

TRANSCONTINENTAL REALTY INVESTORS INC  
Form 10-Q/A  
March 04, 2003

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

FORM 10-Q/A  
AMENDMENT NO. 1

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED SEPTEMBER 30, 2002  
-----

Commission File Number 1-9240  
-----

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.)

1800 Valley View Lane, Suite 300, Dallas, Texas  
-----

75234  
-----

(Address of Principal Executive Office)

(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 X . No \_\_\_\_.

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APPLICABLE ONLY TO CORPORATE ISSUERS:

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

8,072,594

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(Class)

(Outstanding at November 1, 2002)

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This Form 10-Q/A Amendment No. 1 amends the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 as follows:

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Operations - pages 4, 5

NOTE 1. "BASIS OF PRESENTATION" - page 9, 10

NOTE 7. "OPERATING SEGMENTS" - page 19 - 21

NOTE 10. "DISCONTINUED OPERATIONS" - page 22, 23

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Results of Operations" - pages 27 - 30

This amendment is made pursuant to the SEC Staff comment letter dated January 7, 2003, to revise the presentation of discontinued operations, pursuant to Statement of Financial Accounting Standards No. 144. See NOTE 1. "BASIS OF PRESENTATION."

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The accompanying Consolidated Financial Statements as of and for the three and nine month periods ended September 30, 2002, have not been audited by independent certified public accountants, but in the opinion of the management of Transcontinental Realty Investors, Inc. ("TCI"), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of TCI's consolidated financial position, consolidated results of operations and consolidated cash flows at the dates and for the periods indicated, have been included.

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS

	September
	2002
	-----
	(dollars in thousands)
	ex
Assets	
Real estate held for investment .....	\$ 763,8
Less - accumulated depreciation .....	(94,7
	-----

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	669,0
Real estate held for sale .....	40,7
Notes and interest receivable	
Performing (including \$12,574 in 2002 and \$1,970 in 2001 from related parties) .....	27,3
Nonperforming, nonaccruing .....	----- 27,3
Less--allowance for estimated losses .....	(9
	----- 26,4
Investment in real estate entities .....	13,3
Cash and cash equivalents .....	1,7
Other assets (including \$24,717 in 2002 and \$14,170 in 2001 from affiliates and related parties) .....	53,3
	----- \$ 803,5 =====

The accompanying notes are an integral part of these Consolidated Financial Statements.

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS - Continued

	September 2002
	----- (dol ex
Liabilities and Stockholders' Equity	
Liabilities	
Notes and interest payable .....	\$ 522,2
Liabilities related to assets held for sale .....	29,3
Other liabilities (including \$4,886 in 2002 and \$1,068 in 2001 to affiliates and related parties) .....	29,7
	----- 581,3
Commitments and contingencies	
Minority interest .....	6,5
Stockholders' equity	
Preferred Stock	
Series A; \$.01 par value; authorized, 6,000 shares; issued and outstanding 5,829	

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shares (liquidation preference \$583) .....	
Series C; \$.01 par value; authorized, issued	
and outstanding 30,000 shares (liquidation	
preference \$3,000) .....	
Common Stock, \$.01 par value; authorized, 10,000,000	
shares; issued and outstanding 8,072,594 shares in	
2002 and 8,042,594 in 2001 .....	
Paid-in capital .....	257,0
Accumulated deficit .....	(41,4
Accumulated other comprehensive loss .....	(

-----  
215,6  
-----  
\$ 803,5  
=====

The accompanying notes are an integral part of these Consolidated Financial Statements.

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended September 30,	
	2002	2001
	----- (dollars in thousand)	
Property revenue		
Rents .....	\$ 28,761	\$ 25,708
Property expense		
Property operations .....	19,699	15,410
Operating income .....	9,062	10,298
Other income (loss)		
Interest and other .....	756	945
Equity loss of equity investees .....	(1,181)	(1,040)
Gain on sale of real estate .....	--	17,736
	-----	-----
	(425)	17,641
Other expense		
Interest .....	11,385	7,805
Depreciation .....	4,848	3,955
Provision for asset impairment .....	700	--
Advisory fee to affiliates .....	1,525	1,267
Net income fee to affiliate .....	--	946
Incentive fee paid to affiliate .....	--	1,326
General and administrative .....	2,276	1,686
Provision for loss on notes receivable .....	(180)	--

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Minority interest .....	(209)	(71)
	-----	-----
	20,345	16,914
Net income (loss) from continuing operations .....	(11,708)	11,025
Discontinued operations:		
Income (loss) from operations .....	(199)	91
Gain on sale of operations .....	13,744	--
Equity in investees gain on sale of real estate .....	2	--
	-----	-----
	13,547	91
Net income (loss) .....	1,839	11,116
Preferred dividend requirement .....	(45)	(7)
	-----	-----
Net income (loss) applicable to Common shares .....	\$ 1,794	\$ 11,109
	=====	=====

The accompanying notes are an integral part of these Consolidated Financial Statements.

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,
	2002	2001	2002
	-----		
	(dollars in thousands, except per share)		
Basic and diluted earnings (loss) per share			
Net income (loss) from continuing operations .....	\$ (1.46)	\$ 1.28	\$ (3.32)
Discontinued operations .....	1.68	.01	3.14
	-----	-----	-----
Net income (loss) applicable to Common shares .....	\$ .22	\$ 1.29	\$ (.18)
	=====	=====	=====
Weighted average Common shares used in computing earnings per share .....	8,071,180	8,603,614	8,052,227

TCI had 35,829 and 5,829 convertible preferred shares outstanding during the three and nine months ended September 30, 2002 and 2001, which were not included in the computation of diluted earnings per share because the conversion would have been antidilutive.

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Options to purchase 25,000 of TCI's Common Stock were excluded in the computation of diluted earnings available to common shares for the three and nine months ended September 30, 2001 because the effect would be antidilutive.

The accompanying notes are an integral part of these Consolidated Financial Statements.

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Paid-in Capital	Accumula Defici
	Shares	Amount		
(dollars in thousands,				
Balance, January 1, 2002 .....	8,042,594	\$ 80	\$ 256,833	\$ (40,
Unrealized loss on foreign currency translation .....	--	--	--	
Net loss .....	--	--	--	(1,
Issuance of Common Stock upon exercise .....	30,000	1	397	
Series A Preferred Stock cash dividend (\$3.75 per share) .....	--	--	(22)	
Series C Preferred Stock cash dividend (\$3.75 per share) .....	--	--	(112)	
Balance, September 30, 2002 .....	8,072,594	\$ 81	\$ 257,096	\$ (41,

The accompanying notes are an integral part of these Consolidated Financial Statements.

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine  
Ended Septe

-----  
2002

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(dollars in thousands)

Cash Flows from Operating Activities		
Rents collected .....	\$ 95,335	\$
Interest collected .....	2,303	
Interest paid .....	(30,536)	
Payments for property operations .....	(59,890)	
Advisory and net income fee paid to affiliate .....	(4,259)	
Incentive fee paid to affiliate .....	--	
General and administrative expenses paid .....	(7,578)	
Distributions from operating cash flow of equity investees .....	--	
Other .....	98	
	-----	
Net cash (used in) provided by operating activities .....	(4,527)	
Cash Flows from Investing Activities		
Collections on notes receivable (including \$1,333 in 2002 from related parties) .....	18,730	
Funding of notes receivable (including \$14,480 in 2002 to related parties) .....	(16,816)	
Acquisition of real estate .....	(9,486)	
Real estate improvements .....	(4,039)	
Real estate construction .....	(54,355)	
Proceeds from sale of real estate .....	67,536	
Deposits on pending purchases and financings .....	(709)	
Payments for interest swap .....	(187)	
Contributions to equity investees .....	(145)	
Payments from (to) advisor .....	(30,813)	
Net advance from affiliates .....	243	
	-----	
Net cash (used in) provided by investing activities .....	(30,041)	
Cash Flows from Financing Activities		
Payments on notes payable .....	(73,779)	
Proceeds from notes payable .....	102,685	
Deferred financing costs .....	(3,268)	
Dividends to stockholders .....	(97)	
Repurchase of Common Stock .....	--	
Proceeds from exercise of stock options .....	398	
	-----	
Net cash provided by (used in) financing activities .....	25,939	
Net (decrease) increase in cash and cash equivalents .....	(8,629)	
Cash and cash equivalents, beginning of period .....	10,346	
	-----	
Cash and cash equivalents, end of period .....	\$ 1,717	\$
	=====	==

The accompanying notes are an integral part of these Consolidated Financial Statements

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	For th Ended
	----- 2002 -----
	(dollar
Reconciliation of net income (loss) to net cash used in operating activities	
Net income (loss) .....	\$ (1,350)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities	
Depreciation and amortization .....	15,354
Provision for loss on notes receivable .....	169
Gain on sale of real estate .....	(26,443)
Provision for asset impairment .....	2,579
Equity in loss of equity investees .....	2,748
Distributions from operating cash flow of equity investees .....	--
Increase in interest receivable .....	(233)
(Increase) decrease in other assets .....	(1,712)
Increase in interest payable .....	542
Increase in other liabilities .....	3,819
	-----
Net cash (used in) provided by operating activities .....	\$ (4,527)
	=====
Schedule of noncash investing and financing activities	
Notes payable assumed on purchase of real estate .....	\$ 56,405
Notes payable assumed by buyer on sale of real estate .....	--
Limited partnership interest received on sale of real estate .....	--
Notes receivable provided on sale of real estate .....	(6,700)
Real estate received on exchange with related party .....	4,145
Real estate exchanged with related party .....	(4,145)
Real estate received from related party as payment of debt .....	79,287

The accompanying notes are an integral part of these Consolidated Financial Statements.

TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

TCI is a Nevada corporation and successor to a California business trust which was organized on September 6, 1983. TCI invests in real estate through direct ownership, leases and partnerships. TCI also invests in mortgage loans on real estate.

The accompanying Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation



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S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Dollar amounts in tables are in thousands, except per share amounts.

Operating results for the nine month period ended September 30, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the Consolidated Financial Statements and notes included in TCI's Annual Report on Form 10-K for the year ended December 31, 2001 (the "2001 Form 10-K").

Certain balances for 2001 have been reclassified to conform to the 2002 presentation.

On January 1, 2002, TCI adopted Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). The Statement superceded Statement 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS No. 121") and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), for business segments that are to be disposed. SFAS 144 retains the requirements of SFAS No. 121 relating to the recognition and measurement of an impairment loss and resolves certain implementation issues resulting from SFAS No. 121. The adoption of SFAS No. 144 did not have a material impact on the consolidated financial position or results of operations of TCI.

The financial statements and accompanying footnotes have been amended to revise the presentation of discontinued operations, pursuant to SFAS No. 144. The revision had no impact on the net income (loss) for the periods reported.

In April 2002, the FASB issued Statement 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction" ("SFAS No. 145"). Statement 4, "Reporting Gains and Losses from Extinguishment of Debt" ("SFAS No. 4"), required that gains and losses from the extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary item. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 will require TCI to reclassify

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 1. BASIS OF PRESENTATION (Continued)

prior period items that do not meet the extraordinary classification. The provisions of SFAS No. 145 that relate to the rescission of SFAS No. 4 become effective in fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the consolidated financial position or results of operations of TCI.

In June 2002, the FASB issued SFAS No. 146, "Accounting for costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force ("EITF") Issue No. 94-3. TCI will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a company's commitment to an exit plan. SFAS No. 146 also establishes that the

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liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized.

In October 2002, the FASB issued Financial Accounting Standards No. 147, "Acquisition of Certain Financial Institutions" ("SFAS No. 147") which clarifies the accounting treatment for acquisitions of financial institutions. In addition, the Statement amends SFAS Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," to include in its scope long-term customer-relationship intangible assets of financial institutions such as depositor- and borrower-relationship intangible assets and credit cardholder intangible assets. SFAS No. 147 is effective October 1, 2002. TCI's adoption of SFAS No. 147 is not expected to have a material impact on TCI's financial statements.

NOTE 2. REAL ESTATE

In the first nine months of 2002, TCI purchased the following properties:

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurred
First Quarter					
Apartments					
Blue Lake Villas/(1)/	Waxahachie, TX	186 Units	\$ 1,012	\$ 1,048	\$ --
Echo Valley/(1)/	Dallas, TX	216 Units	787	788	--
Spy Glass/(1)/	Mansfield, TX	256 Units	1,280	1,042	208
Shopping Center					
Oak Tree Village/(2)/	Lubbock, TX	45,623 Sq.Ft.	1,467	196	1,389 / (3) /
Land					
Lakeshore Villas/(2)/	Humble, TX	16.89 Acres	947	127	--
Rasor/(2)/	Plano, TX	24.5 Acres	2,319	310	--
Second Quarter					
Apartments					
DeSoto Ranch/(1)/	DeSoto, TX	248 Units	1,364	1,489	2,246

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 2. REAL ESTATE (Continued)

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurr
Second Quarter - Continued					
Office Building					
Centura/(4)/	Farmers Branch, TX	410,901 Sq.Ft.	50,000	--	43,739

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Land					
Hollywood Casino/(4)/	Dallas, TX	42.64 Acres	16,987	--	6,222
Marine Creek/(4)/	Fort Worth, TX	54 Acres	3,700	--	1,500
Mason Park/(4)/	Houston, TX	18 Acres	2,790	--	2,600
Nashville/(4)/	Nashville, TN	16.57 Acres	1,890	--	955
Palm Desert/(4)/	Palm Desert, CA	61 Acres	3,920	--	--

Third Quarter

Land					
2301 Valley Branch	Farmers Branch, TX	23.76 Acres	4,165	1,000	3,124

- 
- (1) Land purchased for apartment construction.
  - (2) Property exchanged with American Realty Investors, Inc. ("ARI"), a related party, for the Plaza on Bachman Creek Retail Center.
  - (3) Assumed debt.
  - (4) Property received from ARI, a related party, for payment of debt.
  - (5) Weighted average. The Centura Tower is encumbered by two loans, one for \$28.7 million at 10.5% and the other for \$15.0 million at 17.9%.
  - (6) The note was extended to January 2003.
  - (7) Extension negotiations are currently under way on this loan.

In the first nine months of 2001, TCI purchased the following properties:

Property	Location	Units/ Acres	Purchase Price	Net Cash Paid	Debt Incurred
Apartments					
By the Sea	Corpus Christi, TX	153 Units	\$ 6,175	\$ 862	\$ 5,538 / (
Baywalk	Galveston, TX	192 Units	6,590	390	5,856 / (
Courtyard	Midland, TX	133 Units	1,425	425	1,051 / (
Island Bay	Galveston, TX	458 Units	20,360	3,225	16,232 / (
Marina Landing	Galveston, TX	256 Units	12,050	518	10,912 / (
Land					
Solco-Valley Ranch	Dallas, TX	6.07 Acres	1,454	1,525	--
Limestone Ranch	Lewisville, TX	10.5 Acres	505 / (5) /	--	--
Mira Lago	Farmers Branch, TX	8.88 Acres	541 / (5) /	--	--
Seminary West	Fort Worth, TX	5.36 Acres	222	232	--

- 
- (1) Assumed debt of \$5.4 million and financed the remaining \$100,000 from the seller.
  - (2) The Island Bay, Marina Landing and Baywalk Apartments were purchased in a single transaction. TCI assumed the existing debt of \$31.3 million on the apartments, financed the remaining \$1.7 million from the seller, and issued 30,000 shares of Series C Preferred Stock.

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### NOTE 2. REAL ESTATE (Continued)

- (3) Assumed debt.
- (4) Variable rate.
- (5) Land was received from a related party in exchange for the Glenwood Apartments.

In the first nine months of 2002, TCI sold the following properties:

Property	Location	Units/ Sq.Ft./Acres	Sales Price	Net Cash Received	Debt Discharged
First Quarter					
Apartments					
Primrose	Bakersfield, CA	162 Units	\$ 5,000	\$ 1,722	\$ 2,920
Office Building					
Hartford	Dallas, TX	174,513 Sq.Ft.	4,000	--	--
Industrial Warehouse					
Central Storage	Dallas, TX	216,035 Sq.Ft.	4,000	2,095	1,063
Shopping Center					
Plaza on Bachman Creek(2)	Dallas, TX	80,278 Sq.Ft.	4,707	--	--
Second Quarter					
Apartments					
Southgreen	Bakersfield, CA	80 Units	3,600	1,011	2,381
Office Building					
Jefferson	Washington, DC	78,159 Sq.Ft.	16,550	5,957	9,679
Nasa	Clear Lake, TX	71,877 Sq.Ft.	2,600	2,341	--
Windsor Plaza	Windcrest, TX	80,522 Sq.Ft.	4,250	3,813	--
Third Quarter					
Apartments					
4242 Cedar Springs	Dallas, TX	76 Units	2,600	971	1,288
Camelot	Largo, FL	120 Units	5,263	1,616	3,298
Country Crossing	Tampa, FL	227 Units	5,800	1,836	3,726
Gladstell Forest	Conroe, TX	168 Units	4,875	1,713	2,360
Heritage on the River	Jacksonville, FL	301 Units	12,475	4,317	7,606
Office Building					
Savings of America	Houston, TX	68,634 Sq.Ft.	2,800	1,104	1,185
Land					
Palm Desert	Palm Desert, CA	36 Acres	3,600	685	--

- (1) Excludes a \$920,000 deferred gain from seller financing. See NOTE 3. "NOTES AND INTEREST RECEIVABLE."
- (2) Property was exchanged with ARI, a related party, for the Oak Tree Village Shopping Center and two parcels of land; the Razor land parcel and Lakeshore Villas land parcel.
- (3) Excludes a \$666,000 deferred gain from seller financing. See NOTE 3. "NOTES AND INTEREST RECEIVABLE."

TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

## NOTE 2. REAL ESTATE (Continued)

In the first nine months of 2001, TCI sold the following properties:

Property	Location	Units/Sq.Ft./ Acres	Sales Price	Net Cash Received
<b>Apartments</b>				
Bent Tree Gardens	Addison, TX	204 Units	\$ 9,000	\$ 2,669
Carseka	Los Angeles, CA	54 Units	4,000	2,138
Fontenelle Hills	Bellevue, NE	338 Units	16,500	3,680
Forest Ridge	Denton, TX	56 Units	2,000	682
Glenwood	Addison, TX	168 Units	3,659 / (2) /	--
Heritage	Tulsa, OK	136 Units	2,286	206
McCallum Crossing	Dallas, TX	322 Units	11,500	1,841
McCallum Glen	Dallas, TX	275 Units	8,450	2,633
Oak Run	Pasadena, TX	160 Units	5,800	1,203
Park at Colonade	San Antonio, TX	211 Units	5,800	927
Park Lane	Dallas, TX	97 Units	2,750	1,526
Sunset Lakes	Waukegan, IL	414 Units	15,000	6,089
<b>Industrial Warehouse</b>				
Technology Trading	Sterling, VA	197,659 Sq.Ft.	10,775	4,120
Zodiac	Dallas, TX	35,435 Sq.Ft.	762	183
<b>Office Buildings</b>				
Chesapeake Center	San Diego, CA	57,493 Sq.Ft.	6,575	3,111
Daley	San Diego, CA	64,425 Sq.Ft.	6,211	2,412
Waterstreet	Boulder, CO	106,257 Sq.Ft.	22,250	7,126
<b>Land</b>				
Eagle Crest	Farmers Branch, TX	4.41 Acres	300	291
McKinney 36	McKinney, TX	1.822 Acres	476	476
Moss Creek	Greensboro, NC	4.79 Acres	15	13
Round Mountain	Austin, TX	110.0 Acres	2,560	2,455

(1) Debt assumed by purchaser.

(2) The Glenwood Apartments were exchanged with a related party for two parcels of land; the 10.5 acre Limestone Ranch and the 8.88 acre Mira Lago.

(3) Excludes a \$1.5 million deferred gain from a limited partnership interest in the sold property.

At September 30, 2002, TCI had the following apartment properties under construction:

Additional      Con

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Property	Location	Units	Amount Expended	Amount to Expend
Blue Lake Villas	Waxahachie, TX	186 Units	\$ 7,052	\$ 5,538
DeSoto Ranch	DeSoto, TX	248 Units	6,691	10,457
Echo Valley	Dallas, TX	216 Units	2,665	11,554
Falcon Lakes	Arlington, TX	284 Units	2,032	13,713
River Oaks	Wiley, TX	180 Units	2,886	9,105
Sendero Ridge	San Antonio, TX	384 Units	17,532	11,128
Spyglass	Mansfield, TX	256 Units	6,074	11,928
Tivoli	Dallas, TX	190 Units	10,565	2,869
Verandas at City View	Fort Worth, TX	314 Units	6,813	16,137

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 2. REAL ESTATE (Continued)

In the second quarter of 2002, TCI completed the 252 unit Limestone Ranch in Lewisville, Texas, and the 165 room Hotel Akademia in Wroclaw, Poland. In the third quarter of 2002, TCI completed the 80 unit Waters Edge IV Apartments in Gulfport, Mississippi.

NOTE 3. NOTES AND INTEREST RECEIVABLE

In January 2002, TCI purchased 100% of the outstanding common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, a related party, for \$4.4 million cash. Two Hickory owns the 96,217 sq. ft. Two Hickory Center Office Building in Farmers Branch, Texas. ARI has guaranteed that the asset shall produce at least a 12% annual return of the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% annual return, ARI shall pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the shares of Two Hickory for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI. In June 2002, the asset was refinanced. TCI received \$1.3 million of the proceeds as a principal reduction on its note receivable from ARI.

Also in January 2002, a mortgage loan with a principal balance of \$608,000 was paid off, including accrued but unpaid interest. With the payoff of the note, TCI recognized a previously deferred gain on the sale of the property of \$608,000.

In August 2001, TCI agreed to fund up to \$5.6 million under a revolving line of credit secured by an office building in Dallas, Texas. In 2002, TCI funded an additional \$1.8 million of the line of credit. At September 30, 2002, TCI had funded a total of \$3.5 million of the note.

In February 2002, TCI sold a \$2.0 million senior participation interest in a loan with a principal balance of \$3.5 million secured by a second lien on a retail center in Montgomery County, Texas to Income Opportunity Realty Investors, Inc. ("IORI"), a related party. TCI and IORI will receive 43% and 57%, respectively, of the remaining principal and interest payments. Also in February 2002, TCI extended the loan until April 2002, receiving \$23,000 as an

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extension fee. In April 2002, TCI extended the loan until July 2002, receiving \$6,500 as an extension fee. In July 2002, the loan was extended until September 2002 and TCI received \$6,500 as an extension fee. In August 2002, the loan was paid off, including accrued but unpaid interest.

Also in February 2002, TCI funded an additional \$231,000 to Sendera Ranch, under a loan secured by 1,714.16 acres of unimproved land in Tarrant County, Texas. In March 2002, TCI received a \$2.4 million payment from Sendera Ranch. TCI received \$1.8 million as a principal

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 3. NOTES AND INTEREST RECEIVABLE (Continued)

paydown, \$277,000 as accrued interest, and \$323,000 as a partnership distribution. In September 2002, TCI funded an additional \$90,000 of the loan.

In March 2002, TCI sold the 174,513 sq.ft. Hartford Office Building in Dallas, Texas, for \$4.0 million and provided the \$4.0 million purchase price as seller financing and an additional \$1.4 million line of credit for leasehold improvements in the form of a mortgage note. The note bears interest at a variable interest rate, currently 6.0% per annum, requires monthly interest only payments of \$14,667 and matures in March 2007. As of September 2002, TCI has funded \$65,000 of the additional line of credit.

In April 2002, TCI purchased 100% of the following entities: ART One Hickory Corporation ("One Hickory"), Garden Confederate Point, LP ("Confederate Point"), Garden Foxwood, LP ("Foxwood"), and Garden Woodsong, LP ("Woodsong"), all wholly-owned subsidiaries of ARI, a related party, for \$10.0 million. One Hickory owns the 120,615 sq. ft. One Hickory Center Office Building in Farmers Branch, Texas. Confederate Point owns the 206 unit Confederate Apartments in Jacksonville, Florida. Foxwood owns the 220 unit Foxwood Apartments in Memphis, Tennessee. Woodsong owned the 190 unit Woodsong Apartments in Smyrna, Georgia. ARI has guaranteed that these assets shall produce at least a 12% return annually of the purchase price for a period of three years from the purchase date. If the assets fail to produce the 12% return, ARI shall pay TCI any shortfall. In addition, if the assets fail to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the entities for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI.

Also in April 2002, a mortgage loan with a principal balance of \$155,000 was paid off, including accrued but unpaid interest.

In July 2002, the Woodsong Apartments were sold. TCI received \$2.6 million from the proceeds as payment of principal and accrued but unpaid interest on the note receivable.

In May 2002, a mortgage loan with a principal balance of \$1.5 million was paid off, including accrued but unpaid interest. TCI agreed to a 5% discount on the note and recognized a loss of \$75,000 from the note. TCI also recognized a previously deferred gain of \$1.5 million on the sale of the property.

In July 2002, a mortgage loan with a principal balance of \$2.2 million was paid off, including accrued but unpaid interest.

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In July 2002, TCI entered into an agreement to fund up to \$300,000 under a revolving line of credit secured by 100% interest in a partnership of

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 3. NOTES AND INTEREST RECEIVABLE (Continued)

the borrower. The line of credit bears interest at 12.0% per annum and requires monthly interest only payments, and matures in June 2005. As of September 2002, TCI has funded \$75,000 of the line of credit.

In August 2002, a mortgage loan with a principal balance of \$4.0 million was paid off, including accrued but unpaid interest.

In September 2002, TCI sold a 36 acre tract of the Palm Desert land parcel for \$3.6 million and provided \$2.7 million as seller financing in the form of a mortgage note. The note bears interest at 8.0% per annum, requires quarterly interest only payments of \$54,000 and matures in September 2004.

Also in September 2002, TCI received \$1.3 million on a non-performing note with a balance of \$1.8 million. With this payment, TCI agreed to release the lien on 44.6 acres of unimproved land in Fort Worth, Texas, substituting a second lien on 21.61 acres of unimproved land in Tarrant County, Texas, from the borrower to secure the remaining \$689,000 in debt. TCI has also extended the maturity to November 2002.

#### NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES

Prior to the first quarter of 2002, TCI accounted for its investments in Tri-City, Nakash and Jor-Trans on the equity method. TCI is a 63.7% limited partner and IORI is a 36.3% general partner in Tri-City, and TCI is a 60% general partner and IORI is a 40% limited partner in Nakash. TCI owns a 55% limited and general partnership interest in Jor-Trans. TCI makes all partnership operating and policy decisions of the partnerships and TCI has the right to approve the sale or refinancing of principal assets, or approve the acquisition of partnership assets. For Tri-City, IORI as general partner only has protective rights in the partnership. TCI and IORI have the same Board of Directors and the same executive officers. Consequently, because TCI has a greater than 50% ownership over the operations of Tri-City, Nakash and Jor-Trans, the operations of the partnership have been consolidated. In the first quarter of 2002, TCI began accounting for its investment in Tri-City, Nakash and Jor-Trans using a consolidated basis. The effect of these consolidations increased TCI's assets, liabilities, and minority interest by \$5.4 million, \$3.9 million and \$1.5 million, respectively.

TCI's investment in real estate entities at September 30, 2002, included equity securities of two publicly traded real estate entities, IORI and ARI, related parties, and interests in real estate joint venture partnerships. Basic Capital Management, Inc. ("BCM"), TCI's advisor, also serves as advisor to IORI and ARI.

TCI accounts for its investment in IORI and ARI and the joint venture partnerships using the equity method.

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES (Continued)

TCI's investment in real estate entities, accounted for using the equity method, at September 30, 2002, was as follows:

Investee	Percentage of TCI's Ownership at September 30, 2002	Carrying Value of Investment at September 30, 2002	Equivalent Investee Book Value at September 30, 2002	Market Value of Investment at September 30, 2002
IORI	24.0%	\$ 4,405	\$ 9,367	\$ 4,408
ARI .....	6.5%	8,633	4,412	7,388
		-----	-----	-----
		13,038	\$13,779	\$11,796
			=====	=====
Other		303		
		-----		
		\$13,341		
		=====		

Management continues to believe that the market value of each of IORI and ARI undervalues their assets and, therefore, TCI may increase its ownership in these entities.

Set forth below is summarized results of operations of equity investees for the first nine months of 2002 and 2001.

	2002	2001
Revenues .....	\$ 121,940	\$ 121,940
Equity in income of partnerships .....	(578)	(578)
Property operating expenses .....	(102,587)	(102,587)
Depreciation .....	(12,316)	(12,316)
Interest expense .....	(53,798)	(53,798)
	-----	-----
Loss before gains on sale of real estate .....	(47,339)	(47,339)
Gain on sale of real estate .....	28,405	28,405
	-----	-----
Net income (loss) .....	\$ (18,934)	\$ (18,934)
	=====	=====

TCI's share of equity investees' loss before gains on the sale of real estate was \$1.2 million and \$2.7 million for the three and nine months ended September 30, 2002, and its share of equity investees' gains on sale of real estate was \$2,000 and \$3.1 million for the three and nine months ended September 30, 2002.

NOTE 5. OTHER ASSETS

Related Party. From time-to-time, TCI and its affiliates and related parties have made advances to each other to fund their respective operations, which

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generally have not had specific repayment terms and have been reflected in TCI's financial statements as other assets. At September 30, 2002, TCI had receivables of \$14.4 million, \$1.8 million and \$8.6 million from BCM, GS Realty Services, Inc. and ARI, respectively, and payables of \$4.3 million and \$592,000 to IORI and GS Realty Services, Inc., respectively.

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 6. NOTES AND INTEREST PAYABLE

In 2002, TCI financed or refinanced the following properties:

Property	Location	Sq.Ft./ Units/Acres	Debt Incurred	Debt Discharged	R
-----	-----	-----	-----	-----	-----
First Quarter					
Industrial Warehouse Addison Hanger / (1) /	Addison, TX	23,650 Sq.Ft.	\$ 2,687	\$ 1,580	\$
Second Quarter					
Apartments					
Paramount Terrace	Amarillo, TX	181 Units	2,700	2,797	
Verandas at City View	Fort Worth, TX	314 Units	2,779 / (3) /	2,197	
Third Quarter					
Apartments					
Echo Valley	Dallas, TX	216 Units	1,639 / (4) /	--	
Quail Creek	Lawrence, KS	95 Units	3,300	2,157	
Land					
McKinney 36 / (5) /	Collin County, TX	34.58 Acres	425	956	
Sandison / (5) /	Collin County, TX	97.97 Acres	1,199	1,040	
Solco-Allen / (5) /	Collin County, TX	55.80 Acres	686	305	
Stacy Road / (5) /	Allen, TX	160.38 Acres	1,979	1,345	
State Highway 121 / (5) /	Collin County, TX	101.94 Acres	1,475	873	
Watters Road / (5) /	Collin County, TX	97.00 Acres	1,189	--	
Whisenant / (5) /	Collin County, TX	16.16 Acres	199	133	
Fourth Quarter					
Land					
Dominion / (6) /	Dallas, TX	14.39 Acres	772	--	
Manhattan / (6) /	Farmers Branch, TX	108.9 Acres	5,846	--	
Pac Trust / (6) /	Farmers Branch, TX	7.11 Acres	382	--	

- 
- (1) The mortgage is cross-collateralized with the 29,000 sq. ft. Addison Hanger II in Addison, Texas.
- (2) Variable interest rate.
- (3) The Verandas at City View Apartments are under construction. The \$2.8 million debt incurred was to fund construction to date. The total construction funding for the project is \$19.4 million.

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- (4) The Echo Valley Apartments are under construction. The \$1.6 million debt incurred was to fund construction to date. The total construction funding for the project is \$12.7 million.
- (5) The mortgages are cross-collateralized.
- (6) The mortgages are cross-collateralized.

In April 2002, TCI sold 12 residential properties to partnerships controlled by Metra Capital, LLC ("Metra"). These properties include: the 75 unit Apple Lane Apartments in Lawrence, Kansas; the 195 unit Arbor Point Apartments in Odessa, Texas; the 264 unit Fairway View Estates Apartments in El Paso, Texas; the 152 unit Fairways Apartments in Longview, Texas; the 166 unit Fountain Lake Apartments in Texas City, Texas; the 172 unit Fountains of Waterford Apartments in Midland, Texas; the 122 unit Harper's Ferry Apartments in Lafayette, Louisiana; the 108

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 6. NOTES AND INTEREST PAYABLE (Continued)

unit Oak Park IV Apartments in Clute, Texas; the 131 unit Quail Oaks Apartments in Balch Springs, Texas; the 300 unit Sunchase Apartments in Odessa, Texas; the 180 unit Timbers Apartments in Tyler, Texas; and the 112 unit Willow Creek Apartments in El Paso, Texas. Innovo Group, Inc. ("Innovo") is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a director of ARI, a related party, controls approximately 11.67% of the outstanding common stock of Innovo. Management has determined to account for this sale as a refinancing transaction, in accordance with SFAS No. 66, "Accounting for Sales of Real Estate." TCI will continue to report the assets and the new debt incurred by the Metra partnerships on the TCI financial statements. The sales price for the properties totaled \$37.6 million. TCI received net cash of \$10.5 million after paying off the existing debt of \$18.0 million and various closing costs. The new debt of \$30.3 million bears interest at 7.57% per annum, requires monthly interest only payments of \$212,000 and matures in May 2012. TCI also received \$8.0 million of 8% non-recourse, non-convertible Series A Preferred Stock ("Preferred Shares") of Innovo.

The dividend on the Preferred Shares will be funded entirely and solely through member distributions from cash flows generated by the operation and subsequent sale of the sold properties. In the event the cash flows for the properties are insufficient to cover the 8% annual dividend, Innovo will have no obligation to cover any shortfall.

The Preferred Shares have a mandatory redemption feature, and are redeemable from the cash proceeds received by Innovo from the operation and sale of the properties. All member distributions that are in excess of current and accrued 8% dividends must be used by Innovo to redeem the Preferred Shares. Since redemption of these shares is subject to the above future events, management has elected to record no basis in the Preferred Shares.

In August 2002, the lender on three of TCI's Chicago hotel properties notified TCI that TCI was in default under the provisions of the loan agreement regarding timely payment and debt service coverage ratio. Management believes payments have been timely and is negotiating with the lender and expects to resolve the issues.

#### NOTE 7. OPERATING SEGMENTS

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Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their operating income and cash flow. Items of income that are not reflected in the segments are interest, equity in partnerships and equity gains on sales of real estate which totaled a loss of \$423,000 and income of \$3.2 million for the three and nine months ended September 30, 2002, and a loss of

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 7. OPERATING SEGMENTS (Continued)

\$95,000 and income of \$1.7 million for the three and nine months ended September 30, 2001. Expenses that are not reflected in the segments are general and administrative expenses, minority interest, incentive, advisory, net income fees, provision for losses, and discontinued operations which totaled \$3.6 million and \$12.0 million for the three and nine months ended September 30, 2002, and \$5.2 million and \$17.4 million for the three and nine months ended September 30, 2001. Also excluded from segment assets are assets of \$89.5 million at September 30, 2002, and \$103.7 million at September 30, 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses.

Presented below is the operating income of each operating segment for the three and nine months ended September 30, 2002 and 2001, and each segment's assets at September 30.

Three Months Ended September 30, 2002	Land	Commercial Properties	Apartments
Rents .....	\$ 147	\$ 15,782	\$ 10,985
Property operating expenses .....	514	9,895	7,581
Operating income (loss) .....	(367)	5,887	3,404
Interest .....	372	6,744	3,676
Depreciation .....	11	3,300	1,137
Real estate improvements .....	2	1,002	277
Real estate construction .....	--	--	25,871
Provision for asset impairment .....	--	--	700
Assets .....	91,723	325,965	256,842
	Land	Commercial Properties	Apartments
Property Sales:			
Sales price .....	\$ 3,600	\$ 2,800	\$ 31,013
Cost of sales .....	3,600	2,179	17,890
Gain on sale .....	\$ -- / (1) /	\$ 621	\$ 13,123

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(1) Excludes \$666,000 of deferred gains on the sale of real estate.

Nine Months Ended September 30, 2002	Land	Commercial Properties	Apartments
-----	-----	-----	-----
Rents .....	\$ 435	\$ 45,292	\$ 32,243
Property operating expenses .....	1,225	26,382	21,871
	-----	-----	-----
Operating income (loss) .....	(790)	18,910	10,372
Interest .....	722	15,403	10,462
Depreciation .....	19	9,663	3,414
Real estate improvements .....	104	3,632	277
Real estate construction .....	--	--	48,938
Provisions for asset impairment .....	707	--	1,872
Assets .....	91,723	325,965	256,842
	Land	Commercial Properties	Apartments
	-----	-----	-----
Property Sales:			
Sales price .....	\$ 3,600	\$38,907	\$39,613
Cost of sales .....	3,600	31,388	23,795
	-----	-----	-----
Gain on sale .....	\$ -- / (2) /	\$ 7,519	\$15,818
	=====	=====	=====

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 7. OPERATING SEGMENTS (Continued)

(2) Excludes \$666,000 of deferred gains on sale or real estate.

(3) Includes \$2.1 million of previously deferred gains on sale of real estate.

Three Months Ended September 30, 2001	Land	Commercial Properties	Apartments	Hotels	Total
-----	-----	-----	-----	-----	-----
Rents .....	\$ 140	\$ 14,661	\$ 9,162	\$ 1,745	\$ 25,708
Property operating expenses .....	355	7,903	5,969	1,183	15,410
	-----	-----	-----	-----	-----
Operating income .....	\$ (215)	\$ 6,758	\$ 3,193	\$ 562	\$ 10,298
	=====	=====	=====	=====	=====

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Interest .....	\$ 225	\$ 4,562	\$ 2,717	\$ 301	\$ 7,805
Depreciation .....	--	2,520	1,137	298	3,955
Real estate improvements .....	239	2,632	2,932	26	5,829
Assets .....	60,902	312,100	212,729	19,342	605,073

Property Sales:	Land	Commercial Properties	Apartments	Total
Sales price .....	\$ 300	\$ 6,575	\$ 39,050	\$ 45,925
Cost of sales .....	515	6,371	21,303	28,189
Gain (loss) on sale .....	\$ (215)	\$ 204	\$ 17,747	\$ 17,736

Nine Months Ended September 30, 2001	Land	Commercial Properties	Apartments	Hotels	Total
Rents .....	\$ 465	\$ 47,990	\$ 40,167	\$ 5,024	\$ 93,646
Property operating expenses .....	920	25,219	23,994	3,532	53,665
Operating income (loss) .....	\$ (455)	\$ 22,771	\$ 16,173	\$ 1,492	\$ 39,981
Interest .....	\$ 733	\$ 16,345	\$ 10,985	\$ 999	\$ 29,062
Depreciation .....	--	7,053	5,525	831	13,409
Real estate improvements .....	1,332	4,917	3,013	242	9,504
Assets .....	60,902	312,100	212,729	19,342	605,073

Property Sales:	Land	Commercial Properties	Apartments	Total
Sales price .....	\$ 3,351	\$ 46,573	\$ 86,745	\$ 136,669
Cost of sales .....	2,235	32,049	58,816	93,100
Gain on sale .....	\$ 1,116	\$ 14,524	\$ 27,929	\$ 43,569

NOTE 8. PROVISION FOR ASSET IMPAIRMENT

For the three and nine months ended September 30, 2002, TCI recorded asset impairments of \$700,000 and \$1.9 million representing the write down of certain operating properties to current estimated fair value. These assets include the following properties:

Property	Location	Units/Acres	Fair Value	Property Basis	Costs to Sell	Impairment
Apartments Apple Lane	Lawrence, KS	75 Units	\$ 1,580	\$ 1,593	\$ 238	\$ 251

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Fairway View	El Paso, TX	264 Units	5,700	5,242	863	405
Fountains of Waterford	Midland, TX	172 Units	1,900	2,006	285	391
Plantation	Tulsa, OK	138 Units	2,545	3,100	145	700
Sunchase	Odessa, TX	300 Units	4,100	3,479	746	125
Land						
Red Cross	Dallas, TX	2.89 Acres	8,400	8,348	758	707

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 8. PROVISION FOR ASSET IMPAIRMENT (Continued)

The Red Cross land is under contract to sell and the sales price was used as fair value. The fair value determined for four apartments above were agreed upon purchase prices as part of the refinancing transaction with Metra Capital, LLC. The costs to sell were actual fees paid to refinance the properties. TCI is in current negotiations with lenders to refinance the Plantation Apartments. Lenders will refinance the property at between 80% and 90% of the value of the property. Currently, the loans are in the range of \$2.0 million and \$2.4 million.

NOTE 9. ADVISORY FEES, PROPERTY MANAGEMENT, ETC.

Revenue, fees and cost reimbursements to BCM and its affiliates for the three and nine months ended:

	For the Three Months Ended September 30,		For the Nine Months Ended September	
	2002	2001	2002	2001
<b>Fees</b>				
Advisory .....	\$ 1,525	\$ 1,267	\$ 4,220	\$ 4,220
Net income .....	--	946	--	2,089
Incentive fee .....	--	1,326	--	1,326
Property acquisition .....	--	1,340	58	1,340
Real estate brokerage .....	979	1,122	2,089	1,122
Mortgage brokerage and equity refinancing .....	133	--	160	--
Property and construction management and leasing commissions* .....	648	519	2,595	519
	<u>\$ 3,285</u>	<u>\$ 6,520</u>	<u>\$ 9,122</u>	<u>\$ 6,520</u>
Cost reimbursements .....	\$ 614	\$ 461	\$ 2,468	\$ 461
Rent revenue .....	\$ 37	\$ 35	\$ 170	\$ 35

\* Net of property management fees paid to subcontractors, other than GS Realty, Inc., which is owned by an affiliate of BCM.

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NOTE 10. DISCONTINUED OPERATIONS

Effective January 1, 2002, TCI adopted Financial Accounting Standards Board Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which established a single accounting model for the impairment or disposal of long-lived assets including discontinued operations. This statement requires that the operations related to properties that have been sold, or properties that are intended to be sold, be presented as discontinued operations in the statement of operations for all periods presented, and the properties intended to be sold are to be designated as "held-for-sale" on the balance sheet.

For the three and nine months ended September 30, 2002 and 2001, income from discontinued operations relates to 15 properties that TCI sold during 2002, 26 properties that TCI sold during 2001, and 11 parcels of

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 10. DISCONTINUED OPERATIONS (Continued)

land, three apartments and one commercial property designated as held-for-sale. The following table summarizes revenue and expense information for these properties sold and held-for-sale.

	For the Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2002	2001	2002	2001
Revenue				
Rental .....	\$ 2,105	\$ 7,039	\$ 10,852	\$ 10,738
Property operations .....	1,101	4,381	7,121	6,851
	1,004	2,658	3,731	3,887
Expenses				
Interest .....	986	1,720	3,676	2,605
Depreciation .....	217	847	1,217	1,568
	1,203	2,567	4,893	4,173
Net loss from discontinued operations before				
gains on sale of real estate .....	(199)	91	(1,162)	(286)
Gain on sale of operations .....	13,744	--	23,337	--
Equity in investees gain on sale of real				
estate .....	2	--	3,106	--
Net income from discontinued operations .....	\$ 13,547	\$ 91	\$ 25,281	\$ (286)

Discontinued operations have not been segregated in the consolidated statements of cash flows. Therefore, amounts for certain captions will not agree with respective consolidated statements of operations.



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### NOTE 11. DERIVATIVE FINANCIAL INSTRUMENTS

During the first quarter of 2002, TCI entered into an interest rate swap agreement with a bank. This agreement contains a notional amount of \$12.8 million and requires TCI to pay the bank a fixed rate of 4.3%, and requires the bank to pay to TCI based on the 30 day LIBOR rate. This agreement was entered into in order to effectively fix the rate on TCI's debt associated with the Limestone Canyon property. The swap agreement expires on December 9, 2004.

TCI has not designated the interest rate swap agreement as a hedge, as defined within Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," and as such, changes in the fair value of the swap agreement are recognized in earnings during the period of change and reflected in the statement of operations as interest expense.

The fair value of the swap agreement at September 30, 2002 represents a liability to the Company of \$611,000 and is included within other liabilities in the accompanying balance sheet. Amounts paid or received under the swap agreement are settled monthly and are reflected as a reduction in the liability when paid. Interest expense for the nine months ended September 30, 2002, was increased by \$798,000 representing both amounts paid to the bank under the agreement and increases in the fair value of the related liability.

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### TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

### NOTE 12. COMMITMENTS AND CONTINGENCIES

Liquidity. Management anticipates that TCI will generate excess cash from operations in 2002 due to increased rental rates and occupancy at its properties, however, such excess will not be sufficient to discharge all of TCI's debt obligations as they mature. Management intends to selectively sell income producing real estate, refinance real estate and incur additional borrowings against real estate to meet its cash requirements.

Commitments. In January 2001, TCI exercised its option under the loan documents to extend the maturity date of three loans with a principal balance of \$30.0 million secured by three office buildings in New Orleans, Louisiana. The lender has disputed TCI's right to extend the loans. This dispute is subject to litigation pending in the United States District Court for the Eastern District of Louisiana.

Litigation. TCI is involved in various lawsuits arising in the ordinary course of business. Except for the Olive Litigation (see PART II. OTHER INFORMATION, ITEM 1. "LEGAL PROCEEDINGS), management is of the opinion that the outcome of these lawsuits will have no material impact on TCI's financial condition, results of operations or liquidity.

### NOTE 13. INCOME TAXES

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. TCI had a loss for federal income tax purposes in the first three quarters of 2002 and 2001; therefore, it recorded no provision for income taxes.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### Introduction

TCI invests in real estate through acquisitions, leases and partnerships. TCI also invests in mortgage loans. TCI is the successor to a business trust organized on September 6, 1983, and commenced operations on January 31, 1984.

#### Critical Accounting Policies

Critical accounting policies are those that are both important to the presentation of TCI's financial condition and results of operations and require management's most difficult, complex or subjective judgements. TCI's critical accounting policies relate to the evaluation of impairment of long-lived assets and the evaluation of the collectibility of accounts and notes receivable.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Critical Accounting Policies (Continued)

If events or changes in circumstances indicate that the carrying value of a rental property to be held and used or land held for development may be impaired, management performs a recoverability analysis based on estimated undiscounted cash flows to be generated from the property in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows the property is written down to estimated fair value and an impairment loss is recognized. If management decides to sell rental properties or land held for development, management evaluates the recoverability of the carrying amounts of the assets. If the evaluation indicates that the carrying value is not recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell and an impairment loss is recognized within income from continuing operations. TCI's estimates of cash flow and fair values of the properties are based on current market conditions and consider matters such as rental rates and occupancies for comparable properties, recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. TCI's estimates are subject to revision as market conditions and TCI's assessments of them change. In the second and third quarter of 2002, TCI recognized \$1.9 million and \$700,000 as impairment losses.

TCI's allowance for doubtful accounts receivable and notes receivable is established based on analysis of the risk of loss on specific accounts. The analysis places particular emphasis on past due accounts. Management considers such information as the nature and age of the receivable, the payment history of the tenant or other debtor, the financial condition of the tenant or other debtor and TCI's assessment of its ability to meet its lease or interest obligations. TCI's estimate of the required allowance, which is reviewed on a quarterly basis, is subject to revision as these factors change and is sensitive to the effects of economic and market conditions.

#### Liquidity and Capital Resources

Cash and cash equivalents totaled \$1.7 million at September 30, 2002, compared with \$10.3 million at December 31, 2001. TCI's principal sources of cash have been and will continue to be from property operations, proceeds from property sales, the collection of mortgage notes receivable and borrowings. Management

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anticipates that TCI's cash on hand, as well as cash generated from property operations, the sale of properties and the refinancing of certain of TCI's mortgage debt will be sufficient to meet TCI's cash requirements, including debt service obligations and expenditures for property maintenance and improvements.

Net cash used in operating activities was \$4.5 million for the nine months ended September 30, 2002, compared to \$3.1 million provided by operations for the nine months ended September 30, 2001. The primary factors affecting TCI's cash from operations are discussed in the following paragraphs.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Liquidity and Capital Resources (Continued)

Cash from property operations (rents collected less payments for expenses applicable to rental income) was \$35.4 million in the nine months ended September 30, 2002, compared to \$44.4 million for the nine months ended September 30, 2001. Of this decrease, \$5.1 million and \$3.1 million was due to the sale of 22 apartments and 14 commercial properties, respectively. Cash from property operations also decreased by \$1.0 million, \$2.0 million and \$649,000 from TCI's apartments, commercial properties, and hotels, respectively, due to decreased occupancies and increased operating expenses. Increases in cash from property operations of \$3.0 million were due to the purchase of nine properties in 2002 and 2001, and the completion of construction projects in 2002.

Interest collected increased to \$2.3 million in the nine months ended September 30, 2002, from \$1.1 million in 2001. The increase was primarily due to the funding of seven loans in 2001 and seven loans in 2002.

Interest paid of \$30.5 million in the nine months ended September 30, 2002, approximated the \$30.7 million in 2001.

Advisory, incentive and net income fees paid decreased to \$4.3 million in the nine months ended September 30, 2002, from \$7.8 million in 2001. The decrease was primarily due to no incentive or net income fees paid in 2002. The incentive fee is equal to 10% of the amount by which the aggregate sales consideration for all TCI's properties sold during the year exceeds the total cost of the property plus a simple 8% annual return to TCI's net investment in such property.

General and administrative expenses paid decreased to \$7.6 million in the nine months ended September 30, 2002, from \$7.7 million in 2001. This decrease was mainly due to a decrease in cost reimbursements to the advisor.

In the first nine months of 2002, TCI sold seven apartments, one warehouse, one shopping center, five office buildings and a 36 acre land parcel for a total of \$82.1 million, receiving net cash of \$29.2 million after the payoff of existing debt and the payment of various closing costs.

Also in the first nine months of 2002, TCI financed or refinanced an industrial warehouse, seven land parcels and 16 apartments for a total of \$50.6 million, receiving \$12.8 million in cash after the payment of various closing costs.

Further in the first nine months of 2002, TCI purchased four parcels of unimproved land for apartment construction, one shopping center, one office building and eight parcels of unimproved land for a total of \$92.6 million. TCI paid \$6.0 million in cash, including various closing costs, assumed existing mortgage debt of \$56.4 million and acquired new debt of \$5.6 million for the

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purchases. TCI also expended \$54.7 million

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Liquidity and Capital Resources (Continued)

on property construction, of which \$51.0 million was funded by debt. For the remainder of 2002 and the first half of 2003, TCI expects to expend an additional \$92.4 million on property construction projects, of which \$85.0 million will be funded by debt.

Also in the first nine months of 2002, TCI advanced funds to affiliated parties, including its advisor, for a total of \$55.5 million. For this funding, TCI received 12% return guarantees for \$14.4 million, and real estate valued at \$79.3 million and assumed the existing debt of \$55.0 million, leaving \$16.8 million of advances still outstanding and owed to TCI.

In the fourth quarter of 2002, TCI financed three parcels of unencumbered land for \$7.0 million, receiving \$6.9 million cash after the payment of various closing costs.

Management reviews the carrying values of TCI's properties and mortgage notes receivable at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow from the property (undiscounted and without interest) is less than the carrying amount of the property. For notes receivable, impairment is considered to exist if it is probable that all amounts due under the terms of the note will not be collected. If impairment is found to exist, a provision for loss is recorded by a charge against earnings. The mortgage note receivable review includes an evaluation of the collateral property securing each note. The property review generally includes: (1) selective property inspections; (2) a review of the property's current rents compared to market rents; (3) a review of the property's expenses; (4) a review of maintenance requirements; (5) a review of the property's cash flow; (6) discussions with the manager of the property; and (7) a review of properties in the surrounding area.

#### Results of Operations

TCI had net income of \$1.8 million and a net loss of \$1.4 million in the three and nine months ended September 30, 2002, including gains on sale of real estate totaling \$13.7 million and \$26.4 million, compared to net income of \$11.1 million and \$25.7 million in the corresponding periods in 2001, including gains on sale of real estate totaling \$17.7 million and \$43.6 million. Fluctuations in this and other components of revenues and expense between the 2002 and 2001 periods are discussed below.

Rents in the three months ended September 30, 2002, increased to \$28.8 million compared to \$25.7 million in 2001. Of this increase, \$3.2 million was due to the purchase of five existing apartments, one office building and one shopping center in 2002 and 2001. Occupancies for TCI's apartments, commercial properties and hotels decreased to 92%, 75% and 40%, respectively, in the three months ended September 30, 2002, from 93%, 81% and 53% in 2001.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Results of Operations (Continued)

Rents in the nine months ended September 30, 2002, decreased to \$82.4 million compared to \$93.6 million in 2001. This decrease is primarily due to the 26 properties sold during 2002, in addition to lower occupancies for TCI's apartments, commercial properties and hotels which decreased to 91%, 78% and 40% compared to 94%, 80% and 53% in 2001. Rents are expected to remain constant or decrease in the remaining quarter of 2002.

Property operations expense increased to \$19.7 million in the nine month period ended September 30, 2002, compared to \$15.4 million in 2001. Of this increase, \$1.4 million was due to the completion of the two apartments and the Hotel Akademia in 2002, \$1.5 million was due to the purchase of five existing apartments in 2001 and \$1.1 million was due to the purchase of two commercial properties in 2002. Property operations expenses for TCI's apartments increased by \$137,000 in the three months ended September 30, 2002. Property operations expenses for TCI's commercial properties increased by \$155,000 in the three months ended September 30, 2002. Property operations expenses for TCI's land properties increased by \$305,000 in the three months ended September 30, 2002. These increases were offset by decreases of \$114,000 due to decreases in occupancies from the U.S. hotels. Property operations expenses for the remaining quarter of 2002 is expected to increase as TCI continues to upgrade its apartments and improve its commercial leasing potential.

Interest and other income was \$756,000 and \$2.8 million in the three and nine months ended September 30, 2002, compared to \$1.0 million and \$2.3 million in 2001. The decrease for the quarter was due to the payoff of four loans in the period, and the nine month increase was primarily due to TCI funding seven loans in 2001 and seven loans in 2002. Interest income for the remaining quarter of 2002 is expected to significantly decrease due to the payoff of four performing loans in the third quarter of 2002.

Equity in losses of investees increased to \$1.2 million and \$2.7 million in the three and nine months ended September 30, 2002 from \$1.0 million and \$516,000 in 2001. The increase in losses from equity investees is primarily attributed to increased operating losses at ARI.

Interest expense increased to \$11.4 million in the three months ended September 30, 2002, from \$7.8 million in 2001. Of this increase, \$3.5 million was due to the purchase of 14 properties subject to debt in 2002 and 2001, \$611,000 was due to an interest swap agreement at the Limestone Canyon Apartments and \$43,000 due to the refinancing of 14 apartments in 2002.

Interest expense decreased to \$28.2 million in the nine months ended September 30, 2002, compared to \$29.1 million in 2001. Of this decrease, \$930,000 was due to lower variable interest rates and principal paydowns at TCI's apartments and commercial properties,

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Results of Operations (Continued)

respectively. Interest expense for the remaining quarter of 2002 may increase

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due to the financing of unencumbered land and refinancing of properties.

Depreciation expense increased to \$4.8 million and \$14.1 million in the three and nine months ended September 30, 2002, from \$3.9 million and \$13.4 million in 2001. Of these increases, \$464,000 and \$1.0 million were due to the purchase of eight properties subject to depreciation in 2002 and 2001 and \$246,000 and \$437,000 were due to the completion of the two apartments and Hotel Akademia in 2002. Increases of \$328,000 were due to building and tenant improvements at TCI's commercial properties for the three months ended September 30, 2002. Depreciation expense for the remaining quarter of 2002 is expected to increase as TCI completes its apartment construction projects.

For the three and nine months ended September 30, 2002, TCI recorded asset impairments of \$700,000 and \$1.9 million representing the write down of certain operating properties to current estimated fair value. These assets include the following properties:

Property	Location	Units/Acres	Fair Value	Property Basis	Cos S
Apartments					
Apple Lane	Lawrence, KS	75 Units	\$ 1,580	\$ 1,593	\$
Fairway View	El Paso, TX	264 Units	5,700	5,242	
Fountains of Waterford	Midland, TX	172 Units	1,900	2,006	
Plantation	Tulsa, OK	138 Units	2,545	3,100	
Sunchase	Odessa, TX	300 Units	4,100	3,479	
Land					
Red Cross	Dallas, TX	2.89 Acres	8,400	8,348	

The Red Cross land is under contract to sell and the sales price was used as fair value. The fair value determined for four apartments above were agreed upon purchase prices as part of the refinancing transaction with Metra Capital, LLC. The costs to sell were actual fees paid to refinance the properties. TCI is in current negotiations with lenders to refinance the Plantation Apartments. Lenders will refinance the property at between 80% and 90% of the value of the property. Currently, the loans are in the range of \$2.0 million and \$2.4 million.

Advisory fee was \$1.5 million and \$4.2 million in the three and nine months ended September 30, 2002, compared to \$1.3 million and \$4.2 million in 2001. The increase for the quarter was due to an increase in TCI's gross assets, the basis for such fee. Advisory fees will decrease with decreases in TCI's gross assets.

Net income fee to affiliate was \$946,000 and \$2.1 million in the three and nine months ended September 30, 2001. The net income fee is payable to TCI's advisor based on 7.5% of TCI's net income. TCI had a net loss for the nine months ended September 30, 2002 and no such fee has been accrued.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations (Continued)

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Incentive fee to affiliate was \$1.3 million and \$2.9 million in the three and nine months ended September 30, 2001. The incentive fee is payable to TCI's advisor based on 10% of aggregate sales consideration less TCI's cost of all properties sold during the year. In the nine months ended September 30, 2002, the criteria for the fee has not been met.

General and administrative expenses were \$2.3 million and \$6.7 million in the three and nine months ended September 30, 2002, compared to \$1.7 million and \$7.6 million in 2001. The quarter increase was mainly due to increased insurance, office rent, and legal fees. The year to date decrease was mainly due to a decrease in advisor cost reimbursements and other professional fees.

In October 2000, TCI's stockholders approved the Director's Stock Option Plan (the "Director's Plan") which provides for options to purchase up to 140,000 shares of TCI's Common Stock. Options granted pursuant to the Director's Plan are immediately exercisable and expire on the earlier of the first anniversary of the date on which a Director ceases to be a Director or 10 years from the date of grant. Each Independent Director was granted an option to purchase 5,000 Common shares at an exercise price of \$14.875 per share on October 10, 2000, the date stockholders approved the plan. On January 1, 2001 and 2002, each Independent Director was granted an option to purchase 5,000 Common shares at an exercise price of \$8.875 and \$16.05, respectively, per common share. In February 2002, TCI purchased 20,000 options outstanding from retired directors R. Douglas Leonhard and Edward Zampa for \$82,000. In July 2002, Ted Stokely and Martin White exercised their options for 15,000 shares. Currently, no options are outstanding.

In the three and nine months of 2002, gains on sale of real estate totaling \$13.7 million and \$26.4 million were recognized. In the three and nine months ended September 30, 2001, gains on sale of real estate totaling \$18.8 million and \$47.5 million were recognized. See NOTE 2. "REAL ESTATE."

### Related Party Transactions

Historically, TCI, ARI, BCM and IORI have each engaged in and may continue to engage in business transactions, including real estate partnerships, with related parties. Management believes that all of the related party transactions represented the best investments available at the time and were at least as advantageous to TCI as could have been obtained from unrelated parties.

### Operating Relationships

In the three and nine months ended September 30, 2002, TCI received \$17,000 and \$51,000 in rent from BCM for BCM's lease at Addison Hanger. BCM owns a corporate jet that is housed at the hanger and TCI has available space at the hanger.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### Property Transactions

In January 2002, TCI purchased 100% of the outstanding common shares of ART Two Hickory Corporation from ARI, for \$4.4 million. See NOTE 3. "NOTES AND INTEREST RECEIVABLE." The purchase price was determined based upon the market value of the property exchanged, using a market rate multiple of net operating income ("cap rate") of 7.0%. The business purpose of the transaction was for TCI to make an equity investment in Two Hickory anticipating a profitable return.

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In February 2002, TCI sold a \$2.0 million senior participation interest in a loan to IORI. See NOTE 3. "NOTES AND INTEREST RECEIVABLE." Management determined that TCI could benefit from the increase in cash and decrease its notes receivable outstanding portfolio.

In March 2002, TCI paid cash of \$600,000 and received from ARI two parcels of land, a 24.5 acre tract of Rasor land, a 16.89 acre tract of Lakeshore Villas land, and the 45,623 sq. ft. Oaktree Village Shopping Center in exchange for the 80,278 sq. ft. Plaza on Bachman Creek Shopping Center. The exchange value prices for the shopping centers were determined based on a cap rate of 10.5% and the value for the Rasor and Lakeshore Villas land was determined on appraised rates of \$3.36 and \$1.29, respectively, per square foot. The business purpose of the transaction was for TCI to construct apartments on the Rasor and Lakeshore Villas land and to give ample value for the property TCI exchanged, the Oaktree Shopping Center was added to the transaction.

In April 2002, TCI purchased 100% of the following entities from ARI: Garden Confederate Point, L.P., Garden Foxwood, L.P., Garden Woodsong, L.P. and ART One Hickory Corporation for \$10.0 million. See NOTE 3. "NOTES AND INTEREST RECEIVABLE." The purchase price for these entities was determined based on a cap rate of 8.41% for the partnerships and 7.0% for ART One Hickory Corporation. The business purpose of the transaction was for TCI to make an equity investment in the entities anticipating a profitable return.

In June 2002, TCI purchased Centura Tower Office Building from ARI for \$50.0 million. See NOTE 2. "REAL ESTATE." The purchase price for the Centura Tower was determined based on appraised value and replacement cost. The business purpose of the transaction was for TCI to acquire a Class A office building with significant upside potential anticipating a profitable return.

Also in June 2002, TCI purchased five parcels of unimproved land from ARI: the Hollywood Casino, Marine Creek, Mason Park, Nashville and Palm Desert land parcels. See NOTE 2. "REAL ESTATE." The purchase price of the Hollywood Casino land was determined based on an appraised rate of \$9.10 per square foot. The business purpose of the transaction was for TCI to consolidate its holdings within the Mercer Crossing development. The purchase price for the Marine Creek, Mason Park, Nashville and Palm Desert land parcels was determined based on appraised rates of \$2.00, \$3.56, \$4.00 and \$1.48 per square foot, respectively. The business purpose of the transaction was for TCI to develop apartments on these four tracts of land.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Tax Matters

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. TCI had a loss for federal income tax purposes in the first nine months of 2002 and 2001; therefore, it recorded no provision for income taxes.

#### Inflation

The effects of inflation on TCI's operations are not quantifiable. Revenues from property operations tend to fluctuate proportionately with inflationary increases and decreases in housing costs. Fluctuations in the rate of inflation



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also affect sales values of properties and the ultimate gain to be realized from property sales. To the extent that inflation affects interest rates, TCI's earnings from short-term investments and the cost of new financings as well as the cost of variable interest rate debt, will be affected.

### Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, TCI may be potentially liable for removal or remediation costs, as well as certain other potential costs, relating to hazardous or toxic substances (including governmental fines and injuries to persons and property) where property-level managers have arranged for the removal, disposal or treatment of hazardous or toxic substances. In addition, certain environmental laws impose liability for release of asbestos-containing materials into the air, and third parties may seek recovery for personal injury associated with such materials.

Management is not aware of any environmental liability relating to the above matters that would have a material adverse effect on TCI's business, assets or results of operations.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

TCI addresses exposure to market risks, principally the market risk of changes in interest rates, through a controlled program of Risk Management that includes the use of an interest rate swap agreement on \$12.8 million of debt (see NOTE 11. "DERIVATIVE FINANCIAL INSTRUMENTS"). In the event of a 1% variance in the LIBOR interest rate, the interest expense related to this agreement would be changed by \$260,000 on an annual basis.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At September 30, 2002, TCI's exposure to a change in interest rates on its debt is as follows:

	Balance -----	Weighted Average Interest Rate -----	Effect of 1% Increase In Base Rates -----
Notes payable:			
Variable rate .....	\$ 158,844 =====	6.12%	\$ 1,588 =====
Total decrease in TCI's annual net income .....			\$ 1,588 =====
Per share .....			\$ (.20) =====

### ITEM 4. CONTROLS AND PROCEDURES

- (a) Within the 90 days prior to the date of this report, TCI carried out an evaluation, under the supervision and with the participation of TCI's management, including TCI's Acting Principal Executive Officer and

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Principal Accounting Officer, of the effectiveness of the design and operation of TCI's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon the evaluation, TCI's Acting Principal Executive Officer and Principal Accounting Officer concluded that TCI's disclosure controls and procedures are effective in timely alerting him to material information relating to TCI (including its consolidated subsidiaries) required to be included in TCI's periodic SEC filings.

- (b) There have been no significant changes in TCI's internal controls or in other factors that could significantly affect TCI's internal controls subsequent to the date TCI carried out this evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

On October 23, 2001, TCI, IORI and ARI jointly announced a preliminary agreement with the plaintiff's legal counsel of a class and derivative action entitled Olive et al v National Income Realty Trust et al for complete settlement of all disputes in the lawsuit. For further information, refer to ITEM 1. "LEGAL PROCEEDINGS" included in TCI's Second Quarter Report on Form 10-Q for the six months ended June 30, 2002.

On November 7, 2002, ARI announced that it intends to commence, through subsidiaries, a tender offer for shares of common stock of TCI and IORI. The price per share to be paid will be \$17.50 for TCI shares and \$19.00

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#### ITEM 1. LEGAL PROCEEDINGS (Continued)

for IORI shares. The tender offers are being made to cure a default under the settlements resulting from ARI's failure to timely complete the SEC review process of the registration statement for the proposed mergers with TCI and IORI. ARI will defer further action on the mergers, pending completion of the tender offers.

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit Number	Description
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

(b) Reports on Form 8-K as follows:

None.

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## SIGNATURES

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

TRANSCONTINENTAL REALTY  
INVESTORS, INC.

Date: March 4, 2003  
-----

By: /s/ Ronald E. Kimbrough  
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Ronald E. Kimbrough  
Executive Vice President  
and Chief Financial Officer  
(Principal Financial and  
Accounting Officer and  
Acting Principal Executive  
Officer)

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## CERTIFICATION

I, Ronald E. Kimbrough, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer and Acting Principal Executive Officer) of Transcontinental Realty Investors, Inc. ("TCI"), certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of TCI;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. I am responsible for establishing and maintaining internal controls and procedures and have:
  - a. designed such internal controls to insure that material information relating to TCI and its consolidated subsidiaries is made known to me by others within those entities, particularly for the periods presented in this quarterly report;
  - b. evaluated the effectiveness of TCI's internal controls as of a date within 90 days prior to the filing date of this quarterly report; and
  - c. presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on a date within 90 days prior to the filing date of this quarterly report;
5. I have disclosed to TCI's auditors and Audit Committee of the Board of

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Directors (or persons fulfilling the equivalent function):

- a. all significant deficiencies in the design or operation of internal controls which could adversely affect TCI's ability to record, process, summarize, and report financial data and have identified for TCI's auditors any material weaknesses in internal controls; and
- b. any fraud, whether or not material, that involves management or other employees who have a significant role in TCI's internal controls; and

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- 6. I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of my most recent evaluation, including corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 4, 2003

/s/ Ronald E. Kimbrough

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Ronald E. Kimbrough  
Executive Vice President  
and Chief Financial Officer  
(Principal Financial and  
Accounting Officer and  
Acting Principal Executive Officer)

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TRANSCONTINENTAL REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q/A

For the Quarter ended September 30, 2002

Exhibit Number	Description	Page Number
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	39

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