If, however, inflation causes operating margins to deteriorate for lessees, or if expenses grow faster than revenues, then, inflation may well negatively impact the portfolio through tenant defaults.

Due to the "triple-net" nature of the property leases, asset values generally move inversely with interest rates.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The Partnership is not subject to market risk as defined by Item 305 of Regulation S-K.

**Item 8. Financial Statements and Supplementary Data**

DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP  
(A Wisconsin limited partnership)

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## Report of Independent Registered Public Accounting Firm

To the Partners  
DiVall Insured Income Properties 2 Limited Partnership

We have audited the accompanying balance sheets of DiVall Insured Income Properties 2 Limited Partnership (a Wisconsin limited partnership) as of December 31, 2011 and 2010 and the related statements of income, partners' capital, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the 2011 financial statement schedules listed in the Index at Item 15(a) (2). These financial statements and financial statement schedules are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Partnership is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DiVall Insured Income Properties 2 Limited Partnership as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/S/ McGladrey & Pullen, LLP

Chicago, Illinois  
April 16, 2012

# DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP

## BALANCE SHEETS

December 31, 2011 and 2010

### ASSETS

	December 31, <u>2011</u>	December 31, <u>2010</u>
INVESTMENT PROPERTIES: (Note 3)		
Land	\$2,956,118	\$3,853,775
Buildings	5,028,699	5,879,051
Accumulated depreciation	<u>(3,684,775)</u>	<u>(4,178,495)</u>
Net investment properties	<u>\$4,300,042</u>	<u>\$5,554,331</u>
OTHER ASSETS:		
Cash	\$771,250	\$427,973
Cash held in Indemnification Trust (Note 9)	451,961	451,387
Property tax cash escrow	28,130	40,417
Rents and other receivables	430,048	403,913
Property held for sale (Note 3)	185,664	33,991
Deferred rent receivable	1,767	12,217
Prepaid insurance	4,910	5,469
Deferred charges, net	221,789	255,844
Note receivable (Note 11)	<u>253,247</u>	<u>276,238</u>
Total other assets	<u>\$2,348,766</u>	<u>\$1,907,449</u>
Total assets	<u>\$6,648,808</u>	<u>\$7,461,780</u>

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

**DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**

**BALANCE SHEETS**

**December 31, 2011 and 2010**

**LIABILITIES AND PARTNERS' CAPITAL**

	December 31, <u>2011</u>	December 31, <u>2010</u>
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$14,586	\$20,098
Property tax payable	28,134	60,088
Due to General Partner ( <b>Note 6</b> )	1,757	1,825
Security deposits	70,440	88,440
Unearned rental income	<u>5,000</u>	<u>5,000</u>
Total current liabilities	<u>\$119,917</u>	<u>\$175,451</u>
 <b>CONTINGENCIES AND COMMITMENTS (Notes 8 and 9)</b>		
 <b>PARTNERS' CAPITAL: (Notes 1, 4 and 10)</b>		
General Partner -		
Cumulative net income	\$315,120	\$312,364
Cumulative cash distributions	<u>(131,952)</u>	<u>(128,871)</u>
	<u>\$183,168</u>	<u>\$183,493</u>
Limited Partners (46,280.3 interests outstanding at December 31, 2011 and 2010)		
Capital contributions, net of offering costs	\$39,358,468	\$39,358,468
Cumulative net income	37,562,752	37,289,865
Cumulative cash distributions	(69,735,268)	(68,705,268)
Reallocation of former general partners' deficit capital	<u>(840,229)</u>	<u>(840,229)</u>
	<u>\$6,345,723</u>	<u>\$7,102,836</u>
Total partners' capital	<u>\$6,528,891</u>	<u>\$7,286,329</u>
Total liabilities and partners' capital	<u>\$6,648,808</u>	<u>\$7,461,780</u>

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

**DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**

**STATEMENTS OF INCOME**

**For the Years Ended December 31, 2011, 2010, and 2009**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
OPERATING REVENUES:			
Rental income (Note 5)	\$1,456,112	\$1,425,617	\$1,427,925
TOTAL OPERATING REVENUES	<u>\$1,456,112</u>	<u>1,425,617</u>	<u>1,427,925</u>
EXPENSES:			
Partnership management fees (Note 6)	244,943	241,579	240,841
Restoration fees (Note 6)	299	497	459
Insurance	5,892	29,105	34,541
General and administrative	63,355	65,594	102,635
Advisory Board fees and expenses	10,500	10,500	10,000
Professional services	226,482	177,514	197,732
Personal property taxes	820	820	820
Depreciation	150,106	150,106	149,894
Amortization	<u>29,021</u>	<u>29,242</u>	<u>19,385</u>
TOTAL OPERATING EXPENSES	<u>731,418</u>	<u>704,957</u>	<u>756,307</u>
OTHER INCOME			
Other interest income	2,462	2,638	3,498
Note receivable interest income (Note 11)	19,273	20,876	1,148
Other income	240	3,904	3,408
Recovery of amounts previously written off (Note 2)	<u>7,464</u>	<u>12,429</u>	<u>11,476</u>
TOTAL OTHER INCOME	<u>29,439</u>	<u>39,847</u>	<u>19,530</u>
INCOME FROM CONTINUING OPERATIONS	754,133	760,507	691,148
(LOSS) INCOME FROM DISCONTINUED OPERATIONS (Note 3)	<u>(478,490)</u>	<u>54,496</u>	<u>80,926</u>
NET INCOME	<u>\$275,643</u>	<u>\$815,003</u>	<u>\$772,074</u>
NET INCOME- GENERAL PARTNER	\$2,756	\$8,150	\$7,721
NET INCOME- LIMITED PARTNERS	<u>272,887</u>	<u>806,853</u>	<u>764,353</u>
	<u>\$275,643</u>	<u>\$815,003</u>	<u>\$772,074</u>
PER LIMITED PARTNERSHIP INTEREST, Based on 46,280.3 interests outstanding:			
INCOME FROM CONTINUING OPERATIONS	\$16.13	\$16.27	\$14.79
(LOSS) INCOME FROM DISCONTINUED OPERATIONS	<u>(10.23)</u>	<u>1.16</u>	<u>1.73</u>
NET INCOME PER LIMITED PARTNERSHIP INTEREST	<u>\$5.90</u>	<u>\$17.43</u>	<u>\$16.52</u>

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

**DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**  
**STATEMENTS OF PARTNERS' CAPITAL**  
**For the years ended December 31, 2011, 2010 and 2009**

	<u>General Partner</u>			Capital Contributions, Net of <u>Offering Costs</u>	<u>Limited Partners</u>			<u>Total Partners' Capital</u>	
	<u>Cumulative Net Income</u>	<u>Cumulative Cash Distributions</u>	<u>Total</u>		<u>Cumulative Net Income</u>	<u>Cumulative Cash Distribution</u>	<u>Reallocation</u>		<u>Total</u>
BALANCE AT DECEMBER 31, 2008	\$296,493	\$(122,321)	\$174,172	\$39,358,468	\$35,718,659	\$(65,480,268)	\$(840,229)	\$8,756,630	\$8,930,802
Cash Distributions (\$44.30 per limited partnership interest)		(3,290)	(3,290)			(2,050,000)		(2,050,000)	(2,053,290)
Net Income	<u>7,721</u>	_____	<u>7,721</u>	_____	<u>764,353</u>	_____	_____	<u>764,353</u>	<u>772,074</u>
BALANCE AT DECEMBER 31, 2009	304,214	(125,611)	178,603	39,358,468	36,483,012	(67,530,268)	(840,229)	7,470,983	7,649,586
Cash Distributions (\$25.39 per limited partnership interest)		(3,260)	(3,260)			(1,175,000)		(1,175,000)	(1,178,260)
Net Income	<u>8,150</u>	_____	<u>8,150</u>	_____	<u>806,853</u>	_____	_____	<u>806,853</u>	<u>815,003</u>
BALANCE AT DECEMBER 31, 2010	312,364	(128,871)	183,493	39,358,468	37,289,865	(68,705,268)	(840,229)	7,102,836	7,286,329
Cash Distributions (\$22.26 per limited partnership interest)		(3,081)	(3,081)			(1,030,000)		(1,030,000)	(1,033,081)
Net Income	<u>2,756</u>	_____	<u>2,756</u>	_____	<u>272,887</u>	_____	_____	<u>272,887</u>	<u>275,643</u>
BALANCE AT DECEMBER 31, 2011	<u>\$315,120</u>	<u>\$(131,952)</u>	<u>\$183,168</u>	<u>\$39,358,468</u>	<u>\$37,562,752</u>	<u>\$69,735,268</u>	<u>\$(840,229)</u>	<u>\$6,345,723</u>	<u>\$6,528,891</u>

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

# DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP

## STATEMENTS OF CASH FLOWS

**For the Years Ended December 31, 2011, 2010, and 2009**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$275,643	\$815,003	\$772,074
Adjustments to reconcile net income to net cash from operating activities -			
Depreciation and amortization	203,868	209,284	213,851
Recovery of amounts previously written off	(7,464)	(12,429)	(11,476)
Provision for non-collectible rents and other receivables	0	0	2,013
Property impairment write-downs	494,822	0	50,000
Net loss (gain) on disposal of assets	1,227	(6,562)	(28,604)
Interest applied to Indemnification Trust account	(574)	(740)	(1,023)
(Increase) Decrease in rents and other receivables	(36,081)	(9,003)	27,100
Decrease (Increase) in property tax cash escrow	12,287	(14,888)	(6,509)
(Increase) Decrease in prepaid insurance	(1,034)	22,543	927
Decrease in deferred rent receivable	10,450	5,760	10,162
Decrease in property tax receivable	0	0	2,422
(Decrease) Increase in accounts payable and accrued expenses	(3,217)	6,952	(48,415)
Decrease in property tax payable	(24,383)	(1,445)	(15,658)
(Decrease) Increase in due to General Partner	(68)	6	(2,646)
Decrease in security deposits	(18,000)	0	(5,000)
Increase in unearned rental income	<u>0</u>	<u>0</u>	<u>5,000</u>
Net cash from operating activities	<u>907,476</u>	<u>1,014,481</u>	<u>964,218</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Net proceeds from sale of investment properties	443,773	6,562	127,720
Note receivable, principal payment received	22,991	21,388	2,374
Investment in building improvements	0	0	(9,000)
Payment of leasing commissions	(5,346)	0	(21,060)
Recoveries from former General Partner affiliates	<u>7,464</u>	<u>12,429</u>	<u>11,476</u>
Net cash from investing activities	<u>468,882</u>	<u>40,379</u>	<u>111,510</u>
<b>CASH FLOWS USED IN FINANCING ACTIVITIES:</b>			
Cash distributions to Limited Partners	(1,030,000)	(1,175,000)	(2,050,000)
Cash distributions to General Partner	<u>(3,081)</u>	<u>(3,260)</u>	<u>(3,290)</u>
Net cash used in financing activities	<u>(1,033,081)</u>	<u>(1,178,260)</u>	<u>(2,053,290)</u>
NET INCREASE (DECREASE) IN CASH	343,277	(123,400)	(977,562)
CASH AT BEGINNING OF YEAR	<u>427,973</u>	<u>551,373</u>	<u>1,528,935</u>
CASH AT END OF YEAR	<u>\$771,250</u>	<u>\$427,973</u>	<u>\$551,373</u>
<b>Supplemental Schedule of Noncash Investing Activity</b>			
Sale of investment property for note receivable	<u>\$0</u>	<u>\$0</u>	<u>\$300,000</u>

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

# DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP

## NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2011, 2010 AND 2009

### **1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES:**

DiVall Insured Income Properties 2 Limited Partnership (the "Partnership") was formed on November 20, 1987, pursuant to the Uniform Limited Partnership Act of the State of Wisconsin. The initial capital, contributed during 1987, consisted of \$300, representing aggregate capital contributions of \$200 by the former general partners and \$100 by the Initial Limited Partner. The minimum offering requirements were met and escrowed subscription funds were released to the Partnership as of April 7, 1988. On January 23, 1989, the former general partners exercised their option to increase the offering from 25,000 interests to 50,000 interests and to extend the offering period to a date no later than August 22, 1989. On June 30, 1989, the general partners exercised their option to extend the offering period to a date no later than February 22, 1990. The offering closed on February 22, 1990, at which point 46,280.3 interests had been sold, resulting in total offering proceeds, net of underwriting compensation and other offering costs, of \$39,358,468.

The Partnership is currently engaged in the business of owning and operating its investment portfolio of commercial real estate properties (the "Properties"). The Properties are leased (with the exception of the vacant Phoenix, AZ property- See Note 3 to the financial statements) on a triple net basis primarily to, and operated by, franchisors or franchisees of national, regional, and local retail chains under primarily long-term leases. The lessees are fast food, family style, and casual/theme restaurants. As of December 31, 2011, the Partnership owned thirteen Properties, which are located in a total of six states.

The Partnership will be dissolved on November 30, 2020 (extended ten years per the results of the 2009 Consent, as defined below), or earlier upon the prior occurrence of any of the following events: (a) the disposition of all properties of the Partnership; (b) the written determination by The Provo Group, Inc., the general partner of the Partnership (the "General Partner", or "TPG", or "Management"), that the Partnership's assets may constitute "plan assets" for purposes of ERISA; (c) the agreement of Limited Partners owning a majority of the outstanding interests to dissolve the Partnership; or (d) the dissolution, bankruptcy, death, withdrawal, or incapacity of the last remaining General Partner, unless an additional General Partner is elected previously by a majority of the Limited Partners. During the second quarters of 2001, 2003, 2005 and 2007, Consent solicitations were circulated (the "2001, 2003, 2005 and 2007 Consents, respectively"), which if approved would have authorized the sale of all of the Partnership's Properties and the dissolution of the Partnership. A majority of the Limited Partners did not vote in favor of any of the Consents. Therefore, the Partnership had continued to operate as a going concern. On July 31, 2009, the Partnership mailed a Consent solicitation (the "2009 Consent") to Limited Partners to determine whether the Limited Partners wished to extend the term of the Partnership for ten years to November 30, 2020 (the "Extension Proposition"), or wished the Partnership to sell its assets, liquidate, and dissolve by November 30, 2010. A majority of the Partnership Interests voted "FOR" the Extension Proposition and therefore, the Partnership continued to operate as a going concern. During the second quarter of 2011, Consent solicitations were circulated ("2011 Consent"), which if approved would have authorized the sale of all of the Partnership's Properties and the dissolution of the Partnership. A majority of the Limited Partners did not vote in favor of the 2011 Consent, and the General Partner declared the 2011 Consent solicitation process concluded on June 30, 2011. Therefore, the Partnership continues to operate as a going concern.

### *Significant Accounting Policies*

Rental revenue from the Properties is recognized on the straight-line basis over the term of the respective lease. Percentage rents are only accrued when the tenant has reached the sales breakpoint stipulated in the lease.

Rents and other receivables are comprised of billed but uncollected amounts due for monthly rents and other charges, and amounts due for scheduled rent increases for which rentals have been earned and will be collected in the future under the terms of the leases. Receivables are recorded at Management's estimate of the amounts that will be collected.

As of December 31, 2011 and 2010 there were no recorded values for allowance for doubtful accounts based on an analysis of specific accounts and historical experience.

The Partnership considers its operations to be in only one segment, the operation of a portfolio of commercial real estate leased on a triple net basis, and therefore no segment disclosure is made.

Depreciation of the Properties is provided on a straight-line basis over the estimated useful lives of the buildings and improvements.

Deferred charges represent leasing commissions paid when the Properties are leased and upon the negotiated extension of a lease. Leasing commissions are capitalized and amortized over the term of the lease. As of December 31, 2011 and 2010, accumulated amortization amounted to \$72,428 and \$90,327, respectively. Fully amortized deferred charges of \$57,300, including related accumulated amortization, were removed from the condensed balance sheets as of September 30, 2011.

Property taxes, general maintenance, insurance and ground rent on the Partnership's Properties are the responsibility of the tenant. However, when a tenant fails to make the required tax payments or when a property becomes vacant (such as the vacant Phoenix, AZ property which formerly operated as China Super Buffet restaurant ("China Buffet") or the formerly owned vacant Park Forest, IL ("Park Forest") property) the Partnership makes the appropriate property tax payments to avoid possible foreclosure of the property. In a property vacancy the Partnership pays for the insurance, maintenance and any utilities related to the vacant property.

Such taxes, insurance and ground rent are accrued in the period in which the liability is incurred. The Partnership owns one restaurant, which is located on a parcel of land where it has entered into a long-term ground lease, as lessee, which is set to expire in 2018. The Partnership has the option to extend the lease for two additional ten year periods. The Partnership owns all improvements constructed on the land (including the building and improvements) until the termination of the ground lease, at which time all constructed improvements will become the land owner's property. The tenant, a Kentucky Fried Chicken restaurant franchisee ("KFC"), is responsible for the \$3,400 per month ground lease payment per the terms of its lease with the Partnership.

The Partnership generally maintains cash in federally insured accounts in a bank that is participating in the FDIC's Transaction Account Guarantee Program ("TAGP"). Under TAGP, through December 31, 2010, all non-interest bearing transaction accounts were fully guaranteed by the FDIC for the entire amount in the account. Pursuant to Section 343 of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), all funds in a non-interest bearing transaction account are insured in full by the FDIC from December 31, 2010 through December 31, 2012. This temporary unlimited coverage is in addition to and separate from, the coverage of at least \$250,000 available to depositors under the FDIC's general deposit insurance rules. Cash maintained in these accounts may exceed federally insured limits after the expiration of the period established by the Dodd- Frank Act. The Partnership has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk.

Financial instruments that potentially subject the Partnership to significant concentrations of credit risk consist primarily of cash investments and leases. Additionally, as of December 31, 2011, nine of the Partnership's thirteen Properties are leased to three significant tenants, Wendgusta, LLC ("Wendgusta"), Wendcharles I, LLC ("Wendcharles I") and Wendcharles II, LLC ("Wendcharles II"), all three of whom are Wendy's restaurant franchisees. The property lease(s) for the three tenants comprised approximately 53%, 21% and 1%, respectively, of the total 2011 operating base rents reflected for the fiscal year ended December 31, 2011.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("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.

Assets disposed of or deemed to be classified as held for sale require the reclassification of current and previous years' operations to discontinued operations in accordance with GAAP applicable to "Accounting for the Impairment or Disposal of Long Lived Assets". As such, prior year operating results for those properties considered as held for sale or properties no longer considered for sale have been reclassified to conform to the current year presentation without affecting total income. When properties are considered held for sale, depreciation of the properties is discontinued, and the properties are valued at the lower of the depreciated cost or fair value, less costs to dispose. If circumstances arise that were previously considered unlikely, and, as a result, the property previously classified as held for sale is no longer to be sold, the property is reclassified as held and used. Such property is measured at the lower of its carrying amount (adjusted for any depreciation and amortization expense that would have been recognized had the property been continuously classified as held and used) or fair value at the date of the subsequent decision not to sell.

Assets are classified as held for sale, generally, when all criteria within GAAP applicable to "Accounting for the Impairment or Disposal of Long Lived Assets" have been met.

The Partnership periodically reviews its long-lived assets, primarily real estate, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The Partnership's review involves comparing current and future operating performance of the assets, the most significant of which is undiscounted operating cash flows, to the carrying value of the assets. Based on this analysis, a provision for possible loss is recognized, if any. The carrying amount of the formerly owned Denny's Phoenix, AZ property (property was sold on November 23, 2011) was reduced by \$104,705 to its estimated fair value less estimated costs to sell of \$445,000 during the third quarter of 2011. The carrying amount of the vacant Phoenix, AZ property was reduced by \$390,117 during the fiscal year 2011, to its estimated fair value of \$150,000. There were no adjustments to carrying values for the fiscal year ended December 31, 2010. For the fiscal year ended December 31, 2009, a \$50,000 adjustment to the land carrying value related to the Park Forest property was recorded.

The Financial Accounting Standards Board ("FASB") guidance on "Fair Value Measurements and Disclosure", defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. The adoption of the provisions of this FASB issuance, with respect to nonrecurring fair value measurements of nonfinancial assets and liabilities, including (but not limited to) the valuation of reporting units for the purpose of assessing goodwill impairment and the valuation of property and equipment when assessing long-lived asset impairment, did not have a material impact on how the Partnership estimated its fair value measurements but did result in increased disclosures about fair value measurements in the Partnership's financial statements as of and for the years ended December 31, 2011 and 2010. See Note 12 for further disclosure.

GAAP applicable to Disclosure About Fair Value of Financial Instruments, requires entities to disclose the fair value of all financial assets and liabilities for which it is practicable to estimate. Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The General Partner believes that the carrying value of the Partnership's assets (exclusive of the Properties) and liabilities approximate fair value due to the relatively short maturity of these instruments.

No provision for federal income taxes has been made, as any liability for such taxes would be that of the individual partners rather than the Partnership. At December 31, 2011 the tax basis of the Partnership's assets exceeded the amounts reported in the December 31, 2011 financial statements by approximately \$7,184,618.

The following represents an unaudited reconciliation of net income as stated on the Partnership statements of income to net income for tax reporting purposes:

	2011 (Unaudited)	2010 (Unaudited)	2009 (Unaudited)
Net income, per statements of income	275,643	\$815,003	\$772,074
Book to tax depreciation difference	(26,249)	(31,622)	(34,855)
Tax over (under) Book gain from asset disposition	(120,194)	(293,243)	(2,840)
Straight line rent adjustment	10,450	5,760	26,038
Penalties	9	0	0
Prepaid rent	0	0	5,000
Impairment write-down of assets held	<u>494,822</u>	<u>0</u>	<u>50,000</u>
Net income for tax reporting purposes	<u>\$634,481</u>	<u>\$495,898</u>	<u>\$815,417</u>

The Partnership is not subject to federal income tax because its income and losses are includable in the tax returns of its partners, but may be subject to certain state taxes. FASB has provided guidance for how uncertain tax positions should be recognized, measured, disclosed and presented in the financial statements. This requires the evaluation of tax positions taken or expected to be taken in the course of preparing the entity's tax returns to determine whether the tax positions are more-likely-than-not to be sustained when challenged or when examined by the applicable taxing authority. Management has determined that there were no material uncertain income tax positions. Tax returns filed by the Partnership generally are subject to examination by U.S. and state taxing authorities for the years ended after December 31, 2007.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in GAAP and IFRSs ("ASU No. 2011-04"). ASU No. 2011-04 updates and further clarifies requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Additionally, ASU No. 2011-04 clarifies the FASB's intent about the application of existing fair value measurements. ASU No. 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and is applied prospectively. The Partnership does not expect that the adoption of ASU No. 2011-04 will have a material impact to its financial statements.

## **2. REGULATORY INVESTIGATION:**

A preliminary investigation during 1992 by the Office of Commissioner of Securities for the State of Wisconsin and the Securities and Exchange Commission (the "Investigation") revealed that during at least the four years ended December 31, 1992, the former general partners of the Partnership, Gary J. DiVall

("DiVall") and Paul E. Magnuson ("Magnuson"), had transferred substantial cash assets of the Partnership and two affiliated publicly registered limited partnerships, DiVall Insured Income Fund Limited Partnership ("DiVall 1"), which was dissolved December of 1998, and DiVall Income Properties 3 Limited Partnership ("DiVall 3"), which was dissolved December of 2003, (collectively, the "three original partnerships") to various other entities previously sponsored by or otherwise affiliated with Gary J. DiVall and Paul E. Magnuson. The unauthorized transfers were in violation of the respective Partnership Agreements and resulted, in part, from material weaknesses in the internal control system of the Partnerships.

Subsequent to discovery, and in response to the regulatory inquiries, TPG was appointed Permanent Manager (effective February 8, 1993) to assume responsibility for daily operations and assets of the Partnerships as well as to develop and execute a plan of restoration for the three original partnerships. Effective May 26, 1993, the Limited Partners, by written consent of a majority of interests, elected TPG as General Partner. TPG terminated the former general partners by accepting their tendered resignations.

In 1993, the General Partner estimated an aggregate recovery of \$3 million for the three original partnerships. At that time, an allowance was established against amounts due from former general partners and their affiliates reflecting the estimated \$3 million receivable. This net receivable was allocated among the three original partnerships based on their pro rata share of the total misappropriation, and restoration costs and recoveries have been allocated based on the same percentage. Through December 31, 2011, approximately \$5,918,000 of recoveries have been received which exceeded the original estimate of \$3 million. As a result, from January 1, 1996 through December 31, 2011, the Partnership has recognized a total of approximately \$1,228,000 as recovery of amounts previously written off in the statements of income, which represents its share of the excess recovery. The General Partner continues to pursue recoveries of the misappropriated funds; however, no further significant recoveries are anticipated.

### **3. INVESTMENT PROPERTIES and PROPERTY HELD FOR SALE:**

The total cost of the Properties includes the original purchase price plus acquisition fees and other capitalized costs paid to an affiliate of the former general partners.

As of December 31, 2011, the Partnership owned thirteen fully constructed fast-food restaurants, which includes one vacant property in Phoenix, AZ that was reclassified to properties held for sale during the third quarter of 2011 (formerly operated as China Buffet). The twelve tenants are composed of the following: nine Wendy's restaurants, an Applebee's restaurant, a KFC restaurant, and a Daytona's All Sports Café ("Daytona's"). The thirteen properties are located in a total of six states.

In late September of 2011 Management executed an Agency and Marketing Agreement ("Marketing Agreement") with an unaffiliated Agent. The Marketing Agreement gave the Agent the exclusive right to sell the vacant Phoenix, AZ property and the Denny's, Phoenix, AZ property through auction, sealed bid, hybrid sealed bid, on-line bid or through private negotiations. The Marketing Agreement terminated upon the later of 30 days after the Live Outcry Auction date of October 18, 2011, or a closing or settlement, if applicable. A marketing fee of approximately \$7,700 was paid to the Agent in September of 2011 for the purpose of advertising, marketing and promoting the properties to the buying public.

#### **Formerly Owned Denny's, Phoenix, AZ Property**

The Denny's, Phoenix, AZ property was reclassified to properties held for sale during September of 2011 due to the execution of the Marketing Agreement. The carrying amount of the property was reduced by \$104,705, to its estimated fair value less estimated costs to sell of \$445,000, during the third quarter of 2011. A contract to sell the Denny's, Phoenix, AZ property was executed at the October 18, 2011 auction

by an unaffiliated party and the property was then sold in November of 2011 for the high bid price of \$475,000.

#### Vacant Phoenix, AZ Property

The China Super Buffet restaurant ceased operations and vacated the Phoenix, AZ property in late June of 2011. Management regained possession of the property in July and lease obligation charges ceased as of June 30, 2011. The property was reclassified to properties held for sale during the third quarter of 2011 upon the execution of the Marketing Agreement. The vacant, Phoenix, AZ property did not sell at the October 18, 2011 auction; however, Management continued to market the property to potential buyers.

The carrying amount of the vacant Phoenix, AZ property was reduced by \$390,117 during the fiscal year 2011, to its estimated fair value of \$150,000. The net book value of the vacant, Phoenix, AZ property at December 31, 2011, classified as property held for sale in the condensed financial statements, was approximately \$151,700, which included \$123,369 related to land, \$26,631 related to building, net of accumulated depreciation, \$9,300 related to a security deposit, \$700 related to rents and other receivables, \$1,600 related to prepaid insurance, \$2,300 related to accounts payable and accrued expenses and \$7,600 related to property tax payable.

A contract (“Contract”) to sell the vacant Phoenix, AZ property to an unaffiliated party was executed on February 14, 2012 for the sale price of \$325,000. The potential buyer provided an earnest money deposit of \$25,000, which is held by an independent escrow company. Per the Contract, closing is anticipated to occur prior to and up to 210 days out from the contract execution date. Closing costs are estimated to be approximately \$30,000, which includes commissions totaling approximately \$23,000 in the aggregate, which are anticipated to be paid to two unaffiliated brokers.

The \$325,000 sales contract has various due diligence and feasibility periods, as well as additional extensions and Management has no measure of certainty that the Contract will close or if a specific and unique re-use of the now vacant property will materialize. Therefore, the \$150,000 net book value for the vacant property at December 31, 2011, is its estimated fair value based on income capitalization calculations using historical capitalization rates (used by Management in relation to the property for annual Partnership Net Unit Valuations) applied to independently identified market rents, less known releasing costs such as estimated roof, parking lot and miscellaneous repairs, as well as leasing commissions. The estimated fair value is not necessarily what the Partnership will settle (sales price net of closing costs), within an actual arms length sales transaction of the vacant property.

#### Wendy’s- 361 Highway 17 Bypass, Mt. Pleasant, SC Property

On November 30, 2010, the County of Charleston made a purchase offer (“Initial Offer”) of approximately \$177,000 to the Partnership in connection with an eminent domain (condemnation) land acquisition of approximately 5,000 square feet of the approximately 44,000 square feet of the Wendy’s-Mt. Pleasant, SC (“Wendy’s- Mt. Pleasant”) property. In October of 2011, the Partnership received Notice (“Condemnation Notice”) that the County of Charleston filed condemnation proceedings on October 12, 2011, which in effect permits the County of Charleston to take possession of approximately 5,000 square feet of the Wendy’s- Mt. Pleasant property and to begin construction of the planned road improvements. The Partnership had until November 11, 2011, to reject the Initial Offer (“Tender of Payment”) for the purchase of the property. The Partnership rejected the Tender of Payment; however, the Initial Offer is still valid during the period the Partnership disputes the County of Charleston’s position that the \$177,000 reflects just compensation for the taking of the property. Management will continue to actively work with legal counsel and Wendcharles I to facilitate a settlement with the County of Charleston and the re-engineering of the County’s plans to preserve the viability of the site for Wendy’s-Mt. Pleasant’s operational use. See Note 13 Subsequent Events for further information. The net book value of the land to be purchased is \$33,991 and was reclassified to a property held for sale

during the fourth quarter of 2010.

Formerly Owned and Vacant Park Forest, IL Property

The Partnership had been unsuccessful in finding a new tenant for the vacant Park Forest property, and on December 31, 2009, the carrying value of this property had been written down to \$0. The property was then sold to an unaffiliated party in December of 2010 for a gross sales price of \$7,000.

Discontinued Operations

During the fiscal years ended December 31, 2011, 2010 and 2009, the Partnership recognized (loss) income from discontinued operations of approximately \$(478,000), \$55,000 and \$81,000, respectively. The 2011, 2010 and 2009 (loss) income from discontinued operations was attributable to the third quarter of 2011 reclassifications of the vacant Phoenix, AZ property and the Denny's, Phoenix, AZ property to properties held for sale upon the execution of Agency and Marketing Agreement with an unaffiliated party in September of 2011 to sell both of the properties. The 2011 loss from discontinued operations includes the fiscal year 2011 property impairment write downs of \$390,117 related to the vacant Phoenix, AZ property and \$104,705 related to the Denny's, Phoenix, AZ property, and the 2011 loss of approximately \$1,000 on the fourth quarter of 2011 sale of the Denny's, Phoenix, AZ property. The 2010 and 2009 income from discontinued operations was attributable to the fourth Quarter of 2010 reclassification of a small strip of the Wendy's- Mt. Pleasant land to a property held for sale due to the pending eminent domain acquisition of the land by the County of Charleston for Right of Way for planned road improvements and the third quarter of 2010 reclassification of the vacant Park Forest property to a property held for sale upon the execution of the Agency and Marketing Agreement in August. The 2010 income from discontinued operations includes the fourth quarter net gain of approximately \$7,000 on the sale of the Park Forest property. The 2009 income from discontinued operations was also attributable to the third quarter of 2009 reclassification of the Panda Buffet property to a property held for sale (executed sales contract dated September 30, 2009). The 2009 income from discontinued operations includes the \$50,000 fourth quarter property impairment write down of the vacant Park Forest, IL property, the fourth quarter net gain of approximately \$29,000 on the sale of the Panda Buffet property, and the second quarter revenue collection of a \$12,500 sales escrow deposit in relation to the termination of the Denny's property sales contract dated February 22, 2008.

The components of property held for sale in the balance sheets as of December 31, 2011 and 2010 are outlined below:

	December 31, <u>2011</u>	December 31, <u>2010</u>
Balance Sheet:		
Land	\$157,360	\$33,991
Buildings, net	26,631	0
Rents and other receivables	686	0
Utilities security deposit	9,260	
Prepaid insurance	1,593	0
Accounts payable and accrued expenses	(2,295)	0
Property tax payable	(7,571)	<u>0</u>
Properties held for sale	<u>\$185,664</u>	<u>\$33,991</u>

The components of discontinued operations included in the statements of income for the years ended December 31, 2011, 2010 and 2009 are outlined below:

	December 31, <u>2011</u>	December 31, <u>2010</u>	December 31, <u>2009</u>
Revenues			
Rental Income	\$70,417	\$106,510	\$166,255
Other Income	<u>1,204</u>	<u>0</u>	<u>12,500</u>
Total Revenues	<u>71,621</u>	<u>106,510</u>	<u>178,755</u>
Expenses			
Insurance	1,183	505	0
General and Administrative	659	946	919
Professional services	3,632	14,486	11,230
Write-off of uncollectible Receivables	0	0	2,013
Property tax expense	9,985	5,035	13,056
Maintenance expense	10,012	4,162	1,376
Property impairment write-downs	494,822	0	50,000
Depreciation	14,361	22,946	35,912
Amortization	10,380	6,990	8,660
Other expenses	<u>3,850</u>	<u>3,506</u>	<u>3,267</u>
Total Expenses	<u>548,884</u>	<u>58,576</u>	<u>126,433</u>
Net Loss (Income) from Rental Operations	\$(477,263)	\$47,934	<u>\$52,322</u>
Net (Loss) Gain on Sale of Properties	<u>(1,227)</u>	<u>6,562</u>	<u>28,604</u>
Net (Loss) Income from Discontinued Operations	<u>\$(478,490)</u>	<u>\$54,496</u>	<u>\$80,926</u>

#### **4. PARTNERSHIP AGREEMENT:**

The Amended Agreement of Limited Partnership was amended, effective as of November 9, 2009, to extend the term of the Partnership to November 30, 2020, or until dissolution prior thereto pursuant to the consent of the majority of the outstanding Units. The Second Amendment to the Partnership Agreement was filed as Exhibit 4.1 to the Partnership Quarterly Report on Form 10-Q filed November 12, 2009.

The Partnership Agreement, prior to an amendment effective May 26, 1993, provided that, for financial reporting and income tax purposes, net profits or losses from operations were allocated 90% to the Limited Partners and 10% to the general partners. The Partnership Agreement also provided for quarterly cash distributions from Net Cash Receipts, as defined, within 60 days after the last day of the first full calendar quarter following the date of release of the subscription funds from escrow, and each calendar quarter thereafter, in which such funds were available for distribution with respect to such quarter. Such distributions were to be made 90% to Limited Partners and 10% to the former general partners, provided, however, that quarterly distributions were to be cumulative and were not to be made to the former general partners unless and until each Limited Partner had received a distribution from Net Cash Receipts in an amount equal to 10% per annum, cumulative simple return on his or her Adjusted Original Capital, as defined, from the Return Calculation Date, as defined.

Net Proceeds, as originally defined, were to be distributed as follows: (a) to the Limited Partners, an amount equal to 100% of their Adjusted Original Capital; (b) then, to the Limited Partners, an amount necessary to provide each Limited Partner a Liquidation Preference equal to a 13.5% per annum, cumulative simple return on Adjusted Original Capital from the Return Calculation date including in the calculation of such return all prior distributions of Net Cash Receipts and any prior distributions of Net Proceeds under this clause; and (c) then, to Limited Partners, 90% and to the General Partners, 10%, of the remaining Net Proceeds available for distribution.

On May 26, 1993, pursuant to the results of a solicitation of written consents from the Limited Partners, the Partnership Agreement was amended to replace the former general partners and amend various sections of the agreement. The former general partners were replaced as General Partner by The Provo Group, Inc., an Illinois corporation. Under the terms of the amendment, net profits or losses from operations are allocated 99% to the Limited Partners and 1% to the current General Partner. The amendment also provided for distributions from Net Cash Receipts to be made 99% to Limited Partners and 1% to the current General Partner, provided that quarterly distributions are cumulative and are not to be made to the current General Partner unless and until each Limited Partner has received a distribution from Net Cash Receipts in an amount equal to 10% per annum, cumulative simple return on his or her Adjusted Original Capital, as defined, from the Return Calculation Date, as defined, except to the extent needed by the General Partner to pay its federal and state income taxes on the income allocated to it attributable to such year.

The provisions regarding distribution of Net Proceeds, as defined, were also amended to provide that Net Proceeds are to be distributed as follows: (a) to the Limited Partners, an amount equal to 100% of their Adjusted Original Capital; (b) then, to the Limited Partners, an amount necessary to provide each Limited Partner a Liquidation Preference equal to a 13.5% per annum, cumulative simple return on Adjusted Original Capital from the Return Calculation Date including in the calculation of such return on all prior distributions of Net Cash Receipts and any prior distributions of Net Proceeds under this clause, except to the extent needed by the General Partner to pay its federal and state income tax on the income allocated to it attributable to such year; and (c) then, to Limited Partners, 99%, and to the General Partner, 1%, of remaining Net Proceeds available for distribution.

Additionally, per the amendment of the Partnership Agreement dated May 26, 1993, the total compensation paid to all persons for the sale of the investment properties is limited to commissions customarily charged by other brokers in arm's-length sales transactions involving comparable properties in the same geographic area, not to exceed six percent of the contract price for the sale of the property. The General Partner may receive up to one-half of the competitive real estate commission, not to exceed three percent, provided that the General Partner provides a substantial amount of services in the sales effort. It is further provided that a portion of the amount of such fees payable to the General Partner is subordinated to its success in recovering the funds misappropriated by the former general partners. See Note 6 for further information.

Effective June 1, 1993, the Partnership Agreement was amended to (i) change the definition of "Distribution Quarter" to be consistent with calendar quarters, and (ii) change the distribution provisions to subordinate the General Partner's share of distributions from Net Cash Receipts and Net Proceeds, except to the extent necessary for the General Partner to pay its federal and state income taxes on Partnership income allocated to the General Partner. Because these amendments do not adversely affect the rights of the Limited Partners, pursuant to section 10.2 of the Partnership Agreement, the General Partner made the amendments without a vote of the Limited Partners.

## **5. LEASES:**

Original lease terms for the majority of the Properties were generally five to twenty years from their inception. The leases generally provide for minimum rents and additional rents based upon percentages of gross sales in excess of specified breakpoints. The lessee is responsible for occupancy costs such as maintenance, insurance, real estate taxes, and utilities. Accordingly, these amounts are not reflected in the statements of income except in circumstances where, in Management's opinion, the Partnership will be required to pay such costs to preserve its assets (i.e., payment of past-due real estate taxes). Management has determined that the leases are properly classified as operating leases; therefore, rental income is reported when earned on a straight-line basis and the cost of the property, excluding the cost of the land, is depreciated over its estimated useful life.

As of December 31, 2011, the aggregate minimum operating lease payments to be received under the current operating leases for the Partnership's Properties are as follows:

Year ending December 31,	
2012	\$1,005,830
2013	892,500
2014	856,500
2015	826,500
2016	813,882
Thereafter	<u>3,399,543</u>
	<u>7,794,755</u>

Operating percentage rents included in operating rental income in 2011, 2010, and 2009 were approximately \$431,000, \$398,000, and \$399,000, respectively. At December 31, 2011, rents and other receivables included \$429,000 of unbilled operating percentage rents. As of December 31, 2011, the \$47,000 in 2011 percentage rents included in discontinued operating rental income had been billed and collected from the Denny's, Phoenix, AZ "(Denny's) property. At December 31, 2010, rents and other receivables included \$35,000 of billed (included in 2010 discontinued operating rental income) and \$404,000 of unbilled operating percentage rents. As of December 31, 2011, all of the 2010 percentage rents had been billed and collected.

At December 31, 2011, six of the Properties are leased to Wendgusta, two of the Properties are leased to Wendcharles I, and one of the properties is leased to Wendcharles II. The three tenants operating base rents have accounted for approximately 53%, 21% and 1%, respectively, of the total 2011 operating base rents.

## **6. TRANSACTIONS WITH GENERAL PARTNER AND ITS AFFILIATES:**

Pursuant to the terms of the Permanent Manager Agreement ("PMA") executed in 1993 and renewed for an additional two year term as of January 1, 2011, the General Partner receives a Base Fee for managing the Partnership equal to four percent of gross receipts, subject to an initial annual minimum amount of \$159,000. The PMA also provides that the Partnership is responsible for reimbursement of the General Partner for office rent and related office overhead ("Expenses") up to an initial annual maximum of \$13,250. Both the Base Fee and Expense reimbursement are subject to annual Consumer Price Index based adjustments. Effective March 1, 2011, the minimum annual Base Fee and the maximum Expense reimbursement increased by 1.64% from the prior year, which represents the allowable annual Consumer Price Index adjustment per the PMA. Therefore, as of March 1, 2011, the minimum monthly Base Fee paid by the Partnership was raised to \$20,492 and the maximum monthly Expense reimbursement was increased to \$1,653.

For purposes of computing the four percent overall fees, gross receipts include amounts recovered in connection with the misappropriation of assets by the former general partners and their affiliates. To date, TPG has received fees from the Partnership totaling \$59,689 on the amounts recovered, which includes restoration fees received for 2011, 2010 and 2009 of \$299, \$497 and \$459, respectively. The fees received from the Partnership on the amounts recovered reduce the four percent minimum fee by that same amount.

Amounts paid and/or accrued to the General Partner and its affiliates for the years ended December 31, 2011, 2010, and 2009, are as follows:

<u>General Partner</u>	Incurred for the Year ended December 31, <u>2011</u>	Incurred for the Year ended December 31, <u>2010</u>	Incurred for the Year ended December 31, <u>2009</u>
Management fees	\$244,943	\$241,579	\$240,841
Restoration fees	299	497	459
Overhead allowance	19,782	19,524	19,464
Advisory fee on sale	14,250	0	13,500
Leasing commissions	5,346	0	21,060
Reimbursement for out-of-pocket expenses	5,822	5,273	5,210
Cash distribution	<u>3,081</u>	<u>3,260</u>	<u>3,290</u>
	<u>\$293,523</u>	<u>\$270,133</u>	<u>\$303,824</u>

At December 31, 2011 and 2010, \$1,757 and \$1,825, respectively, was payable to the General Partner, which primarily represented the applicable year's fourth quarter distribution.

Due to the Denny's lease modifications, approximately \$1,200 of the \$4,000 lease commission paid in 2009 to the General Partner was reimbursed to the Partnership in May of 2011 and is included in other income from discontinued operations in the condensed statements of income.

As of December 31, 2011, TPG Finance Corp. owned 200 limited partnership interests of the Partnership. The President of the General Partner, Bruce A. Provo, is also the President of TPG Finance Corp., but he is not a shareholder of TPG Finance Corp.

## **7. TRANSACTIONS WITH OWNERS WITH GREATER THAN TEN PERCENT BENEFICIAL INTERESTS:**

As of December 31, 2011, Advisory Board Member, Jesse Small, owns beneficially greater than ten percent of the Partnership's Units. As of December 31, 2011, Advisory Board Member, Jesse Small, is a greater than ten percent beneficial unit holder. Amounts paid to Mr. Small for the fiscal years ended December 31, 2011, 2010, and 2009 are as follows:

	Incurred for the Year ended December 31, <u>2011</u>	Incurred for the Year ended December 31, <u>2010</u>	Incurred for the Year ended December 31, <u>2009</u>
Advisory Board Fees paid	<u>\$3,500</u>	<u>\$3,500</u>	<u>\$3,000</u>
	<u>\$3,500</u>	<u>\$3,500</u>	<u>\$3,000</u>

At December 31, 2011 and 2010, there were no outstanding Advisory Board Fees accrued and payable to Jesse Small.

## **8. CONTINGENT LIABILITIES:**

According to the Partnership Agreement, as amended, TPG, as General Partner, may receive a disposition fee not to exceed three percent of the contract price on the sale of the three original Partnerships' properties (See Note 2 for further information as to the original partnerships). In addition, fifty percent of all such disposition fees earned by TPG were to be escrowed until the aggregate amount of recovery of the funds misappropriated from the Partnerships by the former general partners was greater than \$4,500,000. Upon reaching such recovery level, full disposition fees would thereafter be payable and fifty percent of the previously escrowed amounts would be paid to TPG. At such time as the recovery exceeded \$6,000,000 in the aggregate, the remaining escrowed disposition fees were to be paid to TPG. If such levels of recovery were not achieved, TPG would contribute the amounts escrowed toward the recovery until the Partnership's were made whole. In lieu of a disposition fee escrow, the fifty percent of all such disposition fees previously discussed were paid directly to a restoration account and then distributed among the three original Partnerships; whereby the Partnerships recorded the recoveries as income (Note 2). After the recovery level of \$4,500,000 was exceeded, fifty percent of the total disposition fee amount paid to the Partnerships recovery through the restoration account (in lieu of the disposition fee escrow) was refunded to TPG during March 1996. The remaining fifty percent amount allocated to the Partnership through the restoration account, and which was previously reflected as Partnership recovery income, may be owed to TPG if the \$6,000,000 recovery level is met. As of December 31, 2011, the Partnership may owe TPG \$16,296 if the \$6,000,000 recovery level is achieved. TPG does not expect any future refund, as it is uncertain that such a \$6,000,000 recovery level will be achieved.

## **9. PMA INDEMNIFICATION TRUST:**

The PMA provides that TPG will be indemnified from any claims or expenses arising out of or relating to TPG serving in such capacity or as substitute general partner, so long as such claims do not arise from fraudulent or criminal misconduct by TPG. The PMA provides that the Partnership fund this indemnification obligation by establishing a reserve of up to \$250,000 of Partnership assets which would not be subject to the claims of the Partnership's creditors. An Indemnification Trust ("Trust") serving such purposes has been established at United Missouri Bank, N.A. The corpus of the Trust has been fully funded with Partnership assets. Funds are invested in U.S. Treasury securities. In addition, \$201,961 of earnings has been credited to the Trust as of December 31, 2011. The rights of TPG to the Trust will be terminated upon the earliest to occur of the following events: (i) the written release by TPG of any and all interest in the Trust; (ii) the expiration of the longest statute of limitations relating to a potential claim which might be brought against TPG and which is subject to indemnification; or (iii) a determination by a court of competent jurisdiction that TPG shall have no liability to any person with respect to a claim which is subject to indemnification under the PMA. At such time as the indemnity provisions expire or

the full indemnity is paid, any funds remaining in the Trust will revert back to the general funds of the Partnership.

#### **10. FORMER GENERAL PARTNERS' CAPITAL ACCOUNTS:**

The capital account balance of the former general partners as of May 26, 1993, the date of their removal as general partners pursuant to the results of a solicitation of written consents from the Limited Partners, was a deficit of \$840,229. At December 31, 1993, the former general partners' deficit capital account balance in the amount of \$840,229 was reallocated to the Limited Partners.

#### **11. NOTE RECEIVABLE:**

A sales contract was executed on September 30, 2009 for the installment sale of the Panda Buffet property to the tenant for \$520,000 (sales amount was to be reduced to \$450,000 if closing occurred on or before November 15, 2009). The closing date on the sale of the Property was November 12, 2009 at a sales price of \$450,000. The buyer paid \$150,000 at closing with the remaining balance of \$300,000 being delivered in the form of a promissory note ("Buyers Note") to the Partnership. A net gain on the sale of approximately \$29,000 was recognized in the Fourth Quarter of 2009. The Buyers Note reflects a term of three years, an interest rate of 7.25%, and principal and interest payments paid monthly and principal amortized over a period of ten years beginning December 1, 2009 with a balloon payment due November 1, 2012. Pursuant to the Buyers Note, there will be no penalty for early payment of principal. Buyers Note also requires the buyer to escrow property taxes with the Partnership beginning January of 2010 at \$1,050 per month (lowered to \$900 beginning February 1, 2011 and then \$700 per month beginning January 1, 2012). The property tax escrow cash balance held by the Partnership amounted to \$2,000 at December 31, 2011, and is included in the property tax payable in the condensed balance sheets

Per the Buyer's Note amortization schedule, the monthly payments are to total approximately \$3,522 per month. The first payment was received by the Partnership on November 30, 2009 and included \$2,374 in principal and \$1,148 in interest. During the fiscal year ended December 31, 2011, twelve note payments were received by the Partnership and totaled \$22,991 in principal and \$19,273 in interest.

The eleven aggregate amortized principal payments yet to be received under the Buyers Note for the next year are as follows:

Year ending December 31, 2012 (eleven months of payments)	<u>\$253,247</u>
	<u>\$253,247</u>

#### **12. FAIR VALUE DISCLOSURES**

The Partnership has determined the fair value based on hierarchy that gives the highest priority to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy under the accounting principle are described below:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Quoted prices for similar investments in active markets, quoted prices for identical or similar investments in markets that are not active, and inputs other than quoted prices that are observable for the investment.

Level 3. Unobservable inputs for which there is little, if any, market activity for the investment. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation and the use of discounted cash flow models to value the investment.

The fair value hierarchy is based on the lowest level of input that is significant to the fair value measurements. The Partnership's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

The Partnership assesses the levels of the Investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Partnership's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. For the years ended December 31, 2011 and 2010, there were no such transfers.

Fair Value on a Nonrecurring Basis- Vacant and formerly owned Denny's, Phoenix, AZ Properties

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the fair valuation hierarchy (as described above) as of December 31, 2011, for which a nonrecurring change in fair values were recorded during the fiscal year 2011 for the formerly owned Denny's, Phoenix, AZ property (sold on November 23, 2011) and the vacant Phoenix, AZ property.

	<u>Carrying Value at December 31, 2011</u>				<u>Incurred for the</u> <u>Year Ended</u> <u>December 31,</u> <u>2011</u> <u>Total Losses</u>	<u>Incurred for the</u> <u>Year Ended</u> <u>December 31,</u> <u>2010</u> <u>Total Losses</u>
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>		
Formerly owned Denny's, Phoenix, AZ property	\$ -	\$ -	\$ -	\$ -	\$(104,705)	\$ -
Vacant Phoenix, AZ Property	<u>150,000</u>	<u>-</u>	<u>-</u>	<u>150,000</u>	<u>(390,117)</u>	<u>-</u>
Total properties	<u>\$150,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$150,000</u>	<u>\$(494,822)</u>	<u>\$ 0</u>

Investment property measured at fair value on a nonrecurring basis relates to land, building and improvements that were held for investment or held for sale. Losses of \$494,822 represent property impairment charges related to the vacant Phoenix, AZ property and the formerly owned Denny's, Phoenix, AZ property recorded during the fiscal year 2011. The fair value of these assets was determined by Management and incorporates Management's knowledge of comparable properties, past experience and future expectations.

There was no fair value adjustment in the fiscal year ended December 31, 2010. For the fiscal year ended December 31, 2009, total losses of \$50,000 represent an impairment charge related to the Park Forest property recorded in 2009.

### **13. SUBSEQUENT EVENTS**

#### **Vacant Phoenix, AZ Property**

A contract (“Contract”) to sell the vacant Phoenix, AZ property to an unaffiliated party was executed on February 14, 2012 for the sale price of \$325,000. The potential buyer provided an earnest money deposit of \$25,000, which is held by an independent escrow company. Per the Contract, closing is anticipated to occur prior to and up to 210 days out from the contract execution date. Closing costs are estimated to be approximately \$30,000, which includes commissions totaling approximately \$23,000 in the aggregate, which are anticipated to be paid to two unaffiliated brokers. The net book value of the vacant, Phoenix, AZ property at December 31, 2011, classified as property held for sale in the condensed financial statements, was approximately \$151,700, which included \$123,369 related to land, \$26,631 related to building, net of accumulated depreciation, \$9,300 related to a utilities security deposit, \$700 related to rents and other receivables, \$1,600 related to prepaid insurance, \$2,300 related to accounts payable and accrued expenses and \$7,600 related to property tax payable.

The \$325,000 sales contract has various due diligence and feasibility periods, as well as additional extensions and Management has no measure of certainty that the Contract will close or if a specific and unique re-use of the now vacant property will materialize. Therefore, the \$150,000 net book value for the vacant property at December 31, 2011, is its estimated fair value based on income capitalization calculations using historical capitalization rates (used by Management in relation to the property for annual Partnership Net Unit Valuations) applied to independently identified market rents, less known re-leasing costs such as estimated roof, parking lot and miscellaneous repairs, as well as leasing commissions. The estimated fair value is not necessarily what the Partnership will settle (sales price net of closing costs), within an actual arms length sales transaction of the vacant property.

#### **Limited Partner Distributions**

On February 15, 2012, the Partnership made distributions to the Limited Partners of \$640,000, which amounted to \$13.83 per Interest.

## **Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

### **Item 9A. Control and Procedures**

#### Controls and Procedures

As of December 31, 2011, the Partnership's Management, and the Partnership's principal executive officer and principal financial officer have concluded that the Partnership's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report were effective based on the evaluation of these controls and procedures as required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Securities Exchange Act of 1934, as amended.

#### Management's Report on Internal Control over Financial Reporting

The Partnership's Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). The Partnership's Management assessed the effectiveness of the internal control over financial reporting as of December 31, 2011. In making this assessment, the Partnership's management used the criteria set forth by the Securities and Exchange Commission in Release No. 34-47986 and the interpretive guidance issued thereunder (as permitted in Rules 13a-15(c) and 15d-15(c) under the Securities Exchange Act of 1934, as amended). The Partnership's management has concluded that, as of December 31, 2011, the internal control over financial reporting is effective based on these criteria. Further, there were no changes in the Partnership's controls over financial reporting during the year ended December 31, 2011, that have materially affected, or are reasonably likely to materially affect, the Partnership's internal controls over financial reporting.

The Partnership's Management, does not expect that the disclosure controls and procedures of the internal controls will prevent all error and misstatements. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

This Form 10-K does not include an attestation report of the Partnership's registered public accounting firm regarding internal control over financial reporting. As a non-accelerated filer, Management's report was not subject to attestation by the Partnership's registered public accounting firm pursuant to in the Dodd Frank Act that permit the Partnership to provide only management's report in this Annual Report.

### **Item 9B. Other Information**

None.

## PART III

### **Item 10. Directors and Executive Officers of the Registrant**

The Partnership does not have any employees, executive officers, or directors and therefore no board committees.

TPG is an Illinois corporation with its principal office at 1100 Main Street, Suite 1830, in Kansas City, Missouri 64105. TPG was elected General Partner by vote of the Limited Partners effective on May 26, 1993. Prior to such date, TPG had been managing the Partnership since February 8, 1993, under the terms of the Permanent Manager Agreement as amended ("PMA"), which remains in effect. See Items 1 and 13 hereof for additional information about the PMA and the election of TPG as General Partner.

The executive officer and director of the General Partner who controls the affairs of the Partnership is as follows:

***Bruce A. Provo, Age 61 - President, Founder and Director, TPG.***

Mr. Provo has been involved in the management of real estate and other asset portfolios since 1979. TPG was founded by Mr. Provo in 1985 and he has served as its President since its formation. TPG's focus has been to provide professional real estate services to outside clients. Since the founding of TPG in 1985, Mr. Provo has also founded various entities engaged in unique businesses such as Rescue Services, Owner Representation, Asset Management, Managed Financial and Accounting Systems, Investments, and Virtual Resort Services. The entities are generally grouped under an informal umbrella known as The Provo Group of Companies. Since TPG was appointed General Partner to the Partnership in 1993, Mr. Provo has been primarily responsible for making management, leasing and disposition decisions on behalf of the Partnership.

From 1982 to 1986, Mr. Provo also served as President and Chief Operating Officer of the North Kansas City Development Company ("NKCDC"), North Kansas City, Missouri. NKCDC was founded in 1903 and the assets of the company were sold in December 1985 for \$102,500,000. NKCDC owned commercial and industrial properties, including an office park and a retail district, as well as apartment complexes, motels, recreational facilities, fast food restaurants, and other properties. NKCDC's holdings consisted of over 100 separate properties and constituted approximately 20% of the privately held real property in North Kansas City, Missouri (a four square mile municipality). Following the sale of the company's real estate, Mr. Provo served as the President, Chief Executive Officer and Liquidating Trustee of NKCDC from 1986 to 1991.

Mr. Provo graduated from Miami University, Oxford, Ohio in 1972 with a B.S. in Accounting. He became a Certified Public Accountant in 1974 and was a manager in the banking and financial services division of Arthur Andersen LLP prior to joining Rubloff Development Corporation in 1979. From 1979 through 1985, Mr. Provo served as Vice President - Finance and then as President of Rubloff Development Corporation.

The Advisory Board, although its members are not "Directors" or "Executive Officers" of the Partnership, provides advisory guidance to Management of the Partnership and consists of:

**William Arnold - Investment Broker.** Mr. Arnold works as a financial planner, real estate broker, and investment advisor at his company, Arnold & Company. Mr. Arnold graduated with a Master's Degree from the University of Wisconsin and is a Certified Financial Planner. He serves as a board representative for the brokerage community.

**Jesse Small – CPA.** Mr. Small has been a tax and business consultant in Hallandale, FL for more than 30 years. Mr. Small has a Master's Degree in Economics. Mr. Small is a Limited Partner representing the Partnership's Partners. During the past five years after retiring from the accounting profession, Mr. Small has been developing property on the east and west coast of Florida.

**Albert Kramer - Retired.** Mr. Kramer is now retired, but previously worked as Tax Litigation Manager for Phillips Petroleum Company, now known as ConocoPhillips. His education includes undergraduate and MBA degrees from Harvard and a J.D. Degree from South Texas College of Law. Mr. Kramer is a Limited Partner representing the Partnership's Partners.

### **Code of Ethics**

The Partnership has no executive officers or any employees and, accordingly, has not adopted a formal code of ethics.

Mr. Provo and TPG require that all personnel, including all employees, officers and directors: engage in honest and ethical conduct; ensure full, fair, accurate, timely and understandable disclosure; comply with all applicable governmental laws, rules and regulations; and report to Mr. Provo any deviation from these principles. Because TPG has two employees (including Mr. Provo), and because Mr. Provo is the ultimate decision maker in all instances, TPG has not adopted a formal code of ethics. Mr. Provo, as Chief Executive Officer and Chairman of the Board of Directors of TPG, mitigates and resolves all conflicts to the best of his ability and determines appropriate actions if necessary to deter violations and promote accountability, consistent with his fiduciary obligations to TPG and the fiduciary obligations of TPG to the Partnership.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the officers and directors of TPG, and persons who own 10% or more of the Partnership Interests, to report their beneficial ownership of such Interests in the Partnership to the SEC. Their initial reports are required to be filed using the SEC's Form 3, and they are required to report subsequent purchases, sales, and other changes using the SEC's Form 4, which must be filed within two business days of most transactions. Officers, directors, and persons owning more than 10% of the Partnership Interests are required by SEC regulations to furnish the Partnership with copies of all of reports they file pursuant to Section 16(a).

As of December 31, 2011, Jesse Small was a beneficial owner of more than 10% of the Partnership Interests. Six outsider Form 4's, which included 16 transactions with respect to 2011, were filed late by Jesse Small in 2011 and 2012, An outsider Form 3, due in April 2010, was filed late in June 2010 by Jesse Small.

### **Item 11. Executive Compensation**

The Partnership has not paid any "executive compensation" to the corporate General Partner or to the directors and officers of the General Partner. The General Partner's participation in the income of the Partnership is set forth in the Partnership Agreement, which is filed as Exhibits 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6 hereto. The General Partner received management fees and expense reimbursements during the year.

See Item 13, below, and Note 6 to the Financial Statements in Item 8 hereof for further discussion of payments by the Partnership to the General Partner and the former general partners. The principal executive officer is not directly compensated by the Partnership for controlling the affairs of the Partnership.

## Item 12. Security Ownership of Certain Beneficial Owners and Management

(a) The following table sets forth certain information with respect to such beneficial ownership as of December 31, 2011. Based on information known to the Partnership and filed with the SEC, the following person is known to beneficially own 5% or more of the outstanding Interests as follows:

<u>Title of Class</u>	<u>Name and Address of Beneficial Owner</u>	<u>Interests Beneficially Owned(2)</u>	<u>Percentage of Interests Outstanding(1)</u>
Limited Partnership Interests	Jesse Small (3) 401 NW 10 <sup>th</sup> Terrace Hallandale, FL 33009	5,780.59	12.49%

- (1) Based on 46,280.3 Limited Partnership Interests outstanding as of December 31, 2011.
- (2) Based on Form 4's filed with the SEC in March of 2012.
- (3) Jesse Small may be deemed to beneficially own with such voting and investment power the Interests listed in the table above.

(b) As of December 31, 2011, the General Partner did not own any Limited Partnership Interests in the Partnership. The following chart identifies the security ownership of the Partnership's principal executive officer and principal financial officer as the sole named executive officer:

<u>Title of Class</u>	<u>Name of Beneficial Owner(1)</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percentage of Interests Outstanding(4)</u>
Limited Partnership Interest	Bruce A. Provo	200 (2)(3)	0.43%

- (1) A beneficial owner of a security includes a person who, directly or indirectly, has or shares voting or investment power with respect to such security. Voting power is the power to vote or direct the voting of the security and investment power is the power to dispose or direct the disposition of the security.
- (2) Bruce A. Provo is deemed to have beneficial ownership of all of TPG Finance Corp.'s Limited Partnership interests in the Partnership due to his control as President of TPG Finance Corp.
- (3) Bruce A. Provo may be deemed to beneficially own with such voting and investment power the Interests listed above.
- (4) Based on 46,280.3 Limited Partnership Interests outstanding as of December 31, 2011.

(c) Management knows of no contractual arrangements, the operation or the terms of which may at a subsequent date result in a change in control of the Partnership, except for provisions in the Permanent Manager Agreement ("PMA"). See Item 13 below for further information.

### **Item 13. Certain Relationships and Related Transactions**

Pursuant to the terms of the PMA, the General Partner receives a Base Fee for managing the Partnership equal to four percent of gross receipts, subject to a \$159,000 minimum annually. The PMA also provides that the Partnership is responsible for reimbursement for office rent and related office overhead (“Expenses”) up to a maximum of \$13,250 annually. Both the Base Fee and Expense reimbursement are subject to annual Consumer Price Index based adjustments. Effective March 1, 2011, the minimum annual Base Fee and the maximum Expense reimbursement increased by 1.64% from the prior year, which represents the allowable annual Consumer Price Index adjustment per the PMA. Therefore, as of March 1, 2011, the minimum monthly Base Fee paid by the Partnership was raised to \$20,492 and the maximum monthly Expense reimbursement was raised to \$1,653.

Additionally, TPG, or their affiliates, are allowed up to one-half of the commissions customarily charged by other brokers in arm’s-length sales transactions involving comparable properties in the same geographic area, but such TPG commissions are not to exceed three percent of the contract price on the sale of an investment property. The payment of a portion of such fees is subordinated to TPG’s success at recovering the funds misappropriated by the former general partners. See Note 8 to the financial statements for further information.

The PMA had an original expiration date of December 31, 2002. At the end of the original term, it was extended three years by TPG to an expiration date of December 31, 2005, an additional three years to an expiration date of December 31, 2008, and then an additional two years to an expiration date of December 31, 2010. Effective January 1, 2011, the PMA was renewed by TPG for the two-year period ending December 31, 2012. The PMA can be terminated earlier (a) by a vote at any time by a majority in interest of the Limited Partners, (b) upon the dissolution and winding up of the Partnership, (c) upon the entry of an order of a court finding that TPG has engaged in fraud or other like misconduct or has shown itself to be incompetent in carrying out its duties under the Partnership Agreement, or (d) upon sixty (60) days written notice from TPG to the Limited Partners of the Partnership. Upon termination of the PMA, other than by the voluntary action of TPG, TPG shall be paid a termination fee of one month’s Base Fee allocable to the Partnership, subject to a minimum of \$13,250. In the event that TPG is terminated by action of a substitute general partner, TPG shall also receive, as part of this termination fee, 4% of any proceeds recovered with respect to the obligations of the former general partners, whenever such proceeds are collected.

Under the PMA, TPG shall be indemnified by the Partnership, DiVall and Magnuson, and their controlled affiliates, and shall be held harmless from all claims of any party to the Partnership Agreement and from any third party including, without limitation, the Limited Partners of the Partnership, for any and all liabilities, damages, costs and expenses, including reasonable attorneys’ fees, arising from or related to claims relating to or arising from the PMA or its status as Permanent Manager. The indemnification does not extend to claims arising from fraud or criminal misconduct of TPG as established by court findings. To the extent possible, the Partnership is to provide TPG with appropriate errors and omissions, officer’s liability or similar insurance coverage, at no cost to TPG. In addition, TPG was granted the right to establish an Indemnification Trust in an original amount, not to exceed \$250,000, solely for the purpose of funding such indemnification obligations. Once a determination has been made that no such claims can or will be made against TPG, the balance of the Trust will become unrestricted property of the Partnership. The corpus of the Trust has been fully funded with Partnership assets.

The Partnership paid and/or accrued the following to Management and its affiliates in 2011 and 2010:

The Provo Group, Inc.:

	Incurred for the Year ended December 31, <u>2011</u>	Incurred for the Year ended December 31, <u>2010</u>
Management fees	\$244,943	\$241,579
Restoration fees	299	497
Overhead allowance	19,782	19,524
Advisory Fee on Sale	14,250	0
Leasing commissions	5,346	0
Direct Cost Reimbursement	5,822	5,273
Cash Distributions	<u>3,081</u>	<u>3,290</u>
	<u>\$293,523</u>	<u>\$270,133</u>

#### **Item 14. Principal Accounting Firm Fees and Services**

##### Audit Fees

Aggregate billings during the years 2011 and 2010 for audit and interim review services provided by the Partnership's principal accounting firm, McGladrey & Pullen, LLP ("M&P"), to the Partnership, amounted to \$68,772 and \$62,103, respectively.

##### Audit-Related Fees

For the years ended December 31, 2011 and 2010, M&P did not perform any assurance and related services that were reasonably related to the performance of the audit or interim reviews.

##### Tax Fees

Tax compliance services billed during 2011 and 2010 were \$26,000 and \$25,100, respectively. Through November of 2011, tax services were provided by RSM McGladrey, Inc., which operated under an alternative practice structure with M&P. Subsequent to November of 2011, tax compliance services are provided by M&P.

##### All Other Fees

For the years ended December 31, 2011 and 2010, M&P did not perform any management consulting or other services for the Partnership.

For the years December 31, 2011 and 2010, RSM, did not perform any management consulting or other services for the Partnership.

## PART IV

### Item 15. Exhibits and Financial Statement Schedule

(a) 1. Financial Statements

The following financial statements of DiVall Insured Income Properties 2 Limited Partnership are included in Part II, Item 8 of this annual report on Form 10-K:

Report of Independent Registered Public Accounting Firm

Independent Auditors' Report

Balance Sheets, December 31, 2011 and 2010

Statements of Income for the Years Ended December 31, 2011, 2010, and 2009

Statements of Partners' Capital for the Years Ended December 31, 2011, 2010, and 2009

Statements of Cash Flows for the Years Ended December 31, 2011, 2010, and 2009

Notes to Financial Statements

2. Financial Statement Schedule

Schedule III – Investment Properties and Accumulated Depreciation, December 31, 2011

All other schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission are not required under the related instruction or are inapplicable and, therefore, have been omitted.

3. Listing of Exhibits

4.1 Agreement of Limited Partnership dated as of November 20, 1987, amended as of November 25, 1987, and February 20, 1988, filed as Exhibit 3A to Amendment No. 1 to the Partnership's Registration Statement on Form S-11 as filed on February 22, 1988, and incorporated herein by reference.

4.2 Amendments to Amended Agreement of Limited Partnership dated as of June 21, 1988, included as part of Supplement dated August 15, 1988, filed under Rule 424(b)(3), incorporated herein by reference.

4.3 Amendment to Amended Agreement of Limited Partnership dated as of February 8, 1993, filed as Exhibit 3.3 to the Partnership's 10-K for the year ended December 31, 1992, Commission File 0-17686, and incorporated herein by reference.

4.4 Amendment to Amended Agreement of Limited Partnership dated as of May 26, 1993, filed as Exhibit 3.4 to the Partnership's 10-K for the year ended

December 31, 1993, Commission File 0-17686, and incorporated herein by reference.

- 4.5 Amendment to Amended Agreement of Limited Partnership dated as of June 30, 1994, filed as Exhibit 3.5 to the Partnership's 10-K for the year ended December 31, 1994, Commission File 0-17686, and incorporated herein by reference.
- 4.6 Amendment to Amended Agreement of Limited Partnership dated as of November 9, 2009, filed as Exhibit 4.1 to the Partnership Quarterly Report on Form 10-Q filed November 12, 2009, Commission File 0-17686, and incorporated herein by reference.
- 4.7 Certificate of Limited Partnership dated November 20, 1987.
- 10.0 Permanent Manager Agreement filed as an exhibit to the Current Report on Form 8-K dated January 22, 1993, Commission File 33-18794, and incorporated herein by reference.
- 31.1 Sarbanes Oxley Section 302 Certifications.
- 32.1 Certification of Periodic Financial Report Pursuant to 18 U.S.C. Section 1350.
- 99.0 Reviewed Financial Statements of Wendgusta, LLC for the fiscal years ended December 25, 2011 and December 26, 2010 prepared by Vrona & Van Schuyler, CPAs, PLLC.
- 99.1 Reviewed Financial Statements of Wendcharles I, LLC for the fiscal years ended December 25, 2011 and December 26, 2010 prepared by Vrona & Van Schuyler, CPAs, PLLC.
- 99.2 Reviewed Financial Statements of Wendcharles II, LLC for the fiscal years ended December 25, 2011 and December 26, 2010 prepared by Vrona & Van Schuyler, CPAs, PLLC.
- 101 The following materials from the Partnership's Annual Report on Form 10-K for the year ended, formatted in XBRL (Extensible Business Reporting Language): (i) Balance Sheets at December 31, 2011 and December 31, 2010, (ii) Statements of Income for the three years ended December 31, 2011, 2010 and 2009, (iii) Statement of Cash Flows for the years ended December 31, 2011, 2010 and 2009, and (v) Notes to the Condensed Financial Statements.<sup>1</sup>

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<sup>1</sup> In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Annual Report on Form 10-K shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act"), or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

**DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**  
**SCHEDULE III – INVESTMENT PROPERTIES AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 2011**

Property	Initial Cost to Partnership				Gross Amount at which Carried at End of Year				Date of Construction	Date Acquired	Life on which Depreciated on in latest statement of operations is computed (years)
	Encumbrances	Land	Building and Improvements	Costs Capitalized Subsequent to Acquisitions	Land	Building and Improvements	Total	Accumulated Depreciation			
Santa Fe, NM	-	-	451,230	-	-	451,230	451,230	332,682	-	10/10/88	31.5
Augusta, GA (2)	-	215,416	434,178	-	213,226	434,177	647,403	324,110	-	12/22/88	31.5
Charleston, SC	-	273,619	323,162	-	273,619	323,162	596,781	241,238	-	12/22/88	31.5
Aiken, SC	-	402,549	373,795	-	402,549	373,795	776,344	277,917	-	2/21/89	31.5
Augusta, GA	-	332,154	396,659	-	332,154	396,659	728,813	294,916	-	2/21/89	31.5
Mt. Pleasant, SC (3)	-	286,060	294,878	-	252,069	294,878	546,947	219,242	-	2/21/89	31.5
Charleston, SC	-	273,625	254,500	-	273,625	254,500	528,125	189,221	-	2/21/89	31.5
Aiken, SC	-	178,521	455,229	-	178,521	455,229	633,750	338,463	-	3/14/89	31.5
Des Moines, IA (1) (4)	-	164,096	448,529	\$296,991	161,996	560,057	722,053	423,284	1989	8/1/89	31.5
North Augusta, SC	-	250,859	409,297	-	250,859	409,297	660,156	290,670	-	12/29/89	31.5
Martinez, GA	-	266,175	367,575	-	266,175	367,575	633,750	261,041	-	12/29/89	31.5
Columbus, OH	-	351,325	708,141	-	351,325	708,140	1,059,465	491,991	-	6/1/90	31.5
	\$0	\$2,994,399	\$4,917,173	\$296,991	\$2,956,118	\$5,028,699	\$7,984,817	\$3,684,775			

- (1) This property was written down to its estimated net realizable value at December 31, 1998.
- (2) In the Fourth Quarter of 2001, a portion of the land was purchased from the Partnership by the County Commission for utility and maintenance easement.
- (3) In the Fourth Quarter of 2010, a portion of the land was reclassified to property held for as the City of Charleston is to purchase the land for right of way purposes.
- (4) Building improvements were incurred at the property during the fourth quarter of 2009.

DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP

SCHEDULE III – INVESTMENT PROPERTIES AND ACCUMULATED DEPRECIATION

DECEMBER 31, 2011

(B) Reconciliation of “Investment Properties and Accumulated Depreciation”:

<u>Investment Properties</u>	<u>Year Ended December 31, 2011</u>	<u>Year Ended December 31, 2010</u>	<u>Accumulated Depreciation</u>	<u>Year Ended December 31, 2011</u>	<u>Year Ended December 31, 2010</u>
Balance at beginning of year	\$9,732,826	\$10,022,119	Balance at beginning of year	\$4,178,495	\$4,260,745
Additions:			Additions charged to costs and expenses	164,467	173,052
Deletions:					
Vacant- Park Forest, IL reclassified and sold (1)		(255,302)	Vacant- Park Forest, IL reclassified and sold (1)		(255,302)
Wendy’s- North Augusta, SC reclassified (2)		(33,991)			
Vacant- Phoenix, AZ property impairment write-down (3)	(390,117)				
Vacant- Phoenix, AZ property reclassified (4)	(475,782)				
Denny’s- Phoenix, AZ property impairment write-down (5)	(104,705)			(325,782)	
Denny’s- Phoenix, AZ reclassified and sold (6)	(777,405)	_____		(332,405)	_____
	_____	_____		_____	_____
Balance at end of year	<u>\$7,984,817</u>	<u>\$9,732,826</u>	Balance at end of year	<u>\$3,684,775</u>	<u>\$4,178,495</u>

- (1) The property was reclassified to property held for sale in the third quarter of 2010 and sold in the fourth quarter of 2010.
- (2) A portion of the land was reclassified to property held for sale in the fourth quarter of 2010 as the City of Charleston is to purchase the land for right of way purposes.
- (3) The property was written-down to its estimated fair value of \$150,000 during the fiscal year 2011.
- (4) The property was reclassified to property held for sale in the third quarter of 2011.
- (5) The property was written-down to its estimated fair value, less costs to sale, of \$475,000 during the third quarter of 2011.
- (6) The property was reclassified to property held for sale in the third quarter of 2011 and sold in the fourth quarter of 2011.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

### **DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP**

By: The Provo Group, Inc., General Partner

By: /s/Bruce A. Provo  
Bruce A. Provo  
President, Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer and  
Chairman of the Board of Directors of The Provo Group, Inc.  
(principal executive officer, principal financial officer and principal accounting officer)

By: /s/Caroline E. Provo  
Caroline E. Provo  
Director of The Provo Group, Inc.

Date: April 16, 2012

**United States of America**  
State of Wisconsin

DEPARTMENT OF FINANCIAL INSTITUTIONS

To All to Whom These Presents Shall Come, Greeting:

I, Richard L. Dean, Secretary of the Department of Financial Institutions of the State of Wisconsin, do hereby certify that, effective September 1, 1984, this department became the department of record in Wisconsin for limited partnerships, and that a Certificate of Limited Partnership of

DIVALL INSURED INCOME PROPERTIES 2 LIMITED PARTNERSHIP

was duly filed in my department on NOVEMBER 20, 1987 and was thereby formed as a limited partnership, as provided by Section 179.11(2) of the Wisconsin Statutes.

I further certify that it appears from the records of this department that said organization continued and now is duly and legally formed, organized and existing by and under the laws of this state.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the official seal of the Department on JUNE 22, 1998.



Richard L. Dean, Secretary  
Department of Financial Institutions

BY: Patricia Weber

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Effective July 1, 1996, the Department of Financial Institutions assumed the functions previously performed by the Corporations Division of the Secretary of State and is the successor custodian of corporate records formerly held by the Secretary of State.

**DIVALL INSURED INCOME PROPERTIES 2  
LIMITED PARTNERSHIP**

**CERTIFICATIONS**

I, Bruce A. Provo, certify that:

1. I have reviewed this annual report on Form 10-K of DiVall Insured Income Properties 2 Limited Partnership;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a- 15(f) and 15(d)- 15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my 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;
  - d) 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 (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and





**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

WENDGUSTA, LLC  
FINANCIAL STATEMENTS  
DECEMBER 25, 2011 and DECEMBER 26, 2010

**VRONA & VAN SCHUYLER CPAs, PLLC**  
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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Members  
Wendgusta, LLC  
27 Central Avenue  
Cortland, New York 13045

We have reviewed the accompanying statement of assets, liabilities and members' capital-income tax basis of Wendgusta, LLC as of December 25, 2011 and December 26, 2010 and the related statements of revenues and expenses-income tax basis, members' capital-income tax basis and cash flows-income tax basis for the years then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis for accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provides a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in Note 1.

*Vrona & Van Schuyler CPAs, PLLC*

CERTIFIED PUBLIC ACCOUNTANTS

January 21, 2012

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendgusta, LLC  
 Statement of Assets, Liabilities and Members' Capital-Income Tax Basis  
 December 25, 2011 and December 26, 2010

ASSETS

	<u>2011</u>	<u>2010</u>
Current assets:		
Cash - (Note 1J)	\$1,200,140	\$ 881,913
Inventories - (Note 1C)	84,875	78,272
Prepaid expenses and other current assets	<u>79,402</u>	<u>124,574</u>
Total current assets	<u>1,364,417</u>	<u>1,084,759</u>
Property and equipment, net of accumulated depreciation - (Notes 1D and 2)	<u>972,706</u>	<u>1,247,745</u>
Other assets:		
Goodwill, net of accumulated amortization of \$1,786,986 in 2011 and \$1,389,878 in 2010- (Note 1E)	4,169,641	4,566,748
Loan cost, net of accumulated amortization of \$33,327 in 2011 and \$25,921 in 2010 - (Note 1G)	33,326	40,732
Organization and start-up cost, net of accumulated amortization of \$62,483 in 2011 \$48,598 in 2010 and - (Note 1F)	6,944	20,828
Deposits	<u>16,647</u>	<u>16,484</u>
Total other assets	<u>4,226,558</u>	<u>4,644,792</u>
<b>TOTAL ASSETS</b>	<u><b>\$6,563,681</b></u>	<u><b>\$6,977,296</b></u>

LIABILITIES AND MEMBERS' CAPITAL

Current liabilities:		
Current maturities of long-term debt - (Note 3)	\$ 396,213	\$ 377,906
Accounts payable and accrued expenses	<u>1,070,921</u>	<u>897,977</u>
Total current liabilities	1,467,134	1,275,883
Long-term debt, less current maturities - (Note 3)	<u>4,865,436</u>	<u>5,261,649</u>
Total liabilities	6,332,570	6,537,532
Commitments and contingencies - (Notes 3,4,5 and 6)	-	-
Members' capital - (Notes 1A, 5, 6B and 6C)	<u>231,111</u>	<u>439,764</u>
<b>TOTAL LIABILITIES AND MEMBERS' CAPITAL</b>	<u><b>\$6,563,681</b></u>	<u><b>\$6,977,296</b></u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendgusta, LLC  
Statement of Revenues and Expenses-Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

	<u>2011</u>	<u>2010</u>
Sales	\$15,103,495	\$14,715,993
Cost of sales	<u>4,631,144</u>	<u>4,486,227</u>
Gross profit	<u>10,472,351</u>	<u>10,229,766</u>
Labor expenses	4,430,800	4,351,423
Store operating and occupancy expenses	2,560,254	2,470,427
General and administrative expenses	620,209	557,601
Advertising expenses - (Note 4A)	711,221	685,875
Royalty expense - (Note 4A)	604,140	588,640
Depreciation and amortization - (Notes 1D, 1E, 1F and 1G)	1,047,442	870,210
Interest expense - (Note 3)	<u>257,189</u>	<u>272,242</u>
Total operating expenses	<u>10,231,255</u>	<u>9,796,418</u>
Operating income (loss)	241,096	433,348
Gain/(loss) on sale/(disposal) of assets	( 6,047)	( 26,250)
Other income	<u>34,848</u>	<u>16,589</u>
Excess(deficiency) of revenues over expenses - (Note 1H)	<u>\$ 269,897</u>	<u>\$ 423,687</u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendgusta, LLC  
Statement of Members' Capital - Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

Members' Capital, December 27, 2009	\$ 498,477
Excess of revenues over expense for the year ended December 26, 2010	423,687
Distributions paid to members	( 379,400)
Purchase of member's interest	<u>( 103,000)</u>
Members' Capital, December 26, 2010	439,764
Excess of revenues over expense for the year ended December 25, 2011	269,897
Distributions paid to members	( 472,750)
Purchase of member's interest	<u>( 5,800)</u>
Members' Capital, December 25, 2011	<u>\$ 231,111</u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendgusta, LLC  
 Statement of Cash Flows-Income Tax Basis  
 For the Years Ended December 25, 2011 and December 26, 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Excess (deficiency) of revenues over expenses	\$ 269,897	\$ 423,687
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	1,047,442	870,210
Decrease (increase) in inventories	( 6,603)	( 12,291)
Decrease (increase) in prepaid expenses and other current assets	45,172	11,794
Increase (decrease) in accounts payable, accrued expenses and taxes	172,942	16,929
(Gain)/loss on (sale)/disposal of assets	<u>6,047</u>	<u>26,250</u>
Total adjustments	<u>1,265,000</u>	<u>912,892</u>
Net cash provided by operating activities	<u>1,534,897</u>	<u>1,336,579</u>
Cash flows from investing activities:		
Capital expenditures, tangible and intangible assets	<u>( 360,051)</u>	<u>( 281,682)</u>
Cash flows from financing activities:		
Repayments of note payable	( 377,906)	( 360,445)
Increase in deposits	( 163)	( 1,752)
Members' distributions	( 472,750)	( 379,400)
Purchase of member's interest	<u>( 5,800)</u>	<u>( 103,000)</u>
Net cash provided by (used in) financing activities	<u>( 856,619)</u>	<u>( 844,597)</u>
Net increase (decrease) in cash	318,227	210,300
Cash, beginning of year	<u>881,913</u>	<u>671,613</u>
Cash, end of year	<u>\$ 1,200,140</u>	<u>\$ 881,913</u>
Supplemental Information:		
Interest paid during the year	\$ 258,681	\$ 273,666

See accountants' review report and notes to the financial statements.

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies

(A) The Company:

Wendgusta, LLC was formed on May 16, 2007 pursuant to the Georgia Limited Liability Company Act to acquire, own and operate eleven existing Wendy's Old Fashioned Hamburger Restaurants in Augusta and Martinez, Georgia and Aiken and North Augusta, South Carolina. The restaurants were acquired from one seller for an aggregate purchase price of \$7,650,000, plus various adjustments in the net aggregate amount of approximately \$50,000. The Company recorded goodwill in the amount of approximately \$6,527,000. The purchase price was financed principally by a \$7,250,000 equipment loan from General Electric Capital Corporation, ("GECC") with the balance provided by capital contributions of the members. The acquisition closed on July 2, 2007. (See Note 3).

In October 2007 the Company closed the Dean Bridge Road restaurant.

The Company currently operates ten restaurants, all of which are leased. (See Note 4B).

The Company is to continue in perpetuity, except it is to be dissolved as a result of the sale of all business operations or the sale of all or substantially all of its assets, in each of such cases upon the receipt of the consideration therefor in cash or the reduction to cash of non-cash consideration, or upon the occurrence of certain events as set forth in the operating agreement. (See Note 5B).

(B) Income Tax Basis of Accounting:

The Company is treated as a partnership for federal, Georgia and South Carolina income tax purposes. The accompanying financial statements have been prepared on the basis of accounting used to prepare the Company's federal partnership return. Such other comprehensive basis of accounting differs in certain respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in accordance with generally accepted accounting principles.

(C) Inventories:

Inventories represent food and supplies and are stated at cost.

(D) Property, Equipment and Depreciation:

Property and equipment are stated at cost. Depreciation is provided by application of the straight-line and declining balance methods over depreciable lives as follows:

Leasehold improvements	15 to 39 years
Restaurant and office equipment	5 to 7 years
Automobile	5 years
Land improvements	15 years

See accountants' review report.

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(D) Property, Equipment and Depreciation - continued:

If it had qualifying property placed in service during the year, the Company has taken additional depreciation deductions in accordance with the federal government's enactment of the Economic Stimulus Act of 2008, amended by the American Recovery and Reinvestment Act of 2009, the Small Business Jobs Act of 2010, and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

(E) Goodwill:

Goodwill, representing the excess of the purchase price over the fair value of the assets acquired, is amortized over fifteen years.

(F) Organizational and Start-Up Costs:

The Company capitalized the costs incurred in the formation of the company. These costs are amortized over 5 years.

(G) Loan Cost:

The Company capitalized the cost incurred in the obtaining the acquisition debt. These costs are amortized over 9 years. (See note 3).

(H) Income Taxes:

The Company was organized as a Limited Liability Company under the laws of Georgia and is not subject to any federal or state income tax. For federal, Georgia and South Carolina income tax purposes, the Company is treated as a partnership. Accordingly, each member is required to report on his federal and applicable state income tax return his distributive share of all items of income, gain, loss, deduction, credit and tax preference of the Company for any taxable year, whether or not any cash distribution has been or will be made to such member.

The Company's tax returns are subject to examination by the Federal and State taxing authorities. The tax rules and regulations governing these returns are complex, technical and subject to varying interpretations. If an examination required the Company to make adjustments, the profit or loss allocated to the members would be adjusted accordingly.

Although income tax rules are used to determine the timing of the reporting revenues and expenses, non-taxable revenues and non-deductible expenses are included in the determination of net income in the accompanying financial statements.

(I) Fiscal Year:

The Company's annual accounting period is a fiscal year ending on the last Sunday of December.

Wendgusta, LLC  
 Notes to the Financial Statements  
 December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(J) Cash:

The Company maintains its cash in various banks. The accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation, to a maximum of \$250,000. At any time during the year, the cash balance may exceed \$250,000.

(K) Use of Estimates:

The preparation of financial statements in conformity with the income tax accrual basis of accounting requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

(L) Advertising:

The Company expenses all advertising costs when incurred.

Note 2 - Property and Equipment

Property and equipment consist of the following:

	<u>2011</u>	<u>2010</u>
Restaurant and office equipment	\$1,544,910	\$1,282,563
Automobile	13,413	7,415
Leasehold improvements	1,369,814	1,318,456
Land improvements	<u>73,735</u>	<u>58,826</u>
Total	3,001,872	2,667,260
Less: Accumulated depreciation	<u>2,029,166</u>	<u>1,419,515</u>
Property and equipment, net	<u>\$ 972,706</u>	<u>\$1,247,745</u>

Note 3 - Acquisition Debt

At the time of the acquisition closing, the Company borrowed \$7,250,000 from GECC. The loan maturity date was August 1, 2016 and was payable in monthly installments assuming a 13.5 year amortization period with a balloon payment due at maturity. In December 2009 the Company made an additional principal payment of \$491,190 reducing the amount owed to \$6,000,000 and restructured the terms of the loan. The loan bears interest at a rate of LIBOR plus 4.5% and is payable in monthly installments based upon a 12.5 year amortization with a balloon payment of approximately \$2,050,919 plus interest due on January 1, 2019.

The note agreement contains various standard affirmative and negative covenants as well as certain formula-based financial covenants. At December 26, 2010 the Company was in compliance with all terms of the loan.

See accountants' review report.

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 3 - Acquisition Debt - (Continued):

The future annual principal payments are as follows:

2012	\$ 396,213
2013	415,407
2014	435,531
2015	456,629
2016	478,750
2017	501,942
2018	526,258
2019	<u>2,050,919</u>
	<u>\$5,261,649</u>

Note 4 - Commitments and Contingencies

(A) Franchise Agreement Commitments:

The Company is the franchisee for the ten Wendy's restaurants it owns and operates. The franchise agreements obligate the Company to pay to Wendy's International a monthly royalty equal to 4% of the gross sales of each restaurant, or \$250, whichever is greater. The Company must also pay to Wendy's National Advertising Program 2% of the gross sales and spend not less than 2% of the gross sales of each restaurant for local and regional advertising.

(B) Minimum Operating Lease Commitments:

The lease for the restaurant located at 517 Martintown Road in North Augusta expires on November 6, 2021. The annual rent is \$87,780. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$746,181.

The lease for the restaurant located at 1730 Walton Way in Augusta expires on November 6, 2021. The annual rent is \$96,780. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$768,937.

The lease for the restaurant located at 2738 Washington Road in Augusta had a primary term that expired on October 31, 2004. The current term expires on October 31, 2014 and includes two remaining five-year renewal options. The annual rent is \$71,573 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 5% of gross sales in excess of \$900,000.

The lease for the restaurant located at 1004 Richland Avenue in Aiken expires on November 6, 2021. The annual rent is \$90,480. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$752,048.

The lease for the restaurant located at 3342 Wrightsboro Road in Augusta had a primary term that expired on October 31, 2004. The current term expires on October 31, 2014 and includes two remaining five-year renewal options. The annual rent is \$68,581 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 5% of gross sales in excess of \$687,458.

See accountants' review report.

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(B) Minimum Operating Lease Commitments - continued:

The lease for the restaurant located at 3859 Washington Road in Martinez expires on November 6, 2021. The annual rent is \$84,120. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$860,000.

The lease for the restaurant located at 3013 Peach Orchard Road in Augusta expires on November 6, 2021. The annual rent is \$86,160. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$744,784.

The lease for the restaurant located at 1901 Whiskey Road in Aiken expires on November 6, 2021. The annual rent is \$96,780. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$960,000.

The lease for the restaurant located at 449 Walton Way in Augusta had a primary term that expired on February 28, 2003. The current term expires on February 28, 2013 and includes one remaining five-year renewal option. The annual rent is \$96,600 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 6% of gross sales less base rent.

The lease for the restaurant located at 430 South Belair Road in Augusta has a primary term that expires on November 30, 2025 and includes two five-year renewal options. The annual rent is \$152,196 through November 30, 2012. At that time and on each one year anniversary thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1.5%.

The leases are all net leases and require the Company to pay real estate taxes, insurance, maintenance and other property expenses.

Rent expense was \$1,278,837 in 2011 and \$1,255,179 in 2010 including percentage rent of \$349,849 in 2011 and \$328,410 in 2010.

Future annual minimum rentals are as follows:

2012	\$ 931,240
2013	853,026
2014	815,887
2015	701,447
2016	691,219
Thereafter	<u>3,774,872</u>
	<u>\$ 7,767,691</u>

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(C) Financial and Operational Advisory Services Agreement:

At the closing, the Company entered into a financial and operational advisory services agreement with its two managing members and another individual. The agreement provides for these three individuals to: (I) consult with and advise the Company on applicable financial and/or operational matters; and (ii) if required by the Company's debt, lease or franchise agreements, to which they are signatories, to remain ready, willing and able to maintain such status for the benefit of the Company, except where such guarantees are not needed; and (iii) remain able to provide such additional personal guarantees as, within their sole discretion, may reasonably be necessary to maintain the business of the Company. The initial term ended December 31, 2010 and is automatically renewable annually thereafter, as long as the Company remains in business. The agreement also provides for the reimbursement of reasonable expenses incurred by the individuals in fulfilling their duties. Fees paid pursuant to this agreement aggregated \$81,000 in 2011 and \$66,000 in 2010. (See Note 6A).

Note 5 - Capitalization and Operating Agreement

(A) Capitalization:

The Company's initial capitalization consisted of 800 units, of which 24 and 21 were sold to two managing members at \$25 per unit, or \$1,125 in the aggregate, and 80 units were sold to the third managing member at \$125 per unit, or \$10,000 in the aggregate. Of the remaining 675 units, 192 were sold at \$25 per unit, or \$4,800 in the aggregate, and 483 units were sold at per unit contributions of \$4,500 totaling \$2,173,500. All contributions totaled \$2,189,425. (See Note 5B).

In 2009 the Company required each member to contribute \$1,000 per unit of membership interest as an additional capital contribution. The proceeds were used in part to reduce the loan to GECC. (See Notes 3 and 6B).

(B) Operating Agreement:

All purchasers of membership interests are parties to the Company's operating agreement which provides for the capitalization and operation of the Company, distributions to members and transfers of interests. Members' consents representing 75% of all membership interests are required for the following actions: Change in the operating agreement; voluntary dissolution; sale or exchange of substantially all assets; merger or consolidation; incurrence of debt or refinancing other than in the ordinary course of business or in connection with entering new or unrelated businesses; and removal of a manager, for cause. Members are not required to make up negative capital accounts. Distributions either from cash flow generated by operations or capital transactions (as defined) other than capital contributions are made at the sole discretion of the managers,

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 5 - Capitalization and Operating Agreement - (Continued):

(B) Operating Agreement - continued:

acting unanimously. Managers are elected by the members. Outside liens against membership interests are prohibited. For permitted transfers of membership interests, book value is equal to assets less liabilities using the income tax method/accrual basis of accounting, except for transfers involving the interest owned by the Company's President, in which case a special valuation adjustment is required through July 1, 2012.

Members wishing to sell their interests shall submit their request in writing, together with appropriate documentation setting forth the terms of such sale, to the managing members, who within thirty days and at their sole discretion, shall approve or disapprove of such sale. If not approved, the managing members within fourteen additional days may elect to have the Company purchase the offered units at the stated terms. Such action by the managing members is to be by simple majority. If the managing members determine that the offered interests are not to be redeemed by the Company, then the interests shall be offered to the remaining members of the Company, pro-rata at the same offered terms, who will have 14 additional days to purchase the offered shares. If the interests are not purchased by the members, then they may be sold to the third-party purchaser at the offered terms. Membership interests may also be transferred to family members or trusts or by reason of death or incompetence.

In the event of a termination of a member's interest by death, retirement, resignation, expulsion, bankruptcy, incompetence, or in the case of a member that is not a natural person - dissolution, the Company must be dissolved unless it is continued by the consent of all the remaining members. Non-consenting members are deemed to offer and authorized representatives or trustees of deceased or bankrupt members may offer the applicable membership interest, first to the Company, and then to the consenting (continuing) members. In such case, the offered interests must be purchased by either the Company or one or more of the consenting members. Such purchases, unless made by the Company, are to be made pro-rata to the existing interests of purchasing members, unless they agree otherwise or there is only one purchasing member.

In any event, all offered interests of non-consenting members or by the estate, trustee, etc. of deceased or bankrupt members, etc. must be purchased by the Company or one or more consenting members or the Company must be dissolved and liquidated.

Wendgusta, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 6 - Related Party Transactions

(A) Financial and Operating Advisory Service Fees:

The Company paid two of its three managing members and a third individual a total of \$81,000 in 2011 and \$66,000 in 2010 pursuant to a financial and operational advisory services agreement. (See note 4C).

(B) Additional Capital Contributions:

During 2009 additional capital contributions of \$1,000 per unit of membership interest were received by the Company for a total of \$796,000. In lieu of a cash payment, the President's contribution was made by the issuance of a promissory note of \$80,000. The note bears interest at a rate of .75% over the 12 month LIBOR rate and calls for annual payments of \$12,000 beginning on January 11, 2011 until the loan is paid off. The payment is contingent upon the Company making total annual distributions of at least \$430,000. If the annual distributions fall below that amount, the next loan payment will be proportionately reduced.

(C) Other:

In July 2008 the Company redeemed one member's .25% membership interest for \$2,000.

In March 2009 the Company redeemed one member's .13% membership interest for \$2,000.

In October 2009 the Company redeemed one member's .13% membership interest for \$3,600.

In 2010 the Company redeemed four members' 2.62% combined membership interest for an aggregate price of \$103,000.

Note 7 - Pension Plan

The Company maintains a qualified cash or deferred compensation plan under section 401(K) of the Internal Revenue Code. Under the plan, employees may elect to defer up to (15%) of their salary, subject to Internal Revenue Service limits. A discretionary matching contribution may be made by the Company and added to each participant's account. Company contributions for the plan amounted to \$2,299 for 2011 and \$1,834 for 2010.

WENDCHARLES I, LLC

FINANCIAL STATEMENTS

DECEMBER 25, 2011 AND DECEMBER 26, 2010

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS  
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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Members  
Wendcharles I, LLC  
27 Central Avenue  
Cortland, New York 13045

We have reviewed the accompanying statement of assets, liabilities and members' capital-income tax basis of Wendcharles I, LLC as of December 25, 2011 and December 26, 2010 and the related statements of revenues and expenses-income tax basis, members' capital-income tax basis and cash flows-income tax basis for years then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis for accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provides a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in Note 1.

*Vrona & Van Schuyler CPAs, PLLC*

CERTIFIED PUBLIC ACCOUNTANTS

January 21, 2012

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles I, LLC  
 Statement of Assets, Liabilities and Members' Capital-Income Tax Basis  
 December 25, 2011 and December 26, 2010

ASSETS

	<u>2011</u>	<u>2010</u>
Current assets:		
Cash (Note 1I)	\$ 463,628	\$ 381,703
Inventories - (Note 1C)	100,413	84,183
Prepaid expenses and other current assets	<u>0</u>	<u>1,812</u>
Total current assets	<u>564,041</u>	<u>467,698</u>
Property and equipment - (Notes 1D and 2)	<u>817,610</u>	<u>1,108,376</u>
Other assets:		
Goodwill, net of accumulated amortization of \$437,843 in 2011 and \$306,489 in 2010 - (Note 1E)	2,189,216	2,320,570
Deferred costs, net of accumulated amortization of \$52,686 in 2011 and \$36,878 in 2010 - (Note 1F)	50,728	66,536
Deposits	<u>16,765</u>	<u>16,765</u>
Total other assets	<u>2,256,709</u>	<u>2,403,871</u>
<b>TOTAL ASSETS</b>	<u><b>\$3,638,360</b></u>	<u><b>\$3,979,945</b></u>

LIABILITIES AND MEMBERS' CAPITAL

Current liabilities:		
Current maturities of long-term debt - (Note 3)	\$ 169,498	\$ 122,507
Accounts payable and accrued expenses	<u>1,054,502</u>	<u>945,265</u>
Total current liabilities	1,224,000	1,067,772
Long-term debt, less current maturities - (Note 3)	<u>1,655,501</u>	<u>1,712,760</u>
Total liabilities	2,879,501	2,780,532
Commitments and contingencies - (Notes 3, 4, 5 and 6)	-	-
Members' capital - (Notes 1A, 5 and 6B)	<u>758,859</u>	<u>1,199,413</u>
<b>TOTAL LIABILITIES AND MEMBERS' CAPITAL</b>	<u><b>\$3,638,360</b></u>	<u><b>\$3,979,945</b></u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles I, LLC  
Statement of Revenues and Expenses-Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

	<u>2011</u>	<u>2010</u>
Sales	\$13,659,916	\$13,378,747
Cost of sales	<u>4,196,825</u>	<u>4,094,186</u>
Gross profit	<u>9,463,091</u>	<u>9,284,561</u>
Labor expenses	4,640,763	4,688,198
Store operating and occupancy expenses	2,890,129	2,901,803
General and administrative expenses	720,688	678,493
Advertising expenses - (Note 4A)	674,827	631,966
Royalty expense - (Note 4A)	546,397	535,150
Depreciation and amortization - (Notes 1D, 1E, and 1F)	675,912	572,821
Interest expense - (Note 3)	<u>52,783</u>	<u>58,359</u>
Total operating expenses	<u>10,201,499</u>	<u>10,066,790</u>
Operating income (loss)	( 738,408)	( 782,229)
Gain/(loss) on sale/(disposal) of assets	( 4,380)	( 8,047)
Workers' compensation refund	450,000	670,000
Other income	<u>20,024</u>	<u>156,843</u>
Excess (deficiency) of revenues over expenses - (Note 1G)	<u><u>\$ ( 272,764)</u></u>	<u><u>\$ 36,567</u></u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles I, LLC  
Statement of Members' Capital-Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

Members' Capital, December 27, 2009	\$ 1,346,616
Excess (deficiency) of revenues over expenses December 26, 2010	36,567
Distributions paid to members	<u>( 183,770)</u>
Members' Capital, December 26, 2010	1,199,413
Excess (deficiency) of revenues over expenses December 25, 2011	( 272,764)
Distributions paid to members	<u>( 167,790)</u>
Members' Capital, December 25, 2011	<u>\$ 758,859</u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles I, LLC  
 Statement of Cash Flows-Income Tax Basis  
 For the Years Ended December 25, 2011 and December 26, 2010

	2011	2010
Cash flows from operating activities:		
Excess (deficiency) of revenues over expenses	\$( 272,754)	\$ 36,567
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	675,912	572,821
Decrease (increase) in inventories	( 16,230)	8,431
Decrease (increase) in prepaid expenses and other current assets	1,812	( 1,812)
Increase (decrease) in accounts payable, accrued expenses and taxes	109,237	( 197,857)
(Gain)/loss on (sale)/disposal of assets	4,380	8,047
Total adjustments	775,111	389,630
Net cash provided by operating activities	502,357	426,197
Cash flows from investing activities:		
Capital expenditures, tangible and intangible assets	( 242,374)	( 262,262)
Net cash provided by (used in) investing activities	( 242,374)	( 262,262)
Cash flows from financing activities:		
Repayments of note payable	( 130,268)	( 109,657)
Members' distributions	( 167,790)	( 183,770)
Redemption of member's interest	0	0
Proceeds from debt	120,000	250,000
Net cash provided by (used in) financing activities	( 178,058)	( 43,427)
Net increase (decrease) in cash	81,925	120,508
Cash, beginning of period	381,703	261,195
Cash, end of period	\$ 463,628	\$ 381,703
Additional Cash Flow Information:		
Interest paid during the year	\$ 52,863	\$ 53,199

See accountants' review report and notes to the financial statements.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies

(A) The Company:

Wendcharles I, LLC was formed on June 24, 2008 pursuant to the South Carolina Code of Laws to acquire, own and operate eleven existing Wendy's Old Fashioned Hamburger Restaurants in the Charleston, South Carolina metropolitan area. As part of the same overall transaction, another South Carolina limited liability company, Wendcharles II, LLC, affiliated with the Company by certain common management and ownership interests, acquired six other existing Wendy's Old Fashioned Hamburger Restaurants in and proximate to North Charleston. The restaurants were all acquired from one unrelated seller for an aggregate purchase price of \$5,760,000, less net adjustments to the Company of approximately \$14,000. The Company's recorded goodwill in the amount of approximately \$4,060,000. The purchase price was financed principally by a \$3,500,000 loan from Bank of America, with the balance provided by capital contributions of the members. The acquisition closed and restaurant operations commenced on September 16, 2008.

The leases for the eleven leasehold estates, all in South Carolina, were assigned to the Company from different lessors. Four locations each are in Charleston and North Charleston and three are in Mt. Pleasant as follows: Charleston: 1721 Sam Rittenberg Boulevard; 194 Cannon Street; 343 Folly Road; and 5275 International Blvd; North Charleston: 4113 Rivers Avenue; 5115 Dorchester Rd; 9145 University Blvd; and 4892 Ashley Phosphate Road; Mt Pleasant: 361 Highway 17 By-Pass; 935 Chuck Dawley Boulevard; and 596 Long Point Road. (See Note 4B).

The Company is to continue in perpetuity, except it is to be dissolved as a result of the sale of all business operations or the sale of all or substantially all of its assets, in each of such cases upon the receipt of the consideration therefor in cash or the reduction to cash of non-cash consideration, or upon the occurrence of certain events as set forth in the operating agreement. (See Note 5B).

The Company currently operates eleven restaurants, all of which are leased.

(B) Income Tax Basis of Accounting:

The Company is treated as a partnership for Federal and South Carolina income tax purposes. The accompanying financial statements have been prepared on the basis of accounting used to prepare the Company's federal partnership return. Such other comprehensive basis of accounting differs from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in accordance with generally accepted accounting principles.

(C) Inventories:

Inventories represent food and supplies and are stated at cost.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(D) Property, Equipment and Depreciation:

Property and equipment are stated at cost. Depreciation is provided by application of the straight-line method over depreciable lives as follows:

Land improvements	15 years
Leasehold improvements	15 to 39 years
Restaurant equipment	5 to 7 years
Automobile	5 years

If it had qualifying property placed in service during the year, the Company has taken additional depreciation deductions in accordance with the federal government's enactment of the Economic Stimulus Act of 2008, amended by the American Recovery and Reinvestment Act of 2009, the Small Business Jobs Act of 2010, and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

(E) Goodwill:

Goodwill, representing the excess of the purchase price over the fair value of the assets acquired, is amortized over fifteen years.

(F) Deferred Costs:

The Company capitalized the costs incurred in obtaining its financing and its leases. These costs are amortized over the life of the loan.

(G) Income Taxes:

The Company was organized as a Limited Liability Company under the laws of South Carolina and is not subject to any federal or state income tax. For federal and South Carolina income tax purposes, the Company is treated as a partnership. Accordingly, each member is required to report on his federal and applicable state income tax return his distributive share of all items of income, gain, loss, deduction, credit and tax preference of the Company for any taxable year, whether or not any cash distribution has been or will be made to such member.

The Company's tax returns are subject to examination by the Federal and State taxing authorities. The tax laws, rules and regulations governing these returns are complex, technical and subject to varying interpretations. If an examination required the Company to make adjustments, the profit or loss allocated to the members would be adjusted accordingly.

Although income tax rules are used to determine the timing of the reporting revenues and expenses, non-taxable and non-deductible expenses are included in the determination of net income in the accompanying financial statements.

See accountants' review report.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(H) Fiscal Year:

The Company's annual accounting period is a fiscal year ending on the last Sunday of December.

(I) Cash:

The Company maintains its cash in various banks. The accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation, to a maximum of \$250,000. At any time during the year, the cash balance may exceed \$250,000.

(J) Use of Estimates:

The preparation of financial statements in conformity with the income tax accrual basis of accounting requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

(K) Advertising:

The Company expenses all advertising costs when incurred.

Note 2 - Property and Equipment

Property and equipment consist of the following:

	<u>2011</u>	<u>2010</u>
Land improvements	\$ 62,541	\$ 62,541
Leasehold improvements	943,511	869,747
Restaurant equipment	1,731,357	1,576,123
Construction in progress	2,416	0
Automobile	<u>4,940</u>	<u>4,940</u>
Total	2,744,765	2,513,351
Less: Accumulated depreciation	<u>1,927,155</u>	<u>1,404,975</u>
Property and equipment, net	<u>\$ 817,610</u>	<u>\$1,108,376</u>

Note 3 - Acquisition Debt

At the closing of the purchase transaction, the Company and its affiliate, Wendcharles II, LLC, jointly obtained a \$3,500,000 loan from Bank of America, with interest at a floating rate, initially equal to the thirty-day adjusted LIBOR plus 250 basis points for the period commencing on the closing date until four quarterly financial reports have been submitted and reviewed in accordance with the loan agreement and, thereafter, equal to the thirty day adjusted LIBOR plus a margin based on the funded debt to earnings before interest, taxes depreciation and amortization ("EBITDA") ratio. Based on the relative values of the leasehold interests acquired, \$1,800,000 and \$1,700,000, representing 51% and 49%, respectively, of the total principal amount, were recorded on the books of the Company and its affiliate, although they are jointly and severally liable for the loan.

See accountants' review report.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 3 - Acquisition Debt - (Continued):

A combined initial payment of interest only of \$7,277, based on LIBOR of 2.49%, set two business days before the closing date was due and paid on October 1, 2008. Beginning on November 1, 2008 and ending on August 1, 2015, monthly payments of interest and principal are due in an amount sufficient to amortize the loan over 13.5 years. LIBOR is adjusted on the first business day of each month. The loan matures on August 16, 2015. The loan may be prepaid at any time upon five days written notice, in minimum increments of \$250,000, provided the Companies pay any costs incurred by the bank in the termination of any interest swap agreements between the parties.

The Loan was guaranteed by two of the Companies three managing members until the later occurrence of one year from the closing date or the date the Companies achieve a combined funded debt to EBITDA ratio of less than 3.75 to 1.00 for two consecutive quarters. (See Note 4C). The guarantee was released by the lender on March 31, 2010.

The loan is secured by all the assets of each company. The agreement contains various standard affirmative and negative covenants as well as certain formula-based covenants. At December 31, 2011, the companies were not in compliance with the formula-based covenants.

The Company's share of the estimated aggregate annual principal amounts required on the note through maturity are as follows: 2012: \$106,851; 2013: \$112,491; 2014: \$119,432; and 2015: \$1,158,701.

On March 17, 2010, the Company borrowed \$250,000 from Wen-Restaurants LLC (a related company, see note 6C). Repayment terms are \$2,440 per month including interest at 3.25% per annum. The note matures in April 2020.

Aggregate principal payments are as follows:

2012	\$ 22,647
2013	23,396
2014	24,168
2015	24,967
2016	25,791
Thereafter	93,222
	<u>\$ 214,191</u>

In October 2011 the Company borrowed \$120,000 from M&T Bank. Repayment terms are \$3,333 per month for 36 months plus interest at 3.25%.

The annual principle payments are as follows:

2012	\$ 40,000
2013	40,000
2014	33,333
Thereafter	<u>\$ 113,333</u>

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies

(A) Franchise Agreement Commitments:

The Company is the franchisee for the eleven Wendy's restaurants it owns and operates. The franchise agreements obligate the Company to pay to Wendy's International a monthly royalty equal to 4% of the gross sales of each restaurant, or \$250, whichever is greater. The Company must also pay to Wendy's National Advertising Program 3% of the gross sales and spend not less than 1% of the gross sales of each restaurant for local and regional advertising.

(B) Minimum Operating Lease Commitments:

The lease for the restaurant located at 1721 Sam Rittenberg Blvd in Charleston has a primary term that expires on November 6, 2021 and includes two five-year renewal options. The annual rent is \$76,920 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$662,665.

The lease for the restaurant located at 4113 Rivers Ave in North Charleston has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$103,837 through March 31, 2012. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%.

The lease for the restaurant located at 194 Canon Street in Charleston had a primary term that expired on September 14, 2004. The current term expires on September 14, 2014 and includes two remaining five-year renewal options. The annual rent is \$131,560 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 5% of gross sales in excess of \$1,087,872.

The lease for the restaurant located at 343 Folly Road in Charleston has a primary term that expires on November 6, 2021 and includes two five-year renewal options. The annual rent is \$70,200 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$589,488.

The lease for the restaurant located at 5115 Dorchester Road in North Charleston has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$100,769 through March 31, 2012. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%.

The lease for the restaurant located at 361 Hwy 17 Bypass in Mt Pleasant has a primary term that expires on November 6, 2021 and includes two five-year renewal options. The annual rent is \$77,280 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 7% of gross sales in excess of \$750,000.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(B) Minimum Operating Lease Commitments - continued:

The lease for the restaurant located at 935 Chuck Dawley Blvd in Mt Pleasant had a primary term that expired on September 9, 1996. The current term expires on September 9, 2016. The annual rent is \$97,020 for the remainder of the current term. In addition the Company is required to pay percentage rent equal to 6% of gross sales in excess of base rent.

The lease for the restaurant located at 9145 University Blvd in North Charleston has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$105,452 through March 31, 2012. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%.

The lease for the restaurant located at 4892 Ashley Phosphate Road in North Charleston has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$100,168 through March 31, 2012. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%.

The lease for the restaurant located at 596 Long Point Road in Mt Pleasant has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$97,328 through March 31, 2012. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%

The lease for the restaurant located at 5275 International Blvd in North Charleston has a primary term that expires on April 30, 2027 and includes four five-year renewal options. The current annual rent for the lease is \$123,000 through June 30, 2013. At that time and on each five year anniversary thereafter, annual rent will be increased by the previous year's annual rent multiplied by 5%.

The Company is required to pay all realty taxes, insurance, routine maintenance and common charges for the above leases.

Rent expense was \$1,198,666 in 2011 and \$1,178,207 in 2010 including percentage including percentage rent of \$123,990 in 2011 and \$110,824 in 2010.

Future annual minimum rentals are as follows:

2012	\$ 1,084,330
2013	1,092,488
2014	1,061,961
2015	974,323
2016	949,646
Thereafter	<u>7,076,284</u>
	<u>\$12,239,032</u>

See accountants' review report.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(C) Financial and Operational Advisory Services Agreement:

The Company has a financial and operational advisory services agreement with three of its corporate officers. The agreement provides for these officers to: Consult with and advise the Company on applicable financial and/or operational matters and if required by the Company's debt, lease or franchise agreements, to which they are signatories, to remain ready, willing and able to maintain such status for the benefit of the Company, except where such guarantees are not needed; and remain able to provide such additional personal guarantees as, within their sole discretion, may reasonably be necessary to maintain the business of the Company. The initial term expires December 2011, and is automatically renewable annually thereafter, as long as the Company remains in business. The agreement also provides for the reimbursement of reasonable expenses incurred by the individuals in fulfilling their duties. The aggregate annual fee under this agreement is \$42,000. (See Note 6).

Note 5 - Capitalization and Operating Agreement

(A) Capitalization:

The Company's initial capitalization consisted of 800 units, of which 42 and 32 were sold to two managing members at \$100 per unit, or \$ 7,400 in the aggregate, and 80 units were sold to the third managing member at \$125 per unit, or \$10,000 in the aggregate. Of the remaining 646 units, 67 were sold at \$100 per unit, or \$6,700 in the aggregate, and 579 units were sold at per unit contributions of \$4,700 totaling \$2,721,300. All contributions totaled \$2,745,400. (See Note 5B).

(B) Operating Agreement:

All purchasers of membership interests are parties to the Company's operating agreement which provides for the capitalization and operation of the Company, distributions to members and transfers of interests. Members' consents representing 75% of all membership interests are required for the following actions: Change in the operating agreement; voluntary dissolution; sale or exchange of substantially all assets; merger or consolidation; incurrence of debt or refinancing other than in the ordinary course of business or in connection with entering new or unrelated businesses; and removal of a manager, for cause. Members are not required to make up negative capital accounts. Distributions either from cash flow generated by operations or capital transactions (as defined) other than capital contributions are made at the sole discretion of the managers, acting unanimously. Managers are elected by the members. Outside liens against membership interests are prohibited. For permitted transfers of membership interests, book value is equal to assets less liabilities using the income tax method/accrual basis of accounting, except for transfers involving the interest owned by the Company's President, in which case a special valuation adjustment is required through August 2013.

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 5 - Capitalization and Operating Agreement - (Continued):

(B) Operating Agreement:

Members wishing to sell their interests shall submit their request in writing, together with appropriate documentation setting forth the terms of such sale, to the managing members, who within thirty days and at their sole discretion, shall approve or disapprove of such sale. If not approved, the managing members within fourteen additional days may elect to have the Company purchase the offered units at the stated terms. Such action by the managing members is to be by simple majority. If the managing members determine that the offered interests are not to be redeemed by the Company, then the interests shall be offered to the remaining members of the Company, pro-rata at the same offered terms, who will have 14 additional days to purchase the offered shares. If the interests are not purchased by the members, then they may be sold to the third-party purchaser at the offered terms, but the purchaser must become bound by the terms of the operating agreement. Membership interests may also be transferred to family members or trusts or by reason of death or incompetence.

In the event of a termination of a member's interest by death, retirement, resignation, expulsion, bankruptcy, incompetence, or in the case of a member that is not a natural person - dissolution, the Company must be dissolved unless it is continued by the consent of all the remaining members. Non-consenting members are deemed to offer and authorized representatives or trustees of deceased or bankrupt members may offer the applicable membership interest, first to the Company, and then to the consenting (continuing) members. In such case, the offered interests must be purchased by either the Company or one or more of the consenting members. Such purchases, unless made by the Company, are to be made pro-rata to the existing interests of purchasing members, unless they agree otherwise or there is only one purchasing member.

In any event, all offered interests of non-consenting members or by the estate, trustee, etc. of deceased or bankrupt members, etc. must be purchased by the Company or one or more consenting members or the Company must be dissolved and liquidated.

Note 6 - Related Party Transactions

(A) Financial and Operational Advisory Services:

The Company paid two of its three managing members and a third individual a total of \$42,000 in 2011 and \$42,000 in 2010 pursuant to a financial and operational advisory services agreement.

(B) Redemption of Membership Interest:

In October 2009 the Company redeemed one member's .125% membership interest for \$2,000.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles I, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 6 - Related Party Transactions - (Continued):

(C) Note Payable:

In March 2010 the Company borrowed \$250,000 from Wen-Restaurants Associates L.P. Both Companies have common owners but are not under common control.

Note 7 - Pension Plan

The Company maintains a qualified cash or deferred compensation plan under section 401(K) of the Internal Revenue Code. Under the plan, employees may elect to defer up to (15%) of their salary, subject to Internal Revenue Service limits. A discretionary matching contribution may be made by the Company and added to each participant's account. Company contributions for the plan amounted to \$0 for 2011 and \$0 for 2010.

Note 8 - Subsequent Event

On December 26, 2011 the restaurant located at 1721 Sam Rittenberg Blvd in Charleston was sold by the Company to it's affiliate Wendcharles II for \$66,922 representing the net asset value of the restaurant.

See accountants' review report.

WENDCHARLES II, LLC

FINANCIAL STATEMENTS

December 25, 2011 and DECEMBER 26, 2010

**VRONA & VAN SCHUYLER CPAs, PLLC**  
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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Members  
Wendcharles II, LLC  
27 Central Avenue  
Cortland, New York 13045

We have reviewed the accompanying statement of assets, liabilities and members' capital-income tax basis of Wendcharles II, LLC as of December 25, 2011 and December 26, 2010 and the related statements of revenues and expenses-income tax basis, members' capital-income tax basis and cash flows-income tax basis for the years then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis for accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provides a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in Note 1.

*Vrona & Van Schuyler CPAs, PLLC*

CERTIFIED PUBLIC ACCOUNTANTS

January 21, 2012

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
 Statement of Assets, Liabilities and Members' Capital-Income Tax Basis  
 December 25, 2011 and December 26, 2010

ASSETS

	<u>2011</u>	<u>2010</u>
Current assets:		
Cash (Note 1I)	\$ 344,168	\$ 294,080
Inventories - (Note 1C)	49,701	38,660
Prepaid expenses and other current assets	<u>0</u>	<u>298</u>
Total current assets	<u>393,869</u>	<u>333,038</u>
Property and equipment - (Notes 1D and 2)	<u>511,567</u>	<u>670,499</u>
Other assets:		
Goodwill, net of accumulated amortization of \$318,430 in 2011 and \$222,901 in 2010 - (Note 1E)	1,114,511	1,210,040
Deferred costs, net of accumulated amortization of \$28,894 in 2011 and \$20,524 in 2010 - (Note 1F)	33,429	41,799
Deposits	<u>9,585</u>	<u>9,585</u>
Total other assets	<u>1,157,525</u>	<u>1,261,424</u>
TOTAL ASSETS	<u>\$2,062,961</u>	<u>\$2,264,961</u>

LIABILITIES AND MEMBERS' CAPITAL

Current liabilities:		
Current maturities of long-term debt - (Note 3)	\$ 117,581	\$ 96,877
Accounts payable and accrued expenses	<u>559,969</u>	<u>470,278</u>
Total current liabilities	677,550	567,155
Long-term debt, less current maturities - (Note 3)	<u>1,343,899</u>	<u>1,413,410</u>
Total liabilities	2,021,449	1,980,565
Commitments and contingencies - (Notes 3, 4, 5 and 6)	-	-
Members' capital - (Notes 1A, 5 and 6B)	<u>41,512</u>	<u>284,396</u>
TOTAL LIABILITIES AND MEMBERS' CAPITAL	<u>\$2,062,961</u>	<u>\$2,264,961</u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
Statement of Revenues and Expenses-Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

	<u>2011</u>	<u>2010</u>
Sales	\$7,512,661	\$7,343,782
Cost of sales	<u>2,340,316</u>	<u>2,269,948</u>
Gross profit	<u>5,172,345</u>	<u>5,073,834</u>
Labor expenses	2,379,330	2,409,424
Store operating and occupancy expenses	1,592,350	1,564,054
General and administrative expenses	383,048	345,351
Advertising expenses - (Note 4A)	340,609	337,727
Royalty expense - (Note 4A)	300,509	293,748
Depreciation and amortization - (Notes 1D, 1E and 1F)	396,832	307,899
Interest expense - (Note 3)	<u>42,155</u>	<u>45,315</u>
Total operating expenses	<u>5,434,833</u>	<u>5,303,518</u>
Operating income (loss)	( 262,488)	( 229,684)
Gain/(loss)on sale/(disposal) of assets	( 3,569)	10,742
Workers' Compensation Refund	250,000	425,000
Other income	<u>14,073</u>	<u>2,968</u>
Excess(deficiency)of revenues over expenses - (Note 1G)	<u><u>\$ ( 1,984)</u></u>	<u><u>\$ 209,026</u></u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
Statement of Members' Capital-Income Tax Basis  
For the Years Ended December 25, 2011 and December 26, 2010

Members' capital, December 27, 2009	\$ 300,370
Excess of revenues(deficit)over expenses for the period ended December 26, 2010	209,026
Distributions paid to members	( 223,500)
Redemption of member's interest	<u>( 1,500)</u>
Members' capital, December 26, 2010	284,396
Excess of revenues(deficit)over expenses for the period ended December 25, 2011	( 1,984)
Distributions paid to members	( 239,400)
Redemption of member's interest	<u>( 1,500)</u>
Members' capital, December 25, 2011	<u>\$ 41,512</u>

See accountants' review report and notes to the financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
 CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
 Statement of Cash Flows-Income Tax Basis  
 For the Years Ended December 25, 2011 and December 26, 2010

	2011	2010
Cash flows from operating activities:		
Excess (deficiency) of revenues over expenses	\$( 1,984)	\$ 209,026
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	396,832	307,899
Decrease (increase) in inventories	( 11,041)	1,961
Decrease (increase) in prepaid expenses and other current assets	298	( 298)
Increase (decrease) in accounts payable, accrued expenses and taxes	89,691	( 25,050)
(Gain)/loss on (sale)/disposal of assets	3,569	( 10,742)
Total adjustments	479,349	273,770
Net cash provided by operating activities	477,365	482,796
Cash flows from investing activities:		
Capital expenditures, tangible and intangible assets	( 137,570)	( 69,331)
Proceeds from sale of asset	0	25,000
Net cash provided by (used in) investing activities	( 137,570)	( 44,331)
Cash flows from financing activities:		
Repayments of note payable	( 98,807)	( 90,450)
Members' distributions	( 239,400)	( 223,500)
Redemption of member's interest	( 1,500)	( 1,500)
Proceeds from loan	50,000	0
Net cash provided by (used in) financing activities	( 289,707)	( 315,450)
Net increase (decrease) in cash	50,088	123,015
Cash, beginning of period	294,080	171,065
Cash, end of period	\$ 344,168	\$ 294,080
Supplemental Information:		
Interest paid during the year	\$ 41,954	\$ 45,030

See accountants' review report and notes to the financial statements.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies

(A) The Company:

Wendcharles II, LLC was formed on June 24, 2008 pursuant to the South Carolina Code of Laws to acquire, own and operate six existing Wendy's Old Fashioned Hamburger Restaurants in the Charleston, South Carolina metropolitan area. As part of the same overall transaction, another South Carolina limited liability company, Wendcharles I, LLC, affiliated with the Company by certain common management and ownership interests, acquired eleven other existing Wendy's Old Fashioned Hamburger Restaurants in and proximate to North Charleston. The restaurants were all acquired from one unrelated seller for an aggregate purchase price of \$5,760,000, less net adjustments to the Company of approximately \$14,000. The Company's recorded goodwill in the amount of approximately \$4,060,000. The purchase price was financed principally by a \$3,500,000 loan from Bank of America, with the balance provided by capital contributions of the members. The acquisition closed and restaurant operations commenced on September 16, 2008.

The leases for the six leasehold estates, all in South Carolina, were assigned to the Company from different lessors. Two locations each are in Goose Creek and Summerville and one each is in North Charleston and Moncks Corner as follows: Goose Creek: 101 Red Bank Road; and 601 St. James Avenue; Summerville: 740 North Main Street; and 10012 Dorchester Road; North Charleston: 7440 Northwoods Boulevard; and Moncks Corner: 515 North Highway 52.

The Company is to continue in perpetuity, except it is to be dissolved as a result of the sale of all business operations or the sale of all or substantially all of its assets, in each of such cases upon the receipt of the consideration therefor in cash or the reduction to cash of non-cash consideration, or upon the occurrence of certain events as set forth in the operating agreement. (See Note 5B).

The Company currently operates six restaurants, all of which are leased. (See Note 4B).

(B) Income Tax Basis of Accounting:

The Company is treated as a partnership for federal and South Carolina income tax purposes. The accompanying financial statements have been prepared on the basis of accounting used to prepare the Company's federal partnership return. Such other comprehensive basis of accounting differs in certain respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in accordance with generally accepted accounting principles.

(C) Inventories:

Inventories represent food and supplies and are stated at cost.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(D) Property, Equipment and Depreciation:

Property and equipment are stated at cost. Depreciation is provided by application of the straight-line method over depreciable lives as follows:

Land improvements	15 to 39 years
Leasehold improvements	15 to 39 years
Restaurant equipment	5 to 7 years

If it had qualifying property placed in service during the year, the Company has taken additional depreciation deductions in accordance with the federal government's enactment of the Economic Stimulus Act of 2008, amended by the American Recovery and Reinvestment Act of 2009, the Small Business Jobs Act of 2010, and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

(E) Goodwill:

Goodwill, representing the excess of the purchase price over the fair value of the assets acquired, is amortized over fifteen years.

(F) Deferred Costs:

The Company capitalized the costs incurred in obtaining its financing and its leases. These costs are amortized over the life of the loan.

(G) Income Taxes:

The Company was organized as a Limited Liability Company under the laws of South Carolina and is not subject to any federal or state income tax. For federal and South Carolina income tax purposes, the Company is treated as a partnership. Accordingly, each member is required to report on his federal and applicable state income tax return his distributive share of all items of income, gain, loss, deduction, credit and tax preference of the Company for any taxable year, whether or not any cash distribution has been or will be made to such member.

The Company's tax returns are subject to examination by the Federal and State taxing authorities. The tax laws, rules and regulations governing these returns are complex, technical and subject to varying interpretations. If an examination required the Company to make adjustments, the profit or loss allocated to the members would be adjusted accordingly.

Although income tax rules are used to determine the timing of the reporting of revenues and expenses, non-taxable revenues and non-deductible expenses are included in the determination of net income in the accompanying financial statements.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 1 - Summary of Significant Accounting Policies - (Continued):

(H) Fiscal Year:

The Company's annual accounting period is a fiscal year ending on the last Sunday of December.

(I) Cash:

The Company maintains its cash in various banks. The accounts at each bank are guaranteed by the Federal Deposit Insurance Corporation, to a maximum of \$250,000. At any time during the year, the cash balance may exceed \$250,000.

(J) Use of Estimates:

The preparation of financial statements in conformity with the income tax basis of accounting requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

(K) Advertising:

The Company expenses all advertising costs when incurred.

Note 2 - Property and Equipment

Property and equipment consist of the following:

	<u>2011</u>	<u>2010</u>
Land improvements	\$ 160,325	\$ 150,624
Leasehold improvements	520,764	511,804
Restaurant equipment	<u>1,020,519</u>	<u>911,470</u>
Total	1,701,608	1,573,898
Less: Accumulated depreciation	<u>1,190,041</u>	<u>903,399</u>
Property and equipment, net	<u>\$ 511,567</u>	<u>\$ 670,499</u>

Note 3 - Acquisition Debt

At the closing of the purchase transaction, the Company and its affiliate, Wendcharles I, LLC, jointly obtained a \$3,500,000 loan from Bank of America, with interest at a floating rate, initially equal to the thirty-day adjusted LIBOR plus 250 basis points for the period commencing on the closing date until four quarterly financial reports have been submitted and reviewed in accordance with the loan agreement and, thereafter, equal to the thirty day adjusted LIBOR plus a margin based on the funded debt to earnings before interest, taxes depreciation and amortization ("EBITDA") ratio. Based on the relative values of the leasehold interests acquired, \$1,800,000 and \$1,700,000, representing 51% and 49%, respectively, of the total principal amount, were recorded on the books of the Company and its affiliate, although they are jointly and severally liable for the loan.

See accountants' review report.

**VRONA & VAN SCHUYLER CPAs, PLLC**  
CERTIFIED PUBLIC ACCOUNTANTS

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 3 - Acquisition Debt - (Continued):

A combined initial payment of interest only of \$7,277, based on LIBOR of 2.49%, set two business days before the closing date was due and paid on October 1, 2008. Beginning on November 1, 2008 and ending on August 1, 2015, monthly payments of interest and principal are due in an amount sufficient to amortize the loan over 13.5 years. LIBOR is adjusted on the first business day of each month. The loan matures on August 16, 2015. The loan may be prepaid at any time upon five days written notice, in minimum increments of \$250,000, provided the Companies pay any costs incurred by the bank in the termination of any interest swap agreements between the parties.

The Loan was guaranteed by two of the Companies three managing members until the later occurrence of one year from the closing date or the date the Companies achieve a combined funded debt to EBITDA ratio of less than 3.75 to 1.00 for two consecutive quarters. (See Note 4C). The guarantee was released by the lender on March 31, 2010.

The loan is secured by all the assets of each company. The agreement contains various standard affirmative and negative covenants as well as certain formula-based covenants. At December 31, 2011, the companies were not in compliance with these formula-based covenants.

The Company's share of the estimated aggregate annual principal amounts required on the note through maturity are as follows: 2012: \$100,914; 2013: \$108,080; 2014: \$114,748; and 2015: \$1,090,516.

In October 2011 the Company borrowed \$50,000 from M&T Bank for restaurant equipment. Repayment terms are monthly payments of \$1,388 plus interest at 3.24% for 36 months.

Future annual principal payments are as follows:

2012	\$ 16,667
2013	16,667
2014	<u>13,888</u>
	<u>\$ 47,222</u>

Note 4 - Commitments and Contingencies

(A) Franchise Agreement Commitments:

The Company is the franchisee for the six Wendy's restaurants it owns and operates. The franchise agreements obligate the Company to pay to Wendy's International a monthly royalty equal to 4% of the gross sales of each restaurant, or \$250, whichever is greater. The Company must also pay to Wendy's National Advertising Program 3% of the gross sales and spend not less than 1% of the gross sales of each restaurant for local and regional advertising.

See accountants' review report.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(B) Minimum Operating Lease Commitments:

The lease for the restaurant located at 101 Red Bank Road in Goose Creek has a primary term that expires on November 8, 2020 and includes two ten-year renewal options. The current annual rent for the lease is \$119,070 through November 8, 2015. At that time and on each five year anniversary thereafter, annual rent will be increased by the previous year's annual rent multiplied by 5%. In addition the Company is required to pay percentage rent equal to 6% of gross sales in excess of base rent.

The lease for the restaurant located at 740 North Main Street in Summerville had a primary term that expired on June 20, 2004. The current term expires on June 20, 2014 and includes two remaining five-year renewal options. The annual rent is \$67,628 for all terms of the lease.

The lease for the restaurant located at 1295 West Dorchester Road in Summerville had a primary term that expired on April 30, 1995. The current term expires on April 30, 2015. The annual rent is \$56,012 for all terms of the lease. In addition the Company is required to pay percentage rent equal to 6% of gross sales in excess of base rent.

The lease for the restaurant located at 7440 Northwoods Blvd in North Charleston has a primary term that expires on November 8, 2020 and includes two ten year renewal options. The current annual rent for the lease is \$123,237 through November 30, 2015. At that time and on each five year anniversary thereafter, annual rent will be increased by the previous year's annual rent multiplied by 5%. In addition the Company is required to pay percentage rent equal to 6% of gross sales in excess of base rent.

The lease for the restaurant located at 601 St. James Avenue in Goose Creek has a primary term that expires on March 31, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$105,875 through March 31, 2011. At that time and on each April 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1%.

The lease for the restaurant located at 515 North Highway 52 in Moncks Corner has a primary term that expires on November 30, 2025 and includes two five-year renewal options. The current annual rent for the lease is \$124,911 through November 30, 2015. At that time and on each December 1 thereafter, annual rent will be increased by the previous year's annual rent multiplied by 1.5%.

The Company is required to pay all realty taxes, insurance, routine maintenance and common charges for the above leases.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 4 - Commitments and Contingencies - (Continued):

(B) Minimum Operating Lease Commitments:

Rent expense was \$620,867 in 2011 and \$605,047 in 2010 including percentage rent of \$24,239 in 2011 and \$21,544 in 2010.

Future annual minimum rentals are as follows:

2012	599,556
2013	602,526
2014	569,844
2015	504,990
2016	500,152
Thereafter	<u>3,234,189</u>
	<u>\$6,011,257</u>

(C) Financial and Operational Advisory Services Agreement:

The Company has a financial and operational advisory services agreement with three of its corporate officers. The agreement provides for these officers to: Consult with and advise the Company on applicable financial and/or operational matters and if required by the Company's debt, lease or franchise agreements, to which they are signatories, to remain ready, willing and able to maintain such status for the benefit of the Company, except where such guarantees are not needed; and remain able to provide such additional personal guarantees as, within their sole discretion, may reasonably be necessary to maintain the business of the Company. The initial term expires December 2011, and is automatically renewable annually thereafter, as long as the Company remains in business. The agreement also provides for the reimbursement of reasonable expenses incurred by the individuals in fulfilling their duties. The aggregate annual fee under this agreement is \$18,000. (See Note 6A).

Note 5 - Capitalization and Operating Agreement

(A) Capitalization:

The Company's initial capitalization consisted of 800 units, of which 42 and 32 were sold to two managing members at \$100 per unit, or \$7,400 in the aggregate, and 64 units were sold to the third managing member at \$156 per unit, or \$10,000 in the aggregate. Of the remaining 646 units, 83 were sold at \$100 per unit, or \$8,300 in the aggregate, and 579 units were sold at per unit contributions of \$2,300 totaling \$1,331,700. All contributions totaled \$1,357,400. (See Note 5B).

(B) Operating Agreement:

All purchasers of membership interests are parties to the Company's operating agreement which provides for the capitalization and operation of the Company, distributions to members and transfers of interests. Members' consents representing 75% of all membership interests are required for the following actions: Change in the operating agreement; voluntary dissolution; sale or exchange of substantially all assets; merger or consolidation; incurrence of debt or refinancing other than in the ordinary course of business or in connection with entering new or unrelated businesses; and removal of a manager, for cause. Members are not required to make up negative capital accounts.

See accountants' review report.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 25, 2010

Note 5 - Capitalization and Operating Agreement - (Continued):

(B) Operating Agreement-continued:

Distributions either from cash flow generated by operations or capital transactions (as defined) other than capital contributions are made at the sole discretion of the managers, acting unanimously. Managers are elected by the members. Outside liens against membership interests are prohibited. For permitted transfers of membership interests, book value is equal to assets less liabilities using the income tax method/accrual basis of accounting, except for transfers involving the interest owned by the Company's President, in which case a special valuation adjustment is required through August 2013.

Members wishing to sell their interests shall submit their request in writing, together with appropriate documentation setting forth the terms of such sale, to the managing members, who within thirty days and at their sole discretion, shall approve or disapprove of such sale. If not approved, the managing members within fourteen additional days may elect to have the Company purchase the offered units at the stated terms. Such action by the managing members is to be by simple majority. If the managing members determine that the offered interests are not to be redeemed by the Company, then the interests shall be offered to the remaining members of the Company, pro-rata at the same offered terms, who will have 14 additional days to purchase the offered shares. If the interests are not purchased by the members, then they may be sold to the third-party purchaser at the offered terms, but the purchaser must become bound by the terms of the operating agreement. Membership interests may also be transferred to family members or trusts or by reason of death or incompetence.

In the event of a termination of a member's interest by death, retirement, resignation, expulsion, bankruptcy, incompetence, or in the case of a member that is not a natural person - dissolution, the Company must be dissolved unless it is continued by the consent of all the remaining members. Non-consenting members are deemed to offer and authorized representatives or trustees of deceased or bankrupt members may offer the applicable membership interest, first to the Company, and then to the consenting (continuing) members. In such case, the offered interests must be purchased by either the Company or one or more of the consenting members. Such purchases, unless made by the Company, are to be made pro-rata to the existing interests of purchasing members, unless they agree otherwise or there is only one purchasing member.

In any event, all offered interests of non-consenting members or by the estate, trustee, etc. of deceased or bankrupt members, etc. must be purchased by the Company or one or more consenting members or the Company must be dissolved and liquidated.

Wendcharles II, LLC  
Notes to the Financial Statements  
December 25, 2011 and December 26, 2010

Note 6 - Related Party Transactions

(A) Financial and Operating Advisory Service Fees:

The Company paid two of its three managing members and a third individual a total of \$18,000 in 2011 and \$18,000 in 2010 pursuant to a financial and operational advisory services agreement.

(B) Other:

In March 2009 the Company redeemed one member's .13% membership interest for \$500.

In January 2010 the Company redeemed one member's .13% membership interest for \$1,500.

In December 2011 the Company redeemed one member's .13% membership interest for \$1,500.

Note 7 - Pension Plan

The Company maintains a qualified cash or deferred compensation plan under section 401(K) of the Internal Revenue Code. Under the plan, employees may elect to defer up to (15%) of their salary, subject to Internal Revenue Service limits. A discretionary matching contribution may be made by the Company and added to each participant's account. Company contributions for the plan amounted to \$0 for 2011 and \$0 for 2010.

Note 8 - Subsequent Event

On December 26, 2011 the restaurant located at 1721 Sam Rittenberg Blvd in Charleston was purchased by the Company from its affiliate Wendcharles I for \$66,922 representing the net asset value of the restaurant.