



April 18, 2012

Mike Isbell  
Oklahoma Tax Commission  
Ad Valorem Division  
P.O. Box 269060  
Oklahoma City, OK 73126-9060

Re: Preliminary 2012 Capitalization Rate Study, Pipeline MLP Industry

Dear Mike:

Thank you again for organizing this year's cap rate meeting with industry and for posting the OTC's Preliminary 2012 Capitalization Rate Study online. After reviewing the Pipeline MLP Industry section, I have a couple of comments that I would like to share.

- 1. More weight should be given to the DCF Model in the calculation of the cost of equity:** The Master Limited Partnership (MLP) structure creates additional filing requirements and complications with flow through tax issues. Therefore, MLP units tend to trade less frequently than corporate shares that are generally owned and traded by a broader set of investors. This means that the trading pattern for MLP units is different when compared to corporate shares. Consequently, MLP beta estimates tend to be biased on the low side. As a result, the estimated returns of MLP companies may be understated when using a CAPM model to estimate the cost of capital. We feel that a more accurate estimate of the cost of equity for the MLP pipeline industry is the DCF Model. This model focuses on the current dividend yield plus consensus earnings growth estimates which better reflects MLP returns. Therefore, weighting should be higher on the DCF Model (minimum 80%) and lower on the CAPM (maximum 20%). By weighting the equity calculation 80%-20% accordingly, the equity rate would increase from 12.25% to 12.57%, resulting in a new capitalization rate of 10.64%
- 2. Liquidity Adjustment:** It has long been established that smaller stocks offer returns in excess of that calculated by the CAPM, and some of this difference can be attributed to their illiquidity. An adjustment must be made to the discount rate used to discount the cash flows of an illiquid investment by adding a premium to the cost

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of capital estimated from liquid securities. Several studies have estimated a liquidity premium based on various measures of illiquidity. For companies similar to NuStar Logistics, LP, Ibbotson Associates suggest a minimum premium of 2.8% be added to the equity rate. This would result in an equity rate of about 15.37%, and a corresponding capitalization rate of 12.65%.

We appreciate the opportunity to provide input for the cost of capital process this year. Please feel free to contact me if you have any questions regarding our recommendations or if you have any additional questions or concerns.

Sincerely,

A handwritten signature in cursive script that reads "Tillman Davis".

Tillman Davis

NuStar Logistics, LP