

TRANSCONTINENTAL REALTY INVESTORS INC  
Form 10-Q  
May 13, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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 001-09240

TRANSCONTINENTAL REALTY INVESTORS, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

94-6565852  
(I.R.S. Employer  
Identification No.)

1603 Lyndon B. Johnson Freeway, Suite 800, Dallas, Texas 75234  
(Address of principal executive offices)  
(Zip Code)

(469) 522-4200  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) 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 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  (do not check if a smaller reporting company)

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.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, \$.01 par value  
(Class)

8,717,767  
(Outstanding at May 5, 2015)

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

	March 31, 2015	December 31, 2014
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	\$782,939	\$781,794
Real estate subject to sales contracts at cost, net of depreciation (\$2,387 for 2015 and \$2,300 for 2014)	20,416	20,395
Less accumulated depreciation	(117,334 )	(113,068 )
Total real estate	686,021	689,121
Notes and interest receivable:		
Performing (including \$76,387 in 2015 and \$77,853 in 2014 from related parties)	90,147	84,863
Non-performing	594	584
Less allowance for doubtful accounts (including \$1,825 in 2015 and \$1,825 in 2014 from related parties)	(1,990 )	(1,990 )
Total notes and interest receivable	88,751	83,457
Cash and cash equivalents	19,605	12,201
Restricted cash	35,749	48,238
Investments in unconsolidated joint ventures and investees	1,714	1,543
Receivable from related party	47,519	58,404
Other assets	38,477	37,441
Total assets	\$917,836	\$930,405
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$579,788	\$588,749
Notes related to real estate held for sale	1,227	1,552
Notes related to real estate subject to sales contracts	18,434	18,616
Deferred gain (from sales to related parties)	51,356	51,356
Accounts payable and other liabilities (including \$5,129 in 2015 and \$4,909 in 2014 to related parties)	33,984	36,684
Total liabilities	684,789	696,957
Shareholders' equity:		
Preferred stock, Series C: \$0.01 par value, authorized 10,000,000 shares; issued and outstanding zero shares in 2015 and 2014 (liquidation preference \$100 per share). Series D: \$0.01 par value, authorized,	1	1

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issued and outstanding 100,000 shares in 2015 and 2014 (liquidation preference \$100 per share)

Common stock, \$0.01 par value, authorized 10,000,000 shares; issued 8,717,967 shares in 2015 and

2014; outstanding 8,717,767 shares in 2015 and 2014

Treasury stock at cost, 200 shares in 2015 and 2014

Paid-in capital

Retained earnings

Total Transcontinental Realty Investors, Inc. shareholders' equity

Non-controlling interest

Total shareholders' equity

Total liabilities and shareholders' equity

87		87	
(2	)	(2	)
271,427		271,649	
(56,346	)	(56,451	)
215,167		215,284	
17,880		18,164	
233,047		233,448	
\$917,836		\$930,405	

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

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(unaudited)

	For the Three Months Ended March 31,	
	2015	2014
	(dollars in thousands, except per share amounts)	
<b>Revenues:</b>		
Rental and other property revenues (including \$170 and \$175 for the three months ended 2015 and 2014, respectively, from related parties)	\$22,304	\$18,303
<b>Expenses:</b>		
Property operating expenses (including \$153 and \$145 for the three months ended 2015 and 2014, respectively, from related parties)	10,864	9,203
Depreciation and amortization	4,644	4,280
General and administrative (including \$820 and \$744 for the three months ended 2015 and 2014, respectively, from related parties)	1,768	1,551
Net income fee to related party	45	490
Advisory fee to related party	1,943	1,852
Total operating expenses	19,264	17,376
Net operating income	3,040	927
<b>Other income (expenses):</b>		
Interest income (including \$3,419 and \$2,113 for the three months ended 2015 and 2014, respectively, from related parties)	3,760	2,113
Other income	67	153
Mortgage and loan interest (including \$0 and \$31 for the three months ended 2015 and 2014, respectively, from related parties)	(7,744)	(6,487)
Deferred borrowing costs amortization	(591)	(931)
Loan charges and prepayment penalties	(1,850)	(1,582)
Earnings (losses) from unconsolidated joint ventures and investees	33	(4)
Litigation settlement	(73)	3,839
Total other expenses	(6,398)	(2,899)
Loss before gain on land sales, non-controlling interest, and taxes	(3,358)	(1,972)
Gain on land sales	2,876	753
Net loss from continuing operations before taxes	(482)	(1,219)
Income tax benefit	102	2,049
Net income (loss) from continuing operations	(380)	830
<b>Discontinued operations:</b>		
Net income (loss) from discontinued operations	292	(199)
Gain on sale of real estate from discontinued operations	-	6,053

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Income tax expense from discontinued operations	(102	)	(2,049	)
Net income from discontinued operations	190		3,805	
Net income (loss)	(190	)	4,635	
Net (income) loss attributable to non-controlling interest	295		(84	)
Net income attributable to Transcontinental Realty Investors, Inc.	105		4,551	
Preferred dividend requirement	(222	)	(274	)
Net income (loss) applicable to common shares	\$(117	)	\$4,277	
Earnings per share - basic				
Net income (loss) from continuing operations	\$(0.04	)	\$0.06	
Net income from discontinued operations	0.02		0.45	
Net income (loss) applicable to common shares	\$(0.02	)	\$0.51	
Earnings per share - diluted				
Net income (loss) from continuing operations	\$(0.04	)	\$0.05	
Net income from discontinued operations	0.02		0.44	
Net income (loss) applicable to common shares	\$(0.02	)	\$0.49	
Weighted average common shares used in computing earnings per share	8,717,767		8,413,469	
Weighted average common shares used in computing diluted earnings per share	8,717,767		8,639,679	
Amounts attributable to Transcontinental Realty Investors, Inc.				
Net income (loss) from continuing operations	\$(85	)	\$746	
Net income from discontinued operations	190		3,805	
Net income	\$105		\$4,551	

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

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
For the Three Months Ended March 31, 2015  
(unaudited, dollars in thousands)

	Total Equity	Comprehensive Loss	Preferred Stock	Common Stock Shares	Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings	Non-controlling Interest
Balance, December 31, 2014	\$ 233,448	\$ (57,670 )	\$1	8,717,967	\$87	\$(2 )	\$271,649	\$(56,451 )	\$ 18,164
Series D preferred stock dividends (9.0% per year)	(222 )	-	-	-	-	-	(222 )	-	-
Net income (loss)	(190 )	(190 )	-	-	-	-	-	105	(295 )
Contributions from non-controlling interests	11	-	-	-	-	-	-	-	11
Balance, March 31, 2015	\$ 233,047	\$ (57,860 )	\$1	8,717,967	\$87	\$(2 )	\$271,427	\$(56,346 )	\$ 17,880

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



TRANSCONTINENTAL REALTY INVESTORS, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (unaudited)

	For the Three Months Ended March 31,	
	2015	2014
	(dollars in thousands)	
Net income (loss)	\$(190 )	\$4,635
Other comprehensive income (loss)	-	-
Total comprehensive income (loss)	(190 )	4,635
Comprehensive (income) loss attributable to non-controlling interest	295	(84 )
Comprehensive income attributable to Transcontinental Realty Investors, Inc.	\$105	\$4,551

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

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

	For the Three Months Ended March 31,	
	2015	2014
	(dollars in thousands)	
<b>Cash Flow From Operating Activities:</b>		
Net income (loss)	\$(190	) \$4,635
Adjustments to reconcile net income applicable to common shares to net cash flows from operating activities:		
Gain on sale of land	(2,876	) (753
Gain on sale of income-producing properties	-	(6,053
Depreciation and amortization	4,644	4,609
Amortization of deferred borrowing costs	591	1,213
Losses (earnings) from unconsolidated joint ventures and investees	(33	) 4
Decrease (increase) in assets:		
Accrued interest receivable	1,117	10,587
Other assets	1,913	(13
Prepaid expense	(1,112	) (777
Escrow	12,210	4,607
Earnest money	(1,720	) (65
Rent receivables	(491	) (238
Related party receivables	10,885	(27,759
Increase (decrease) in liabilities:		
Accrued interest payable	25	(62
Other liabilities	(2,640	) (13,554
Net cash provided by (used in) operating activities	22,323	(23,619
<b>Cash Flow From Investing Activities:</b>		
Originations or advances on notes receivable	(6,411	) (4,449
Acquisition of land held for development	-	(93
Proceeds from sale of income-producing properties	-	22,480
Proceeds from sale of land	6,849	1,504
Investment in unconsolidated real estate entities	(138	) (131
Improvement of land held for development	(984	) (115
Improvement of income-producing properties	(3,457	) (1,162
Construction and development of new properties	(785	) (205
Net cash provided by (used in) investing activities	(4,926	) 17,829
<b>Cash Flow From Financing Activities:</b>		
Proceeds from notes payable	11,488	61,212
Recurring amortization of principal on notes payable	(4,132	) (4,668
Payments on maturing notes payable	(16,849	) (44,486
Deferred financing costs	(289	) (3,903
Contributions from non-controlling interests	11	-
Preferred stock dividends - Series C	-	(52

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Preferred stock dividends - Series D	(222 )	(222 )
Net cash provided by (used in) financing activities	(9,993 )	7,881
Net increase in cash and cash equivalents	7,404	2,091
Cash and cash equivalents, beginning of period	12,201	16,086
Cash and cash equivalents, end of period	\$19,605	\$18,177
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$7,744	\$7,151

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

#### Organization

As used herein, the terms “TCI”, “the Company”, “we”, “our” or “us” refer to Transcontinental Realty Investors, Inc., a Nevada corporation. TCI is the successor to a California business trust which was organized on September 6, 1983, and commenced operations on January 31, 1984. Effective March 31, 2003, TCI’s financial results were consolidated in American Realty Investors, Inc. (“ARL”) Form 10-K and related Consolidated Financial Statements.

The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange (“NYSE”) under the symbol (“TCI”). Subsidiaries of ARL own approximately 80.9% of the Company’s common stock. ARL’s common stock trades on the New York Stock Exchange under the symbol (“ARL”). We have no employees.

TCI is a “C” corporation for U.S. federal income tax purposes and files an annual consolidated tax return with ARL and its ultimate parent, May Realty Holdings, Inc. (“MRHI”).

TCI owns approximately 81.1% of the common stock of Income Opportunity Realty Investors, Inc. (“IOT”). Effective July 17, 2009, IOT’s financial results were consolidated with those of ARL and TCI and their subsidiaries. Shares of IOT are traded on the New York Stock Exchange Euronext (“NYSE MKT”) under the symbol (“IOT”).

TCI invests in real estate through direct ownership, leases and partnerships and also invests in mortgage loans on real estate. Pillar Income Asset Management, Inc. (“Pillar”) is the Company’s external Advisor and Cash Manager. Although the Board of Directors is directly responsible for managing the affairs of TCI, and for setting the policies which guide it, the day-to-day operations of TCI are performed by Pillar, as the contractual Advisor, under the supervision of the Board. Pillar’s duties include, but are not limited to: locating, evaluating and recommending real estate and real estate-related investment opportunities, and arranging debt and equity financing for the Company with third party lenders and investors. Additionally, Pillar serves as a consultant to the Board with regard to their decisions in connection with TCI’s business plan and investment policy. Pillar also serves as an Advisor and Cash Manager to ARL and IOT.

Regis Realty Prime, LLC (“Regis”) manages our commercial properties and provides brokerage services for our real estate portfolio. TCI engages third-party companies to lease and manage its apartment properties.

#### Properties

We own or had interests in a total property portfolio of 45 income-producing properties as of March 31, 2015. The properties consisted of:

• Eight commercial properties consisting of four office buildings, two retail centers, one industrial warehouse and a golf course, comprising in aggregate approximately 1.8 million rentable square feet;

- 37 apartment communities totaling 6,024 units; excluding apartments being developed; and
  - 4,053 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We are in the predevelopment process on several residential apartment communities but have not yet begun construction. At

March 31, 2015, we had one apartment project in development. The third-party developer typically holds a general partner, as well as a majority limited partner interest in a limited partnership formed for the purpose of building a single property, while we generally take a minority limited partner interest in the limited partnership. We may contribute land to the partnership as part of our equity contribution or we may contribute the necessary funds to the partnership to acquire the land. We are required to fund all required equity contributions while the third-party developer is responsible for obtaining construction financing, hiring a general contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our Consolidated Financial Statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer's partnership interests in exchange for any remaining unpaid developer fees.

## Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted in accordance with such rules and regulations, although management believes the disclosures are adequate to prevent the information presented from being misleading. In the opinion of management, all adjustments (consisting of normal recurring matters) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2015, are not necessarily indicative of the results that may be expected for other interim periods or for the full fiscal year.

The year-end Consolidated Balance Sheet at December 31, 2014, was derived from the audited Consolidated Financial Statements at that date, but does not include all of the information and disclosures required by GAAP for complete financial statements. For further information, refer to the Consolidated Financial Statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. Certain 2014 Consolidated Financial Statement amounts have been reclassified to conform to the 2015 presentation, including any adjustments for discontinued operations.

## Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of the Company, its subsidiaries, generally all of which are wholly-owned, and all entities in which we have a controlling interest. Arrangements that are not controlled through voting or similar rights are accounted for as a Variable Interest Entity (VIE), in accordance with the provisions and guidance of ASC Topic 810 “Consolidation”, whereby we have determined that we are a primary beneficiary of the VIE and meet certain criteria of a sole general partner or managing member as identified in accordance with Emerging Issues Task Force (“EITF”) Issue 04-5, Investor’s Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Rights (“EITF 04-5”). VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders as a group lack adequate decision making ability, the obligation to absorb expected losses or residual returns of the entity, or have voting rights that are not proportional to their economic interests. The primary beneficiary generally is the entity that provides financial support and bears a majority of the financial risks, authorizes certain capital transactions, or makes operating decisions that materially affect the entity’s financial results. All significant intercompany balances and transactions have been eliminated in consolidation.

In determining whether we are the primary beneficiary of a VIE, we consider qualitative and quantitative factors, including, but not limited to: the amount and characteristics of our investment; the obligation or likelihood for us or other investors to provide financial support; our and the other investors’ ability to control or significantly influence key decisions for the VIE; and the similarity with and significance to the business activities of us and the other investors. Significant judgments related to these determinations include estimates about the current future fair values and performance of real estate held by these VIEs and general market conditions.

For entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary, the entities are accounted for using the equity method of accounting. Accordingly, our share of the net earnings or losses of these entities is included in consolidated net income. Our investment in ARL is accounted for under the equity method.

## Real Estate, Depreciation and Impairment

Real estate assets are stated at the lower of depreciated cost or fair value, if deemed impaired. Major replacements and betterments are capitalized and depreciated over their estimated useful lives. Depreciation is computed on a straight-line basis over the useful lives of the properties (buildings and improvements – 10-40 years; furniture, fixtures and equipment – 5-10 years). The Company continually evaluates the recoverability of the carrying value of its real estate assets using the methodology prescribed in ASC Topic 360, “Property, Plant and Equipment”. Factors considered by management in evaluating impairment of its existing real estate assets held for investment include significant declines in property operating profits, annually recurring property operating losses and other significant adverse changes in general market conditions that are considered permanent in nature. Under ASC Topic 360, a real estate asset held for investment is not considered impaired if the undiscounted, estimated future cash flows of an asset (both the annual estimated cash flow from future operations and the estimated cash flow from the theoretical sale of the asset) over its estimated holding period are in excess of the asset’s net book value at the balance sheet date. If any real estate asset held for investment is considered impaired, a loss is provided to reduce the carrying value of the asset to its estimated fair value.

### Real Estate Held for Sale

We periodically classify real estate assets as “held for sale”. An asset is classified as held for sale after the approval of our Board of Directors, after an active program to sell the asset has commenced and if the sale is probable. One of the deciding factors in determining whether a sale is probable is whether the firm purchase commitment is obtained and whether the sale is probable within the year. Upon the classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its estimated fair value, less costs to sell the asset. Subsequent to the classification of assets as held for sale, no further depreciation expense is recorded. Real estate assets held for sale are stated separately on the accompanying Consolidated Balance Sheets. Upon a decision that the sale is no longer probable, the asset is classified as an operating asset and depreciation expense is reinstated. The operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying Consolidated Statements of Operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. This classification of operating results as discontinued operations applies retroactively for all periods presented. Additionally, gains and losses on assets designated as held for sale are classified as part of discontinued operations.

### Cost Capitalization

Costs related to planning, developing, leasing and constructing a property are capitalized and classified as Real Estate in the Consolidated Balance Sheets. We capitalize interest to qualifying assets under development based on average accumulated expenditures outstanding during the period. In capitalizing interest to qualifying assets, we first use the interest incurred on specific project debt, if any, and next use the weighted average interest rate of non-project specific debt. We capitalize interest, real estate taxes and certain operating expenses until building construction is substantially complete and the building is ready for its intended use, but no later than one year from the cessation of major construction activity.

We capitalize leasing costs, which include commissions paid to outside brokers, legal costs incurred to negotiate and document a lease agreement and any internal costs that may be applicable. We allocate these costs to individual tenant leases and amortize them over the related lease term.

### Fair Value Measurement

We apply the guidance in ASC Topic 820, “Fair Value Measurements and Disclosures”, to the valuation of real estate assets. These provisions define fair value as the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date, establish a hierarchy that prioritizes the information used in developing fair value estimates and require disclosure of fair value measurements by level within the fair value hierarchy. The hierarchy gives the highest priority to quoted prices in active markets (Level 1 measurements) and the lowest priority to unobservable data (Level 3 measurements), such as the reporting entity’s own data.

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date and includes three levels defined as follows:

- Unadjusted quoted prices for identical and unrestricted assets or liabilities in Level 1 active markets.
- Level 2 Quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 Unobservable inputs that are significant to the fair value measurement.



A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

#### Related Parties

We apply ASC Topic 805, "Business Combinations", to evaluate business relationships. Related parties are persons or entities who have one or more of the following characteristics, which include entities for which investments in their equity securities would be required, trust for the benefit of persons including principal owners of the entities and members of their immediate families, management personnel of the entity and members of their immediate families and other parties with which the entity may deal if one party controls or can significantly influence the decision making of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests, or affiliates of the entity.

## Newly Issued Accounting Pronouncements

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our Consolidated Financial Statements, including that which we have not yet adopted. We do not believe that any such guidance will have a material effect on our financial position or results of operations.

## NOTE 2. REAL ESTATE ACTIVITY

Below is a summary of the real estate owned as of March 31, 2015 (dollars in thousands):

Apartments	\$452,888
Apartments under construction	1,514
Commercial properties	182,371
Land held for development	146,165
Real estate subject to sales contract	22,804
Total real estate	\$805,742
Less accumulated depreciation	(119,721 )
Total real estate, net of depreciation	\$686,021

The highlights of our significant real estate transactions for the three months ended March 31, 2015, are listed below:

On March 19, 2015, the Company sold 15.515 acres of land known as McKinney Ranch land, located in McKinney, Texas, to an independent third party, for a sales price of \$3.4 million. TCI paid \$3.2 million on the existing mortgage to satisfy a portion of the multi-tract collateral debt of \$5.1 million, secured by various land parcels located in McKinney, Texas. A gain of \$1.3 million was recorded on the sale.

On March 31, 2015, the Company sold 17.872 acres of land known as McKinney Ranch land, located in McKinney, Texas, to an independent third party, for a sales price of \$3.9 million. TCI paid \$1.9 million to pay off the remaining balance of the multi-tract collateral debt, secured by various land parcels located in McKinney, Texas. A gain of \$1.6 million was recorded on the sale.

As of March 31, 2015, there is one apartment complex, one commercial building and 110 acres of land that we have sold to a related party and have deferred the recognition of the sale. These are treated as “subject to sales contract” on the Consolidated Balance Sheets. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and may or may not be transferred back to the seller upon resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. According to the loan documents, the maker is currently in default on these mortgages primarily due to lack of payment and is actively involved in discussions with every lender in order to settle or cure the default situation. We have reviewed each asset and taken impairment to the extent we feel the value of the property was less than our current basis. The Company did not recognize or record the sale in accordance with ASC 360-20 due to our continuing involvement, which included the potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer’s inadequate initial investment and the Company’s questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20. The buyers received no compensation for the facilitation of the bankruptcy or debt restructuring process.

We continue to invest in the development of apartment projects. During the three months ended March 31, 2015, we have expended \$0.8 million related to the construction or predevelopment of various apartment complexes.

NOTE 3. NOTES AND INTEREST RECEIVABLE

A portion of our assets are invested in mortgage notes receivable, principally secured by real estate. We may originate mortgage loans in conjunction with providing purchase money financing of property sales. Notes receivable are generally collateralized by real estate or interests in real estate and personal guarantees of the borrower and, unless noted otherwise, are so secured. Management intends to service and hold for investment the mortgage notes in our portfolio. A majority of the notes receivable provide for principal to be paid at maturity. Our mortgage notes receivable consist of first, wraparound and junior mortgage loans (dollars in thousands):

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Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
Foundation for Better Housing, Inc. (Holland Lake) (1)	12/19	12.00%	4,698	Secured
Foundation for Better Housing, Inc. (Holland Lake) (1)	12/17	12.00%	1,674	Secured
Foundation for Better Housing, Inc. (Overlook at Allensville) (1)	11/19	12.00%	2,472	Secured
Foundation for Better Housing, Inc. (Overlook at Allensville) (1)	12/17	12.00%	1,408	Secured
Foundation for Better Housing, Inc. (Preserve at Prairie Pointe) (1)	03/19	12.00%	1,810	Secured
Foundation for Better Housing, Inc. (Preserve at Prairie Pointe) (1)	03/17	12.00%	1,156	Secured
Foundation for Better Housing, Inc. (Vista Ridge) (1)	04/19	12.00%	3,923	Secured
Foundation for Better Housing, Inc. (Vista Ridge) (1)	06/17	12.00%	1,492	Secured
H198, LLC (Las Vegas Land)	01/20	12.00%	5,907	Secured
HGH Residential, Inc. (Tradewinds Development)	07/19	12.00%	6,131	Secured
Unified Housing Foundation, Inc. (Echo Station) (1)	09/17	12.00%	1,481	100% Interest in Unified Housing of Temple, LLC
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00%	6,363	Membership interest in Housing for Seniors of Humble, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00%	4,663	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/32	12.00%	6,000	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/32	12.00%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing) (1)	12/32	12.00%	1,936	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00%	4,812	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC

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Ridge) (1)				LLC
Unified Housing Foundation, Inc. (Timbers of Terrell) (1)	12/32	12.00%	1,323	100% Interest in Unified Housing of Terrell, LLC
Unified Housing Foundation, Inc. (Tivoli) (1)	12/32	12.00%	7,966	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. (1)	06/17	12.00%	1,261	Unsecured
Unified Housing Foundation, Inc. (1)	12/17	12.00%	1,207	Unsecured
Other related party notes (1)	Various	Various	768	Various secured interests
Other related party notes (1)	Various	Various	4,276	Various unsecured interests
Other non-related party notes	Various	Various	496	Various secured interests
Other non-related party notes	Various	Various	503	Various unsecured interests
Accrued interest			3,940	
Total Performing			\$ 90,147	
Non-Performing loans:				
Other non-related party notes	Various	Various	507	Secured
Accrued interest			87	
Total Non-Performing			\$ 594	
Allowance for doubtful accounts			(1,990)	
Total			\$ 88,751	

(1) Related party notes

Junior Mortgage Loans. We may invest in junior mortgage loans, secured by mortgages that are subordinate to one or more prior liens either on the fee or a leasehold interest in real estate. Recourse on such loans ordinarily includes the real estate on which the loan is made, other collateral and personal guarantees by the borrower.

At March 31, 2015, we had junior mortgage loans and accrued interest receivable from related parties, net of allowances, totaling \$74.6 million. We recognized interest income of \$2.8 million related to these notes receivables.

The Company has various notes receivable from Unified Housing Foundation, Inc. (“UHF”) and Foundation for Better Housing, Inc. (“FBH”). UHF and FBH are determined to be related parties due to our significant investment in the performance of the collateral secured under the notes receivable. Payments are due from surplus cash flow of operations of the properties. A sale or refinance of any of the properties underlying these notes will be used to repay outstanding interest and principal for the remaining notes for the specific borrower. These notes are cross-collateralized for the specific borrower, but to the extent cash is received from a specific UHF or FBH property, it is applied first against any outstanding interest for the related-property note. The allowance on the UHF notes was a purchase allowance that was netted against the notes when acquired.



## NOTE 4. INVESTMENT IN UNCONSOLIDATED JOINT VENTURES AND INVESTEEES

Investments in unconsolidated joint ventures and other investees in which we have a 20% to 50% interest or otherwise exercise significant influence, are carried at cost and adjusted for the Company's proportionate share of their undistributed earnings or losses under the equity method of accounting. ARL is our parent company and is considered as an unconsolidated joint venture.

Investments in unconsolidated joint ventures and investees consist of the following:

	Percentage ownership as of	
	March 31, 2015	March 31, 2014
American Realty Investors, Inc.(1)	1.00 %	1.99 %

(1) Unconsolidated investment in parent company owning 140,000 shares of ARL Common Stock

Our interest in the common stock of ARL in the amount of 1.00% is accounted for under the equity method because we exercise significant influence over the operations and financial activities. Accordingly, the investments are carried at cost, adjusted for the Company's proportionate share of earnings or losses.

The Company acquired 135,000 shares of ARL Series K preferred stock on May 7, 2013. It was pledged as collateral on a \$5.0 million promissory note relating to the Amoco Building settlement agreement. This note has been paid in full and the stock was released. The par value per share was \$2 and the liquidation preference was \$22 per share. It was convertible to common stock at a rate of 5 to 1. The Series K preferred stock was cancelled May 7, 2014.

The following is a summary of the financial position and results of operations from our unconsolidated parent (dollars in thousands):

As of March 31,	2015	2014
Real estate, net of accumulated depreciation	\$15,384	\$15,212
Notes receivable	49,412	67,450
Other assets	128,103	128,291
Notes payable	(41,714 )	(51,138 )
Other liabilities	(84,822 )	(98,220 )
Shareholders' equity	(66,363 )	(61,595 )
For the Three Months Ended March 31,	2015	2014
Rents and interest and other income	\$6,359	\$2,881
Depreciation	(78 )	(68 )
Operating expenses	(1,810 )	(1,486 )
Interest expense	(1,448 )	(1,633 )
Income (loss) from continuing operations	3,023	(306 )
Income (loss) from discontinued operations	-	-
Net income (loss)	\$3,023	\$(306 )
Company's proportionate share of income (loss) (1)	\$30	\$(6 )

(1) Income (loss) represents continued and discontinued operations





## NOTE 5. NOTES PAYABLE

Below is a summary of our notes and interest payable as of March 31, 2015 (dollars in thousands):

	Notes Payable	Accrued Interest	Total Debt
Apartments	\$409,817	\$1,072	\$410,889
Commercial	104,292	461	104,753
Land	59,386	117	59,503
Real estate held for sale	1,227	-	1,227
Real estate subject to sales contract	16,754	1,680	18,434
Other	4,643	-	4,643
Total	\$596,119	\$3,330	\$599,449

The segment labeled as “Other” consists of unsecured or stock-secured notes payable.

With respect to the additional notes payable due to the acquisition of properties or refinancing of existing mortgages, a summary of some of the more significant transactions is discussed below:

On January 28, 2015, the Company refinanced the existing mortgage on Heather Creek apartments, a 200-unit complex located in Mesquite, Texas, for a new mortgage of \$11.5 million. We paid off the existing mortgage of \$11.5 million and \$0.3 million in closing costs. The note accrues interest at 3.24% and payments of interest and principal are due monthly, maturing August 1, 2050.

On January 28, 2015, the Company modified the existing mortgage on Toulon apartments, a 240-unit complex located in Gautier, Mississippi, to reduce the interest rate. The new term accrues interest at 3.24% and payments of interest and principal are due monthly, maturing August 1, 2050.

There are various land mortgages, secured by the property, that are in the process of a modification or extension to the original note due to expiration of the loan. We are in constant contact with these lenders, working together in order to modify the terms of these loans and we anticipate a timely resolution that is similar to the existing agreement or subsequent modification.

The properties that we have sold to a related party and have deferred the recognition of the sale are treated as “subject to sales contract” on the Consolidated Balance Sheets. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and may or may not be transferred back to the seller upon resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. According to the loan documents, the maker is currently in default on these mortgages primarily due to lack of payment and is actively involved in discussions with every lender in order to settle or cure the default situation. We have reviewed each asset and taken impairment to the extent we feel the value of the property was less than our current basis.

## NOTE 6. RELATED PARTY TRANSACTIONS

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of March 31, 2015 (dollars in thousands):

	Pillar	ARL	Total
Related party receivable, December 31, 2014	\$-	\$58,404	\$58,404
Cash transfers	(6,624 )	-	(6,624 )
Advisory fees	(1,943 )	-	(1,943 )
Net income fee	(45 )	-	(45 )
Fees and commissions	(353 )	-	(353 )
Cost reimbursements	(776 )	-	(776 )
Interest income	-	634	634
Expenses paid by advisor	(1,159 )	-	(1,159 )
Financing (mortgage payments)	(619 )	-	(619 )
Purchase of obligations	11,519	(11,519 )	-
Related party receivable, March 31, 2015	\$-	\$47,519	\$47,519

During the ordinary course of business, we have related party transactions that include, but are not limited to, rental income, interest income, interest expense, general and administrative costs, commissions, management fees, and property expenses. In addition, we have assets and liabilities that include related party amounts. The related party amounts included in assets and liabilities, and the related party revenues and expenses received/paid are shown on the face of the Consolidated Financial Statements.

## NOTE 7. OPERATING SEGMENTS

Our segments are based on our method of internal reporting, which classifies our operations by property type. Our property types are grouped into commercial, apartments, land and other operating segments. Significant differences between and among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative and other expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their net operating income and cash flow.

Items of income that are not reflected in the segments are interest, other income, gain on debt extinguishment, gain on condemnation award, equity in partnerships, and gains on sale of real estate. Expenses that are not reflected in the segments are provision for losses, advisory fees, net income and incentive fees, general and administrative, non-controlling interests and net loss from discontinued operations before gains on sale of real estate.

The segment labeled as "Other" consists of revenue and operating expenses related to the notes receivable and corporate debt.

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Presented below is our reportable segments' operating income for the three months ended March 31, 2015 and 2014, including segment assets and expenditures (dollars in thousands):

For the Three Months Ended March 31, 2015	Commercial				Total
	Properties	Apartments	Land	Other	
Rental and other property revenues	\$ 6,786	\$ 15,473	\$-	\$45	\$22,304
Property operating expenses	(4,013 )	(6,660 )	(181 )	(10 )	(10,864 )
Depreciation	(1,895 )	(2,749 )	-	-	(4,644 )
Mortgage and loan interest	(1,509 )	(3,963 )	(954 )	(1,318 )	(7,744 )
Deferred borrowing costs amortization	(97 )	(258 )	(50 )	(186 )	(591 )
Loan charges and prepayment penalties	-	(1,850 )	-	-	(1,850 )
Interest income	-	-	-	3,760	3,760
Gain on land sales	-	-	2,876	-	2,876
Segment operating income (loss)	\$ (728 )	\$ (7 )	\$ 1,691	\$ 2,291	\$ 3,247
Capital expenditures	3,192	257	826	-	4,275
Real estate assets	141,728	389,276	155,017	-	686,021
Property Sales					
Sales price	\$-	\$-	\$7,257	\$-	\$7,257
Cost of sale	-	-	(4,381 )	-	(4,381 )
Gain on sale	\$-	\$-	\$2,876	\$-	\$2,876
For the Three Months Ended March 31, 2014					
	Commercial				Total
	Properties	Apartments	Land	Other	
Rental and other property revenues	\$ 4,449	\$ 13,846	\$-	\$8	\$ 18,303
Property operating expenses	(2,878 )	(6,132 )	(188 )	(5 )	(9,203 )
Depreciation	(1,792 )	(2,488 )	-	-	(4,280 )
Mortgage and loan interest	(1,408 )	(3,738 )	(1,109 )	(232 )	(6,487 )
Deferred borrowing costs amortization	(13 )	(884 )	(31 )	(3 )	(931 )
Loan charges and prepayment penalties	(9 )	(1,573 )	-	-	(1,582 )
Interest income	-	-	-	2,113	2,113
Gain on land sales	-	-	753	-	753
Segment operating income (loss)	\$ (1,651 )	\$ (969 )	\$ (575 )	\$ 1,881	\$ (1,314 )
Capital expenditures	1,130	-	85	-	1,215
Real estate assets	128,617	351,547	158,022	-	638,186
Property Sales					
Sales price	\$-	\$23,131	\$1,565	\$-	\$24,696
Cost of sale	-	(17,078 )	(812 )	-	(17,890 )
Gain on sale	\$-	\$6,053	\$753	\$-	\$6,806

The table below reconciles the segment information to the corresponding amounts in the Consolidated Statements of Operations (dollars in thousands):

For the Three Months  
Ended  
March 31,  
2015                      2014

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Segment operating income (loss)	\$3,247		\$(1,314)	)
Other non-segment items of income (expense)				
General and administrative	(1,768)	)	(1,551)	)
Net income fee to related party	(45)	)	(490)	)
Advisory fee to related party	(1,943)	)	(1,852)	)
Other income	67		153	
Earnings (loss) from unconsolidated joint ventures and investees	33		(4)	)
Litigation settlement	(73)	)	3,839	
Income tax benefit	102		2,049	
Net income (loss) from continuing operations	\$(380)	)	\$830	

The table below reconciles the segment information to the corresponding amounts in the Consolidated Balance Sheets (dollars in thousands):

	March 31,	
	2015	2014
Segment assets	\$686,021	\$638,186
Assets held or sale	-	37,632
Investments in real estate partnerships	1,714	1,824
Notes and interest receivable	88,751	61,769
Other assets	141,350	160,993
Total assets	\$917,836	\$900,404

#### NOTE 8. DISCONTINUED OPERATIONS

We apply the provisions of ASC Topic 360 "Property, Plant and Equipment". ASC Topic 360 requires that long-lived assets that are to be disposed of by sale be measured at the lesser of (1) book value or (2) fair value less cost to sell. In addition, it requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions.

Discontinued operations relates to properties that were either sold or held for sale as of the period ended March 31, 2015. Included in discontinued operations are a total of zero and four properties for 2015 and 2014, respectively. Properties sold in 2015 have been reclassified to discontinued operations for current and prior year reporting periods, if any. There were no sales of income-producing properties in the first quarter of 2015. In 2014, we sold two apartment complexes (Blue Ridge and Pecan Pointe), and two commercial properties (1010 Common and Sesame Square). The gain on sale of the properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for the properties sold and held for sale (dollars in thousands):

	For the Three Months Ended March 31,	
	2015	2014
Revenues:		
Rental and other property revenues	\$15	\$2,571
	15	2,571
Expenses:		
Property operating expenses	(375	) 1,318
Depreciation	-	329
General and administrative	97	174
Total operating expenses	(278	) 1,821
Other income (expense):		
Other income	-	42
Mortgage and loan interest	(1	) (664
Deferred borrowing costs amortization	-	(282
Litigation settlement	-	(45
Total other expenses	(1	) (949
Gain (loss) from discontinued operations before gain on sale of real estate and tax	292	(199
Gain on sale of real estate from discontinued operations	-	6,053

