

TRANSCONTINENTAL REALTY INVESTORS INC
Form 10-Q
August 14, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

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)

1800 Valley View Lane, Suite 300

Dallas, Texas 75234

95-6565852
(I.R.S. Employer

Identification No.)

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(Address of principal executive offices)

(Zip Code)

(469) 522-4200

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No .

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
(Class)

7,876,389
(Outstanding at August 3, 2007)

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****TRANSCONTINENTAL REALTY INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS**

	June 30, 2007 (dollars in thousands) (unaudited)	December 31, 2006
Assets		
Real estate held for investment	\$ 1,290,270	\$ 1,089,995
Less accumulated depreciation	(105,209)	(97,541)
	1,185,061	992,454
Real estate held for sale	42,153	54,935
Real estate subject to sales contract	65,174	66,027
Notes and interest receivable (including \$4,360 in 2007 and \$33,947 in 2006 from affiliates and related parties)	26,188	39,566
Investment in unconsolidated real estate entities	34,232	30,573
Marketable equity securities, at market value	11,226	9,038
Cash and cash equivalents	5,091	4,803
Other assets (including \$248 in 2007 and \$1,085 in 2006 from affiliates and related parties)	67,687	52,771
	\$ 1,436,812	\$ 1,250,167
Liabilities and Stockholders Equity		
Liabilities:		
Notes and interest payable (including \$6,762 in 2007 and \$6,769 in 2006 to affiliates and related parties)	\$ 991,191	\$ 799,069
Liabilities related to assets held for sale	32,224	43,579
Liabilities related to assets subject to sales contract	57,685	58,816
Other liabilities (including \$24,083 in 2007 and \$16,595 in 2006 to affiliates and related parties)	95,236	66,608
	1,176,336	968,072
Commitments and contingencies		
Minority interest	1,623	16,166
Stockholders equity:		
Common Stock; \$.01 par value; authorized 10,000,000 shares; issued 8,113,669 shares at June 30, 2007 and December 31, 2006	81	81
Preferred Stock		
Series C Cumulative Convertible; \$.01 par value; authorized, issued and outstanding 30,000 shares; (liquidation preference \$3,000)		
Series D; \$.01 par value; authorized, issued and outstanding 100,000 shares at June 30, 2007 and December 31, 2006 (liquidation preference \$100 per share)	1	1
Additional paid-in capital	278,997	266,206
Treasury stock, at cost (236,304 shares at June 30, 2007 and 212,800 shares at December 31, 2006)	(3,479)	(3,086)
Retained earnings (deficit)	(17,504)	1,660

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Accumulated other comprehensive income	757	1,067
	258,853	265,929
	\$ 1,436,812	\$ 1,250,167

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

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

	For the Three Months Ended June 30, 2007 2006 (dollars in thousands)		For the Six Months Ended June 30, 2007 2006 (dollars in thousands)	
Property revenue:				
Rental and other property revenues (\$702 in 2007 and \$517 in 2006 from affiliates)	\$ 40,287	\$ 29,384	\$ 76,440	\$ 58,241
Expenses:				
Property operating expenses (\$3,472 in 2007 and \$3,309 in 2006 to affiliates)	22,849	17,811	44,279	35,318
Depreciation and amortization	6,767	4,875	12,194	9,819
General and administrative (\$1,588 in 2007 and \$1,538 in 2006 to affiliates)	2,027	1,667	5,205	3,038
Advisory fee to affiliate	2,696	2,161	5,096	4,187
Total operating expenses	34,339	26,514	66,774	52,362
Operating income	5,948	2,870	9,666	5,879
Other income (expense):				
Interest income from notes receivable (\$688 in 2007 and \$424 in 2006 from affiliates)	1,379	793	1,392	1,668
Gain (loss) on foreign currency transaction	(135)	2	(4)	4
Other income (loss)	(210)	(123)	819	238
Mortgage and loan interest (\$363 in 2007 and \$232 in 2006 to affiliates)	(19,557)	(12,436)	(35,432)	(24,607)
Litigation settlement		1,804	704	1,804
Total other income (expense)	(18,523)	(9,960)	(32,521)	(20,893)
Loss before gain on land sales, minority interest and equity in earnings of investees	(12,575)	(7,090)	(22,855)	(15,014)
Gain on land sales		8,690	1,122	9,022
Minority interest		361	4	189
Equity in earnings of investees	450		700	
Income (loss) from continuing operations	(12,125)	1,961	(21,029)	(5,803)
Income tax benefit (expense)	(267)	941	653	687
Net income (loss) from continuing operations	(12,392)	2,902	(20,376)	(5,116)
Income (loss) from discontinued operations	(763)	2,689	1,865	1,961
Income tax benefit (expense)	267	(941)	(653)	(687)
Net income (loss) from discontinued operations	(496)	1,748	1,212	1,274
Net income (loss)	(12,888)	4,650	(19,164)	(3,842)
Preferred dividend requirement	(228)	(53)	(455)	(105)
Net income (loss) applicable to common shares	\$ (13,116)	\$ 4,597	\$ (19,619)	\$ (3,947)

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

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS - Continued****(unaudited)**

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2007	2006	2007	2006
	(dollars in thousands)		(dollars in thousands)	
Basic earnings per share:				
Income (loss) from continuing operations	\$ (1.60)	\$ 0.36	\$ (2.64)	\$ (0.66)
Income (loss) from discontinued operations	(0.06)	0.22	0.15	0.16
Net income (loss) applicable to common shares	\$ (1.66)	\$ 0.58	\$ (2.49)	\$ (0.50)
Diluted earnings per share:				
Income (loss) from continuing operations	\$ (1.60)	\$ 0.35	\$ (2.64)	\$ (0.66)
Income (loss) from discontinued operations	(0.06)	0.21	0.15	0.16
Net income (loss) applicable to common shares	\$ (1.66)	\$ 0.56	\$ (2.49)	\$ (0.50)
Weighted average common shares used in computing earnings per share:				
Basic	7,877,365	7,900,869	7,888,008	7,900,869
Diluted	7,877,365	8,190,519	7,888,008	7,900,869

Series C Cumulative Convertible Preferred stock (convertible after September 30, 2006 into common stock estimated to be approximately 249,650 shares) and options to purchase 40,000 shares of TCI's common stock were excluded from the computation of diluted earnings per share for the three months ended June 30, 2007 and the six months ended June 30, 2007 and 2006, because the effect of their inclusion would be antidilutive.

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

For the Six Months Ended June 30, 2007

(dollars in thousands)

(unaudited)

	Common Stock		Preferred Stock		Additional Paid-in Capital	Treasury Stock		Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Stockholders Equity
	Shares	Amount	Shares	Amount		Shares	Amount			
Balance, January 1, 2007	8,113,669	\$ 81	100,000	\$ 1	\$ 266,206	212,800	\$ (3,086)	\$ 1,660	\$ 1,067	\$ 265,929
Unrealized loss on foreign currency translation									(1,101)	(1,101)
Unrealized gain on marketable securities									791	791
Net loss								(19,164)		(19,164)
Acquisition of minority interest					13,246					13,246
Repurchase of Common Stock						23,504	(393)			(393)
Series C Preferred Stock cash dividend					(105)					(105)
Series D Preferred Stock cash dividend					(350)					(350)
Balance, June 30, 2007	8,113,669	\$ 81	100,000	\$ 1	\$ 278,997	236,304	\$ (3,479)	\$ (17,504)	\$ 757	\$ 258,853

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

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	For the Six Months Ended June 30,	
	2007	2006
	(dollars in thousands)	
Cash Flows from Operating Activities:		
Reconciliation of net income (loss) to net cash provided by operating activities		
Loss from continuing operations	\$ (20,376)	\$ (5,116)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	12,194	9,819
Amortization of deferred borrowing costs	2,762	1,400
Gain on sale of real estate	(1,122)	(9,022)
Equity in earnings of investees	(700)	
Gain (loss) on foreign currency transaction	4	(4)
(Income) allocated to minority interest	(4)	(189)
(Increase) decrease in:		
Prepaid expense	(2,575)	
Interest receivable		387
Escrows	1,472	
Rent receivables	(1,577)	
Other assets	(14,916)	3,378
Increase (decrease) in:		
Interest payable		(886)
Other liabilities	15,633	(4,894)
Net cash provided (used) by operating activities	(9,205)	(5,127)
Cash Flows from Investing Activities:		
Collections on notes receivable	13,378	9,061
Funding of notes receivable		(2,211)
Acquisition of income producing properties	(112,193)	
Acquisition of land held for development	(14,506)	(46,855)
Real estate improvements		(8,201)
Improvement of income producing properties	(8,094)	
Improvement of land held for development	(2,869)	
Real estate construction and development	(91,682)	
Proceeds from sale of land	4,531	14,041
Payments made for marketable securities	(697)	
Decrease in earnest money deposits	5,310	
Increase in deposits on pending purchases and financings		(988)
Acquisition of minority interest	(1,301)	
Investments in unconsolidated real estate entities	(3,659)	
Net cash used in investing activities	(211,782)	(35,153)
Cash Flows from Financing Activities:		
Principal amortization of notes payable	(6,632)	
Payments on notes payable	(62,997)	(38,128)
Proceeds from notes payable	187,800	80,847
Construction and development financing	84,243	
Increase in due to affiliates	28,186	
Repurchase of common stock	(393)	

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Dividends paid to preferred shareholders	(455)	(105)
Deferred financing costs	(10,039)	(2,499)
Net cash provided by financing activities	219,713	40,115

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued****(unaudited)**

	For the Six Months Ended June 30,	
	2007	2006
	(dollars in thousands)	
Discontinued Operations:		
Cash used in operating activities	(1,981)	2,903
Cash provided by investing activities proceeds from sale of real estate	24,061	3,611
Cash used in financing activities payments on notes payable	(20,518)	
Net cash provided (used) by discontinued operations	1,562	6,514
Net increase in cash and cash equivalents	288	6,349
Cash and cash equivalents, beginning of period	4,803	5,462
Cash and cash equivalents, end of period	\$ 5,091	\$ 11,811
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 35,473	\$ 26,414
Schedule of Non-Cash Investing and Financing Activities:		
Unrealized loss foreign currency translation	(1,101)	
Unrealized gain on marketable securities	791	
Note payable paid by affiliate		10,823
Increase in minority interest related to acquisition of real estate		14,835
Real estate purchased from affiliate, decreasing affiliate receivable		11,273
Note payable assumed by affiliate		4,000
Note receivable received from affiliate	22,111	

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

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

Transcontinental Realty Investors, Inc. (TCI , We , The Company , Our or Us) 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 is externally advised and has no employees. TCI owns a diverse portfolio of residential apartment communities, commercial properties, hotels and land. The Company currently owns approximately 12,250 units in 65 residential apartment communities, 28 commercial properties comprising over four million rentable square feet and four hotels. In addition, TCI owns over 6,500 acres of land held for development and currently has over 2,500 apartment units in 14 projects under construction. The Company currently owns operating properties or land in 20 states as well as in Poland and the U.S. Virgin Islands. The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange under the symbol TCI . Approximately 82% of the Company s common stock is owned by American Realty Investors, Inc. (NYSE: ARL). Prime Income Asset Management, LLC (Prime) is the Company s external advisor. Regis Realty I, LLC, an affiliate of Prime, manages the Company s commercial properties. Regis Hotel I, LLC, another Prime affiliate, manages the Company s hotel investments. TCI engages various third-party companies to lease and manage its apartment properties.

The accompanying interim financial statements are unaudited; however, the financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the financial statements for these periods have been included. The results of operations for the interim periods are not necessarily indicative of the results to be obtained for other interim periods or for the full fiscal year. The year end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the Company s financial statement and notes thereto contained in the Company s Annual Report on Form 10-K for its fiscal year ended December 31, 2006.

Newly issued accounting standards. In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 was effective for fiscal years beginning after December 15, 2006. FIN No. 48, which was adopted by the Company effective January 1, 2007, did not have a material impact on the Company s cash flows, results of operations, financial position or liquidity.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS No. 157 to have a material impact on the Company s cash flows, results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating and assessing the impact of this statement.

NOTE 2. REAL ESTATE

At June 30, 2007, TCI s real estate held for investment consisted of the following:

Cost

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		Accumulated Depreciation
Apartments	\$ 387,655	\$ 39,219
Apartments under construction	128,658	
Commercial buildings	367,205	56,149
Hotels	40,697	9,654
Land held for development	366,055	187
Total	\$ 1,290,270	\$ 105,209

In 2007, TCI purchased the following properties:

Property	Location	Acres/ Sq. Ft./Units	Purchase Price	Net Cash Paid	Debt Incurred	Debt Paid	Interest Rate	Maturity Date
First Quarter								
Office Buildings								
Parkwest I	Farmers Branch, TX	383,114 Sq. Ft.	\$ 40,604	\$ 1,587	\$ 35,000	\$ 5,750	6.06%	1/13
Parkwest II	Farmers Branch, TX	707,559 Sq. Ft.	69,694	8,106	62,000		9.32 ⁽¹⁾	1/09
			110,298	9,693	97,000	5,750		
Land								
Audubon Terrace	Natchez, MS	48.2 Acres	519	504				
Keller Springs	Addison, TX	5.7 Acres	3,183	539	2,021		9.25 ⁽¹⁾	2/08
			3,702	1,043	2,021			
			114,000	10,736	99,021	5,750		
Second Quarter								
Land								
Hines Meridian	Las Colinas, TX	40.1 Acres	8,489	2,998	5,000		9.25	6/10
Waco Land	Waco, TX	151.0 Acres	2,105	453	1,300		9.25 ⁽¹⁾	4/10
Williams Sprowles	Irving, TX	1.2 Acres	210	277				
			10,804	3,728	6,300			
Apartments								
Thornwood	Midland, TX	109 Units	1,895		1,638	1,638		
			12,699	3,728	7,938	1,638		
			\$ 126,699	\$ 14,464	\$ 106,959	\$ 7,388		

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

In 2006, TCI purchased the following properties:

Property	Location	Acre/	Purchase Price	Net Cash Paid	Debt Incurred	Interest Rate	Maturity Date
		Sq. Ft./Units					
First Quarter							
Land							
Circle C Ranch	Austin, TX	1,092.0 Acres	\$ 21,000	\$	\$ 21,000	8.75% ⁽¹⁾	3/08
Pioneer Crossing	Austin, TX	38.5 Acres	614 ⁽²⁾	614	1,515	8.75 ⁽¹⁾	6/08
Southwood 1394	Tallahassee, FL	14.5 Acres	1,150	477	748	8.50 ⁽¹⁾	2/08
Valley Ranch 20	Farmers Branch, TX	20.0 Acres	4,673	1,892	3,038	8.50 ⁽¹⁾	2/08
Polo Estates at Bent Tree	Dallas, TX	5.9 Acres	3,833	1,014	3,000	8.25	1/08
Polo Estates at Park Forest	Dallas, TX	9.3 Acres	4,560	1,868	2,964	8.00	12/07
			35,830	5,865	32,265		
Apartments							
Anderson Estates	Oxford, MS	48 Units	1,144 ⁽³⁾	148	996	9.50 ⁽¹⁾	12/20
David Jordan Phase II	Greenwood, MS	32 Units	743 ⁽³⁾	98	645	8.50 ⁽¹⁾	4/19
David Jordan Phase III	Greenwood, MS	40 Units	812 ⁽³⁾	122	690	8.75 ⁽¹⁾	7/22
Leflore Estates	Greenwood, MS	104 Units	2,114 ⁽³⁾	337	1,777	7.00	2/22
Monticello III Estates	Monticello, AR	32 Units	644 ⁽³⁾	96	548	7.00	1/22
Riverwalk Phase I	Greenwood, MS	32 Units	455 ⁽³⁾	99	356	8.50	2/19
Riverwalk Phase II	Greenwood, MS	72 Units	1,584 ⁽³⁾	226	1,358	8.25 ⁽¹⁾	2/19
			7,496	1,126	6,370		
			43,326	6,991	38,635		
Second Quarter							
Land							
Forney Land	Forney, TX	34.9 Units	3,945	(3,926)			
Parc at Clarksville	Clarksville, TN	10.4 Units	541		547	8.00	08/06 ⁽⁴⁾
Senlac Hutton	Farmers Branch, TX	5.9 Units	1,050	(949)			
Waco 42	Waco, TX	42.8 Units	531	(112)	398	8.00	05/09
			6,067	(4,987)	945		
Office Building							
One Hickory	Farmers Branch, TX	102,615 Sq. Ft.	12,214				
			18,281	(4,987)	945		
			\$ 61,607	\$ 2,004	\$ 39,580		

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- (1) Variable interest rate.
 - (2) Purchased from ARI; purchase price is equal to ARI's cost.
 - (3) Net of minority interest and other liabilities assumed.
 - (4) TCI is negotiating with lender to extend this loan.

In January 2007, subsidiaries of the Company acquired four office buildings containing approximately 1,090,000 rentable square feet and a 4.7 acre tract of undeveloped land located in Farmers Branch, Texas, known collectively as Park West. The properties were acquired for a total purchase price of \$110 million plus closing costs. The acquisition was partially financed with a two year, \$62 million loan from a commercial bank and a six year, \$35 million loan from a life insurance company. The combined weighted average interest rate at closing was approximately 8.15%. The loans are collateralized by the properties and guaranteed by TCI.

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

On May 8, 2007, we purchased 40.1 acres of land in Las Colinas, Texas known as Hines Meridian for \$8.4 million. The acquisition was financed with \$3.0 million cash and a new note for \$5.0 million. The note accrues interest at 9.25%, is payable in installments of interest only for 12 months, then installments of principal and interest for 23 months and one final payment of all accrued, unpaid interest and the outstanding principal balance on maturity in May 2010.

In 2007, TCI sold the following properties:

Property	Location	Acres/ Easement/Units	Sales Price	Net Cash Received	Debt Discharged	Gain on Sale
First Quarter						
Apartments						
Bluffs at Vista Ridge	Lewisville, TX	272 Units	\$ 24,061	\$ 3,128	\$ 20,518	\$ 3,648
Land						
McKinney Ranch	McKinney, TX	15.1 Acres	2,631	793	1,850	1,122
			2,631	793	1,850	1,122
			26,692	3,921	22,368	4,770
Second Quarter						
Land						
Denton Coonrod	Denton, TX	82.2 Acres	1,900		1,637	
			1,900		1,637	
			\$ 28,592	\$ 3,921	\$ 24,005	\$ 4,770

In 2006, TCI sold the following properties:

Property	Location	Acres/Units	Sales Price	Net Cash Received	Debt Discharged	Gain on Sale
First Quarter						
Land						
Hollywood Casino	Farmers Branch, TX	10.5 Acres	\$ 3,225	\$ 1,297	\$	\$ 331
Second Quarter						
Apartments						
Plantation Apartments	Tulsa, OK	138 Units	2,750	638	2,191	432
Willo-Wick Apartments	Pensacola, FL	152 Units	6,500	2,806	2,827	2,860
			9,250	3,444	5,018	3,292

\$ 12,475	\$ 4,741	\$ 5,018	\$ 3,623
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At June 30, 2007, TCI had the following properties under construction:

Property	Location	Units	Amount Expended	Additional Amount to Expend	Construction Loan Funding
Apartments					
Bolivar Homes	Cleveland, MS	65 Units	\$ 2,481	\$ 6,128	\$ 1,619
Broadway Estates	Greenville, MS	104 Units	2,066	6,291	1,190
Lago Vista	Farmers Branch, TX	212 Units	15,831	10,619	6,691
Legends of El Paso	El Paso, TX	240 Units	17,812	4,079	15,166
Longfellow Arms	Longview, TX	216 Units	5,025	3,286	4,046
Mason Park	Houston, TX	312 Units	1,991	17,409	1,567
Mission Oaks	San Antonio, TX	228 Units	15,980		13,688
Parc at Clarksville	Clarksville, TN	206 Units	11,437	2,455	10,659
Parc at Maumelle	Maumelle, AR	240 Units	19,701		15,847
Parc at Metro Center	Nashville, TN	144 Units	12,578		9,927
Parc at Rogers	Rogers, AR	152 Units	12,048	8,777	10,589
Pecan Pointe	Temple, TX	232 Units	8,158	8,679	7,095
Sunflower Estates	Indianola, MS	65 Units	1,494	6,936	902
Yazoo Estates	Yazoo City, MS	96 Units	2,056	6,289	1,176
Total		2,512 Units	\$ 128,658	\$ 80,948	\$ 100,162

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

The Company is involved in the construction of 14 apartment development projects as of June 30, 2007. In addition, the Company invests in numerous tracts of land and is at several stages of predevelopment on many of these properties. The Company partners with various third-party developers to construct residential projects. The third-party developer typically takes a general partner interest in the development partnership while the Company takes a limited partner (and majority) interest. The Company is required to fund all equity contributions. The third-party developer is responsible for obtaining financing, hiring a general contractor and for the overall management and delivery of the project and is compensated with a fee equal to a certain percentage of the construction costs. Initial equity contributions to development projects are recorded as investments in unconsolidated real estate entities. When vertical construction begins, the Company reclassifies the investment in unconsolidated real estate entities to construction in progress. Increases to construction in progress are recorded as development loans are funded and development costs are incurred. As projects near completion and begin to be leased, the Company records revenues as earned and expenses as incurred. When the occupancy of a developed project reaches stabilization, the Company acquires the general partner interest from the third-party developer and reclassifies the property from construction in progress to property held for investment.

NOTE 3. NOTES AND INTEREST RECEIVABLE

Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
Dallas Fund XVII LP ⁽³⁾	10/06	9.00	\$ 3,907	Partnership interests and lawsuit proceeds
Pioneer Austin Development	10/08	10.00	3,178	33 acres undeveloped land, Austin, TX
Basic Capital Management ⁽¹⁾	4/08	10.25 ⁽²⁾	1,523	Retail building, Cary, NC
Garden Centura LP ⁽¹⁾	N/A	7.00	6,372	Excess cash flow from partnership
Basic Capital Management ⁽¹⁾	4/08	10.25 ⁽²⁾	1,252	Industrial building, Arlington, TX
400 St. Paul	10/08	8.00	3,612	Office building, Dallas, TX
Miscellaneous related party notes ⁽¹⁾	Various	Various	4,565	Various security interests
Accrued interest			1,779	
Total			\$ 26,188	

(1) Related party.

(2) Variable rate.

(3) Currently negotiating extension of this note.

NOTE 4. INVESTMENT IN UNCONSOLIDATED REAL ESTATE ENTITIES

Unconsolidated real estate entities. TCI's investment in unconsolidated real estate entities at June 30, 2007 included equity securities of two publicly traded real estate entities, Income Opportunity Realty Investors, Inc. (AMEX: IORI) and ARI, related parties and interests in real estate joint venture partnerships. ARI is a related party that owns 82.2% of TCI's common stock and consolidates TCI's financial accounts and operations.

TCI accounts for its investment in IORI and ARI and the joint venture partnerships using the equity method. Garden Centura, L.P. is accounted for on the cost method.

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

TCI's investment in real estate entities at June 30, 2007, was as follows:

Investee	Percentage of TCI's Ownership at June 30, 2007	Carrying Value of Investment at June 30, 2007	Market Value ⁽¹⁾ of Investment at June 30, 2007
IORI	24.8%	\$ 6,370	\$ 4,079
ARI	6.4	12,057	4,404
Garden Centura, L.P. ⁽²⁾	5.0	1,944	N/A
Other ⁽²⁾		13,861	N/A
		\$ 34,232	\$ 8,483

(1) Based on stock closing price on June 30, 2007 and is not necessarily indicative of the fair market value of the investee's net assets.

(2) No readily determinable market value.

Set forth below is summarized results of operations of equity investees for the first six months of 2007 and 2006.

	2007	2006
Revenues	\$ 46,724	\$ 32,408
Property operating expenses	(33,197)	(24,113)
Depreciation	(3,770)	(2,570)
Interest expense	(19,858)	(7,861)
Loss before gains on sale of real estate and discontinued operations	(10,101)	(2,136)
Gain on sale of real estate		2,409
Loss from discontinued operations	(2,142)	(219)
Net income (loss)	\$ (12,243)	\$ 54

NOTE 5. MARKETABLE EQUITY SECURITIES

TCI owns equity securities of Realty Korea CR-REIT Co., Ltd. No. 1 representing approximately a 9.2% ownership interest. This investment is considered an available for sale security. TCI recognized an unrealized gain of \$791,000 for the six month period ending June 30, 2007 due to an increase in market price.

NOTE 6. RELATED PARTIES

The following table reconciles the beginning and ending affiliate receivable balances as of June 30, 2007.

Balance, December 31, 2006	\$ (7,167)
Cash transfers	43,995

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Cash repayments	(41,508)
Fees and commissions payable to affiliate	(17,884)
Payables clearing through Prime	(461)
Balance, June 30, 2007	\$ (23,025)

In addition, TCI's other assets include \$248,000 due from an affiliate for rent. In addition, at June 30, 2007, TCI owed \$1.1 million to Regis Property Management for management fees and sales commissions.

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued****NOTE 7. LOANS AND INTEREST PAYABLE**

In 2007, TCI refinanced the following properties:

Property	Location	Acres/ Rooms/Units	Debt Incurred	Debt Discharged	Net Cash Received	Interest Rate	Maturity Date
First Quarter							
Hotels							
City Suites	Chicago, IL	45 Rooms	\$ 7,300	\$ 3,551	\$ 3,841	8.25% ⁽¹⁾	2/12
The Majestic	Chicago, IL	55 Rooms	6,000	3,091	2,866	7.76	3/10
Willows Surf	Chicago, IL	52 Rooms	5,160	3,410	1,530	7.76	3/10
			18,460	10,052	8,237		
Land							
Crowley & Wilmer	Crowley & Wilmer, TX	142.6 Acres	3,390		2,633	9.75	7/07 ⁽²⁾
Manhattan	Farmers Branch, TX	108.0 Acres	7,000		6,620	10.00	1/08
Las Colinas Townhomes	Irving, TX	15.6 Acres	6,750	4,338	2,838	9.25 ⁽¹⁾	3/08
			17,140	4,338	12,091		
			35,600	14,390	20,328		
Second Quarter							
Apartments							
Arbor Pointe	Odessa, TX	194 Units	5,088	1,799	4,988	7.03	7/37
Autumn Chase	Midland, TX	64 Units	2,400	1,131	705	9.25 ⁽¹⁾	9/07
Courtyard	Midland, TX	133 Units	3,440	1,303	2,057	7.03	7/37
Coventry Pointe	Midland, TX	120 Units	3,120	1,137	1,858	7.03	7/37
Fountains at Waterford	Midland, TX	172 Units	5,920	1,525	252	7.03	7/37
Hunters Glen	Midland, TX	212 Units	4,462	2,448	938	9.25 ⁽¹⁾	9/07
Southgate	Odessa, TX	180 Units	4,614	1,827	2,671	7.03	7/37
Sunchase	Odessa, TX	300 Units	7,328	3,128	7,196	7.03	7/37
Thornwood	Midland, TX	109 Units	2,784	1,098	1,582	7.03	7/37
Westwood Square	Odessa, TX	79 Units	936	492	418	7.03	7/37
			40,092	15,888	22,665		
Land							
Las Colinas High Rise	Irving, TX	11.8 Acres	2,042		1,961	12.50	4/09
Polo Estates at Park Forest	Dallas, TX	9.3 Acres	3,107	2,964	76	9.25 ⁽¹⁾	12/07
			5,149	2,964	2,037		

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45,241 18,852 24,702

\$ 80,841 \$ 33,242 \$ 45,030

In 2006, TCI refinanced the following properties:

Property	Location	Acres/ Sq. Ft./Units	Debt Incurred	Debt Discharged	Net Cash Received	Interest Rate	Maturity Date
First Quarter							
Apartments							
Hunters Glen	Midland, TX	212 Units	\$ 2,475	\$ 1,804	\$ 421	7.23% ⁽¹⁾	2/09
Land							
West End	Dallas, TX	5.34 Acres	9,000	2,000	6,079	8.00 ₍₁₎	3/07 ₍₂₎
			11,475	3,804	6,500		
Second Quarter							
Land							
Payne Land	Irving, TX	109.9 Acres	5,683		5,591	9.00	12/07
Office Buildings							
Forum Office Building	Richmond, VA	79,791 Sq. Ft.	6,000	4,721	1,152	7.75	7/13
One Hickory	Farmers Branch, TX	102,615 Sq. Ft.	9,300	6,858	2,308	6.93	6/10
			15,300	11,579	3,460		
			20,983	11,579	9,051		
			\$ 32,458	\$ 15,383	\$ 15,551		

(1) Variable rate.

(2) TCI is negotiating with Lender to extend this loan.

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In March 2007, the Company sold 15.6 acres known as Rochelle II or Las Colinas Townhomes to TCI Woodmont XII, a subsidiary of the Company, for \$6.7 million. TCI Woodmont XII obtained financing in the amount of \$6.8 million from a commercial lender and \$3.4 million from the Company. Because the sale was to a consolidated subsidiary, the Company has recorded the transaction as a financing transaction.

On May 8, 2007, we purchased 40.1 acres of land in Las Colinas, Texas known as Hines Meridian for \$8.4 million. The acquisition was financed with \$3.0 million cash and a new note for \$5.0 million. The note accrues interest at 9.25%, is payable in installments of interest only for 12 months, then installments of principal and interest for 23 months and one final payment of all accrued, unpaid interest and the outstanding principal balance, on maturity in June 2010.

On June 6, 2007 we refinanced \$12.4 million in existing mortgages on eight apartment complexes; Arbor Pointe, Courtyard, Coventry Pointe, Fountains at Waterford, Southgate, Sunchase, Thornwood, and Westwood apartments consisting of 1,287 units located throughout Midland and Odessa, Texas for new loans totaling \$33.2 million receiving \$21.0 million in cash and paid down property debt and defeasance costs totaling \$4.1 million. The loans accrue interest at 7.03% is payable in monthly installments of interest and principal, and all accrued and unpaid interest and the outstanding principal balance are due on maturity, July 2037.

On June 28, 2007 we refinanced the existing notes of \$3.6 million on two apartment complexes; Autumn Chase and Hunters Glen apartments consisting of 276 units in total located in Midland, Texas for new loans totaling \$6.9 million, receiving \$1.6 million in cash. The loans accrue interest at prime plus 25 points with interest only payments due monthly and all unpaid accrued interest and the outstanding principal balance payable on maturity in September 2007.

In addition to the foregoing, through June 2007, the Company obtained additional funding for eight of its residential development projects totaling \$36.8 million. The loans represent partial funding of development loans through various sources of financing, including commercial lenders and HUD.

NOTE 8. OPERATING SEGMENTS

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. Excluded from segment assets are assets of \$144 million at June 30, 2007 and \$137 million at June 30, 2006. There are no intersegment revenues and expenses and TCI conducted all of its business within the United States, with the exception of Hotel Akademia, a 161 room hotel in Wroclaw, Poland, which began operations in 2002.

Presented below is the operating income of each operating segment for the six months ended June 30, 2007 and 2006 and each segment's assets at June 30.

Three Months Ended June 30, 2007	Commercial				
	Land	Properties	Apartments	Hotels	Total
Rents	\$ 122	\$ 14,787	\$ 20,976	\$ 4,402	\$ 40,287
Property operating expenses	684	8,740	11,017	2,408	22,849
Depreciation	5	3,228	2,981	553	6,767
Interest	3,961	5,884	9,330	382	19,557
Gain on land sales*					
Segment income (loss)	\$ (4,528)	\$ (3,065)	\$ (2,352)	\$ 1,059	\$ (8,886)

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Real estate improvements and construction	2,044	2,966		1,261	6,271
Assets	363,252	308,252	589,841	31,043	1,292,388
Property Sales:					
Sales price					
Cost of sales					
Gain on sale**	\$	\$	\$	\$	\$

Commercial

Three Months Ended June 30, 2006	Land	Properties	Apartments	Hotels	Total
Rents	\$ 144	\$ 8,740	\$ 18,795	\$ 1,705	\$ 29,384
Property operating expenses	611	5,476	10,875	849	17,811
Depreciation	2	2,261	2,409	203	4,875
Interest	2,750	2,689	6,753	244	12,436
Gain on land sales*	8,690				8,690
Segment income (loss)	\$ 5,471	\$ (1,686)	\$ (1,242)	\$ 409	\$ 2,952
Real estate improvements and construction	1,644	4,044	2,410	37	8,135
Assets	237,366	195,355	540,304	28,021	1,001,046
Property Sales:					
Sales price	26,880		9,250		36,130
Cost of sales	18,190		5,958		24,148
Gain on sale**	\$ 8,690	\$	\$ 3,292	\$	\$ 11,982

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	Commercial				
Six Months Ended June 30, 2007	Land	Properties	Apartments	Hotels	Total
Rents	\$ 265	\$ 28,734	\$ 41,143	\$ 6,298	\$ 76,440
Property operating expenses	1,523	15,803	22,889	4,064	44,279
Depreciation	11	5,196	6,082	905	12,194
Interest	7,449	9,661	16,878	1,444	35,432
Gain on land sales*	1,122				1,122
Segment loss	\$ (7,596)	\$ (1,926)	\$ (4,706)	\$ (115)	\$ (14,343)
Real estate improvements and construction	3,060	4,591		1,261	8,912
Assets	363,252	308,252	589,841	31,043	1,292,388
Property Sales:					
Sales price	2,869		24,650		27,519
Cost of sales	1,747		21,002		22,749
Gain on sale**	\$ 1,122	\$	\$ 3,648	\$	\$ 4,770

	Commercial				
Six Months Ended June 30, 2006	Land	Properties	Apartments	Hotels	Total
Rents	\$ 300	\$ 17,769	\$ 36,631	\$ 3,541	\$ 58,241
Property operating expenses	722	10,366	21,724	2,506	35,318
Depreciation	14	4,486	4,745	574	9,819
Interest	4,953	5,388	13,497	769	24,607
Gain on land sales*	9,022				9,022
Segment income (loss)	\$ 3,633	\$ (2,471)	\$ (3,335)	\$ (308)	\$ (2,481)
Real estate improvements and construction	1,750	5,586	4,159	37	11,532
Assets	237,366	195,355	540,304	28,021	1,001,046
Property Sales:					
Sales price	30,105		9,250		39,355
Cost of sales	21,084		5,958		27,042
Gain on sale**	\$ 9,021	\$	\$ 3,292	\$	\$ 12,313

* Does not include gains from sale of income producing properties.

** Includes gains from sale of income producing properties.

The tables below reconcile the segment information to the corresponding amounts in the Consolidated Statements of Operations:

**For the Six Months
Ended June 30,**

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	2007	2006
Segment operating loss	\$ (14,343)	\$ (2,481)
Other non-segment items of income (expense):		
General and administrative	(5,205)	(3,038)
Advisory fees	(5,096)	(4,187)
Interest income	1,392	1,668
Gain (loss) on foreign currency transaction	(4)	4
Other income	819	238
Litigation settlement	704	1,804
Equity in earnings of investees	700	
Minority interest	4	189
Income tax benefit	653	687
Loss from continuing operations	\$ (20,376)	\$ (5,116)

Table of Contents**TRANSCONTINENTAL REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued****NOTE 9. DISCONTINUED OPERATIONS**

Effective January 1, 2002, TCI adopted Statement of Financial Accounting Standard 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 properties intended to be sold are to be designated as held for sale on the balance sheet. In the event of a future sale, TCI is required to reclassify portions of previously reported operations to discontinued operations within the Statement of Operations.

For the six months ended June 30, 2007 and 2006, income from discontinued operations relates to properties TCI sold or intends to sell in 2007 as well as properties TCI sold during 2005 and 2006. The following table summarizes revenue and expense information for the properties sold and held for sale:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Revenue:				
Rental	\$ 1,867	\$ 3,199	\$ 4,248	\$ 6,683
Expenses:				
Property Operations	1,431	1,542	3,161	3,811
	436	1,657	1,087	2,872
Other (expenses):				
Interest	956	1,476	2,415	3,174
Depreciation	243	784	455	1,029
	1,199	2,260	2,870	4,203
Gain on sale of real estate		3,292	3,648	3,292
Income tax benefit (expense)	267	(941)	(653)	(687)
Income (loss) from discontinued operations	\$ (496)	\$ 1,748	\$ 1,212	\$ 1,274

NOTE 10. COMMITMENTS AND CONTINGENCIES

Partnership Obligations. TCI is the limited partner in ten partnerships that are currently constructing residential properties. As permitted in the respective partnership agreements, TCI intends to purchase the interests of the general and any other limited partners in these partnerships subsequent to the completion of these projects. The amounts paid to buy out the non-affiliated partners are limited to development fees earned by the non-affiliated partners and are set forth in the respective partnership agreements. The total amount of the expected buyouts remaining as of June 30, 2007 is approximately \$3.0 million.

Liquidity. Management believes that TCI will generate excess cash from property operations in 2007; such excess, however, will not be sufficient to discharge all of TCI's obligations as they become due. Management intends to sell income producing assets, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

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Litigation. Waters Edge. Shortly before the advent of Hurricane Katrina, an apartment complex in Mississippi was sold to Waters Edge Living, LLC but notwithstanding such sale, the property continued on insurance coverage applicable to Transcontinental Realty Investors, Inc. (TCI) and others. As a result of sorting out various claims, two items of litigation exist, *Waters Edge Living, LLC v. RUSI Indemnity Co., et al*, civil action No. 4:06-CV-00334-RH-WCS pending in the United States District Court for the Northern district of Florida and *Prime Income Asset Management, Inc., et al v. Waters Edge Living, LLC, et al*, civil action No. 3:07-CV-0102-D pending in the United States District Court for the Northern District of Texas. TCI is not a direct party in either case. In the Texas

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