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

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from _______ to ______

Commission File Number 001-09240

TRANSCONTINENTAL REALTY INVESTORS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Nevada	94-6565852
(State or Other Jurisdiction of	(I.R.S. Employer

Incorporation or Organization) Identification No.)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company)	Smaller reporting company

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

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

Common Stock, $.01 par value	8,717,767
(Class)	(Outstanding at August 5, 2015)

TRANSCONTINENTAL REALTY INVESTORS, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TRANSCONTINENTAL REALTY INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

(unaudited)

	June 30, 2015	**December 31,** 2014
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	$899,769	$781,794
Real estate subject to sales contracts at cost, net of depreciation ($2,475 for 2015 and $2,300 for 2014)	20,402	20,395
Less accumulated depreciation	(127,760)	(113,068)
Total real estate	792,411	689,121
Notes and interest receivable:		
Performing (including $69,050 in 2015 and $77,853 in 2014 from related parties)	76,253	84,863
Non-performing	604	584
Less allowance for doubtful accounts (including $1,825 in 2015 and $1,825 in 2014 from related parties)	(1,990)	(1,990)
Total notes and interest receivable	74,867	83,457
Cash and cash equivalents	19,128	12,201
Restricted cash	52,066	48,238
Investments in unconsolidated joint ventures and investees	2,155	1,543
Receivable from related party	94,080	58,404
Other assets	33,287	37,441
Total assets	$1,067,994	$930,405
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	$727,222	$588,749
Notes related to real estate held for sale	910	1,552
Notes related to real estate subject to sales contracts	18,252	18,616
Deferred gain (from sales to related parties)	51,356	51,356
Accounts payable and other liabilities (including $2,652 in 2015 and $4,909 in 2014 to related parties)	37,010	36,684

Total liabilities	834,750	696,957
Shareholders' equity:		
Preferred stock, Series C: $0.01 par value, authorized 10,000,000 shares; issued and outstanding zero shares in 2015 and 2014 (liquidation preference $100 per share). Series D: $0.01 par value, authorized, issued and outstanding 100,000 shares in 2015 and 2014 (liquidation preference $100 per share)	1	1
Common stock, $0.01 par value, authorized 10,000,000 shares; issued 8,717,967 shares in 2015 and 2014; outstanding 8,717,767 shares in 2015 and 2014	87	87
Treasury stock at cost, 200 shares in 2015 and 2014	(2)	(2)
Paid-in capital	271,203	271,649
Retained earnings	(56,208)	(56,451)
Total Transcontinental Realty Investors, Inc. shareholders' equity	215,081	215,284
Non-controlling interest	18,163	18,164
Total shareholders' equity	233,244	233,448
Total liabilities and shareholders' equity	$1,067,994	$930,405

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(dollars in thousands, except per share amounts)			
Revenues:				
Rental and other property revenues (including $173 and $175 for the three months and $343 and $350 for the six months ended 2015 and 2014, respectively, from related parties)	$23,756	$18,511	$46,060	$36,814
Expenses:				
Property operating expenses (including $178 and $148 for the three months and $331 and $293 for the six months ended 2015 and 2014, respectively, from related parties)	10,929	9,359	21,793	18,562
Depreciation and amortization	5,107	4,271	9,751	8,552
General and administrative (including $727 and $656 for the three months and $1,547 and $1,400 for the six months ended 2015 and 2014, respectively, from related parties)	1,278	2,738	3,045	4,287
Net income fee to related party	45	210	90	700
Advisory fee to related party	1,951	1,811	3,894	3,664
Total operating expenses	19,310	18,389	38,573	35,765
Net operating income	4,446	122	7,487	1,049
Other income (expenses):				
Interest income (including $2,748 and $4,004 for the three months and $6,167 and $6,117 for the six months ended 2015 and 2014, respectively, from related parties)	2,994	4,005	6,755	6,118
Other income	14	244	81	396
Mortgage and loan interest (including $0 and $0 for the three months and $31 and $31 for the six months ended 2015 and 2014, respectively, from related parties)	(8,216)	(7,869)	(18,401)	(16,868)
Earnings (losses) from unconsolidated joint ventures and investees	10	(11)	43	(16)
Litigation settlement (expense)	(45)	(86)	(118)	3,753
Total other expenses	(5,243)	(3,717)	(11,640)	(6,617)
Loss before gain on land sales, non-controlling interest, and taxes	(797)	(3,595)	(4,153)	(5,568)
Gain (loss) on land sales	1,250	(159)	4,126	594

Net income (loss) from continuing operations before taxes	453	(3,754)	(27)	(4,974)
Income tax benefit (expense)	(12)	2,195	90	4,244
Net income (loss) from continuing operations	441	(1,559)	63	(730)
Discontinued operations:				
Net income (loss) from discontinued operations	(34)	(732)	258	(931)
Gain on sale of real estate from discontinued operations	—	7,003	—	13,057
Income tax benefit (expense) from discontinued operations	12	(2,195)	(90)	(4,244)
Net income (loss) from discontinued operations	(22)	4,076	168	7,882
Net income	419	2,517	231	7,152
Net income (loss) attributable to non-controlling interest	(281)	(127)	12	(211)
Net income attributable to Transcontinental Realty Investors, Inc.	138	2,390	243	6,941
Preferred dividend requirement	(224)	(277)	(446)	(551)
Net income (loss) applicable to common shares	$(86)	$2,113	$(203)	$6,390
Earnings per share - basic				
Net loss from continuing operations	$(0.01)	$(0.23)	$(0.04)	$(0.18)
Net income from discontinued operations	—	0.48	0.02	0.93
Net income (loss) applicable to common shares	$(0.01)	$0.25	$(0.02)	$0.75
Earnings per share - diluted				
Net loss from continuing operations	$(0.01)	$(0.23)	$(0.04)	$(0.18)
Net income from discontinued operations	—	0.48	0.02	0.93
Net income (loss) applicable to common shares	$(0.01)	$0.25	$(0.02)	$0.75
Weighted average common shares used in computing earnings per share	8,717,767	8,413,469	8,717,767	8,413,469
Weighted average common shares used in computing diluted earnings per share	8,717,767	8,413,469	8,717,767	8,413,469
Amounts attributable to Transcontinental Realty Investors, Inc.				
Net income (loss) from continuing operations	$160	$(1,686)	$75	$(941)
Net income (loss) from discontinued operations	(22)	4,076	168	7,882
Net income	$138	$2,390	$243	$6,941

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Six Months Ended June 30, 2015
(unaudited, dollars in thousands)

	Total Equity	Comprehensive Loss	Preferred Stock	Common Stock Shares	Common Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings	Non-controlling Interest
Balance, December 31, 2014	$233,448	$(57,670)	$1	8,717,967	$87	$(2)	$271,649	$(56,451)	$18,164
Series D preferred stock dividends (9.0% per year)	(446)	—	—	—	—	—	(446)	—	—
Net income (loss)	231	231	—	—	—	—	—	243	(12)
Contributions from non-controlling interests	11	—	—	—	—	—	—	—	11
Balance, June 30, 2015	$233,244	$(57,439)	$1	8,717,967	$87	$(2)	$271,203	$(56,208)	$18,163

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

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

	For the Six Months Ended June 30,	
	2015	2014
	(dollars in thousands)	
Net income	$231	$7,152
Other comprehensive income	—	—
Total comprehensive income	231	7,152
Comprehensive (income) loss attributable to non-controlling interest	12	(211)
Comprehensive income attributable to Transcontinental Realty Investors, Inc.	$243	$6,941

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
(unaudited)

	For the Six Months Ended June 30,	
	2015	2014
	(dollars in thousands)	
Cash Flow From Operating Activities:		
Net income	$231	$7,152
Adjustments to reconcile net income applicable to common shares to net cash flows from operating activities:		
Gain on sale of land	(4,126)	(594)
Gain on sale of income-producing properties	—	(13,057)
Depreciation and amortization	9,751	9,061
Amortization of deferred borrowing costs	949	1,544
Losses (earnings) from unconsolidated joint ventures and investees	(43)	286
Decrease (increase) in assets:		
Accrued interest receivable	185	7,281
Other assets	2,385	574
Prepaid expense	(8,687)	(1,182)
Escrow	(4,746)	8,910
Earnest money	(1,395)	(265)
Rent receivables	(883)	(397)
Related party receivables	(35,676)	(22,026)
Increase (decrease) in liabilities:		
Accrued interest payable	327	104
Other liabilities	(3,358)	(13,082)
Net cash used in operating activities	(45,086)	(15,691)
Cash Flow From Investing Activities:		
Proceeds from notes receivable	16,060	—
Originations or advances on notes receivable	(7,655)	(8,449)
Acquisition of land held for development	—	(93)
Acquisition of income-producing properties	(105,729)	—
Proceeds from sale of income-producing properties	—	41,428
Proceeds from sale of land	8,618	2,221
Investment in unconsolidated real estate entities	3,176	(98)
Improvement of land held for development	(1,469)	(181)
Improvement of income-producing properties	(6,539)	(3,134)
Construction and development of new properties	(3,176)	(620)
Net cash provided by (used in) investing activities	(96,714)	31,074
Cash Flow From Financing Activities:		
Proceeds from notes payable	198,770	59,487

Recurring amortization of principal on notes payable	(7,802)	(10,133)
Payments on maturing notes payable	(33,865)	(61,740)
Deferred financing costs	(7,941)	(5,135)
Contibutions (distributions) non-controlling interests	11	(15)
Preferred stock dividends - Series C	—	(106)
Preferred stock dividends - Series D	(446)	(445)
Net cash provided by (used in) financing activities	148,727	(18,087)
Net increase (decrease) in cash and cash equivalents	6,927	(2,704)
Cash and cash equivalents, beginning of period	12,201	16,086
Cash and cash equivalents, end of period	$19,128	$13,382
Supplemental disclosures of cash flow information:		
Cash paid for interest	$16,748	$15,153

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

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

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

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

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

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

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

Properties

We own or had interests in a total property portfolio of 52 income-producing properties as of June 30, 2015. The properties consisted of:

- Nine commercial properties consisting of five office buildings, two retail centers, one industrial warehouse and a golf course, comprising in aggregate approximately 1.9 million rentable square feet;
- 43 apartment communities totaling 7,085 units; excluding apartments being developed; and
- 4,044 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We are in the predevelopment process on several residential apartment communities that have not yet begun construction. At June 30, 2015, we had two apartment projects in development. The third-party developer typically holds a general partner, as well as a majority limited partner interest in a limited partnership formed for the purpose of building a single property, while we generally take a minority limited partner interest in the limited partnership. We may contribute land to the partnership as part of our equity contribution or we may contribute the necessary funds to the partnership to acquire the land. We are required to fund all necessary equity contributions while the third-party developer is responsible for obtaining construction financing, hiring a general contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our Consolidated Financial Statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer's partnership interests in exchange for any remaining unpaid developer fees.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted in accordance with such rules and regulations, although management believes the disclosures are adequate to prevent the information presented from being misleading. In the opinion of management, all adjustments (consisting of normal recurring matters) considered necessary for a fair presentation have been included. The results of operations for the six months ended June 30, 2015, are not necessarily indicative of the results that may be expected for other interim periods or for the full fiscal year.

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

Principles of Consolidation

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

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

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

Real Estate, Depreciation and Impairment

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

Real Estate Held for Sale

We periodically classify real estate assets as “held for sale”. An asset is classified as held for sale after the approval of our Board of Directors, after an active program to sell the asset has commenced and if the sale is probable. One of the deciding factors in determining whether a sale is probable is whether the firm purchase commitment is obtained and whether the sale is probable within the year. Upon the classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its estimated fair value, less costs to sell the asset. Subsequent to the classification of assets as held for sale, no further depreciation expense is recorded. Real estate assets held for sale are stated separately on the accompanying Consolidated Balance Sheets. Upon a decision that the sale is no longer probable, the asset is classified as an operating asset and depreciation expense is reinstated.

Prior to January 1, 2015, the operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying Consolidated Statements of Operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. Subsequent to January 1, 2015, Accounting Standards Update 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” (“ASU 2014-08”) substantially changed the criteria for determining whether a disposition qualifies for discontinued operations presentation. Adoption of this standard will result in substantially fewer of the Company’s dispositions meeting the discontinued operations criteria.

Cost Capitalization

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

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

Fair Value Measurement

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

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

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

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

Deferred Costs

Costs relating to the financing of properties are deferred and amortized over the life of the related financing agreement. Amortization is reflected as interest expense in the Consolidated Statements of Operations, with remaining terms ranging from 6 months to 40 years. Unamortized financing costs are written off when the financing agreement is extinguished before the maturity date.

Related Parties

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

Newly Issued Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity”, which changes the criteria for determining which disposals qualify to be accounted for as discontinued operations and modifies related reporting and disclosure requirements.

Disposals representing a strategic shift in operations, such as change in a major line of business, a major geographical area or major equity investment, that have a major effect on a company’s operations and financial results will be presented as discontinued operations. If the disposal does qualify as a discontinued operation under ASU 2014-08, the company will be required to expand their disclosures about discontinued operations to provide more information on the assets, liabilities, income and expenses of the disposed of component. The classification of operating results as discontinued operations are applied retroactively for all periods presented. The new standard was effective January 1, 2015. We adopted ASU 2014-08 as of January 1, 2015 and believe future sales of our individual operating properties will no longer qualify as discontinued operations. Adoption of this standard has resulted in substantially fewer of the Company’s dispositions meeting the discontinued operations criteria. See Note 8 below.

In May 2014, Accounting Standards Update (“ASU”) No. 2014-09 (“ASU 2014-09”), “Revenue from Contracts with Customers,” was issued. This new guidance established a new single comprehensive revenue recognition model and provides for enhanced disclosures. Under the new guidance, the nature, timing and amount of revenue recognized for certain transactions could differ from those recognized under existing accounting guidance. This new guidance does not affect revenue recognized under lease contracts. ASU 2014-09 is effective for reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of this guidance, if any, on its financial position and results of operations.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"). ASU 2015-03 requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. Prior to the issuance of the standard, debt issuance costs were required to be presented in the balance sheet as an asset. The Company has adopted this standard effective June 30, 2015. The accompanying financials have been reclassified to reflect the adoption.

NOTE 2. REAL ESTATE ACTIVITY

Below is a summary of the real estate owned as of June 30, 2015 (dollars in thousands):

Apartments	$546,904
Apartments under construction	3,261
Commercial properties	202,912
Land held for development	146,692
Real estate subject to sales contract	22,877
Total real estate	$922,646
Less accumulated depreciation	(130,235)
Total real estate, net of depreciation	$792,411

The highlights of our significant real estate transactions for the six months ended June 30, 2015, are listed below:

Purchases

For the six months ended June 30, 2015, the Company acquired three income-producing apartment complexes from third parties in the states of Texas (1) and Florida (2), increasing the total number of units by 349, for a combined purchase price of $31.5 million. In addition, the Company acquired three income-producing apartment complexes from related parties in the states of Texas (2) and Kansas (1), increasing the total number of units by 698, for a combined purchase price of $11.6 million. The Company also purchased a commercial office building in Texas, comprised of 92,723 square feet, for $16.8 million.

Sales

For the six months ended June 30, 2015, the Company sold approximately 43 acres of land located in Texas to independent third parties, for a total sales price of $9.1 million. We recorded a total gain of $4.1 million from the sales.

As of June 30, 2015, there is one apartment complex, one commercial building and 110 acres of land that we have sold to a related party and have deferred the recognition of the sale. These are treated as “subject to sales contract” on the Consolidated Balance Sheets. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and may or may not be transferred back to the seller upon resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. According to the loan documents, the maker is currently in default on these mortgages primarily due to lack of payment and is actively involved in discussions with every lender in order to settle or cure the default situation. We have reviewed each asset and taken impairment to the extent we feel the value of the property was less than our current basis. The Company did not recognize or record the sale in accordance with ASC 360-20 due to our continuing involvement, which included the potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer’s inadequate initial investment and the Company’s questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20. The buyers received no compensation for the facilitation of the bankruptcy or debt restructuring process.

We continue to invest in the development of apartment projects. During the six months ended June 30, 2015, we have expended $3.2 million related to the construction or predevelopment of various apartment complexes and capitalized $25,109 of interest costs.

NOTE 3. NOTES AND INTEREST RECEIVABLE

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

Borrower	Maturity Date	**Interest** Rate		Amount	Security
Performing loans:					
Foundation for Better Housing, Inc. (Overlook at Allensville) (1)	11/19	12.00	%	2,472	Secured
Foundation for Better Housing, Inc. (Overlook at Allensville) (1)	12/17	12.00	%	1,408	Secured
Foundation for Better Housing, Inc. (Vista Ridge) (1)	04/19	12.00	%	3,923	Secured
Foundation for Better Housing, Inc. (Vista Ridge) (1)	06/17	12.00	%	1,492	Secured
H198, LLC (Las Vegas Land)	01/20	12.00	%	5,907	Secured
Unified Housing Foundation, Inc. (Echo Station) (1)	09/17	12.00	%	1,481	100% Interest in Unified Housing of Temple, LLC
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00	%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00	%	6,363	Membership interest in Housing for Seniors of Humble, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00	%	4,663	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00	%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/32	12.00	%	6,000	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/32	12.00	%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing) (1)	12/32	12.00	%	1,936	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00	%	4,812	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00	%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Timbers of Terrell) (1)	12/32	12.00	%	1,323	100% Interest in Unified Housing of Terrell, LLC

Unified Housing Foundation, Inc. (Tivoli) [1]	12/32	12.00 %	7,966	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. [1]	06/17	12.00 %	1,261	Unsecured
Unified Housing Foundation, Inc. [1]	12/17	12.00 %	1,207	Unsecured
Other related party notes [1]	Various	Various	768	Various secured interests
Other related party notes [1]	Various	Various	4,929	Various unsecured interests
Other non-related party notes	Various	Various	496	Various secured interests
Other non-related party notes	Various	Various	503	Various unsecured interests
Accrued interest			4,862	
Total Performing			**$76,253**	
Non-Performing loans:				
Other non-related party notes	Various	Various	507	Secured
Accrued interest			97	
Total Non-Performing			**$604**	
Allowance for doubtful accounts			(1,990)	
Total			**$74,867**	

(1) Related party notes

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

At June 30, 2015, we had junior mortgage loans and accrued interest receivable from related parties, net of allowances, totaling $67.2 million. We recognized interest income of $4.9 million related to these notes receivables.

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

NOTE 4. INVESTMENT IN UNCONSOLIDATED JOINT VENTURES AND INVESTEES

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

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

	Percentage ownership as of	
	June 30, 2015	June 30, 2014
American Realty Investors, Inc.[1]	1.00%	1.99%

[1] Unconsolidated investment in parent company owning 140,000 shares of ARL Common Stock

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

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

As of June 30,	2015	2014
Real estate, net of accumulated depreciation	$14,285	$15,149
Notes receivable	50,519	68,940
Other assets	127,217	128,581
Notes payable	(28,193)	(52,369)
Other liabilities	(94,201)	(100,149)
Shareholders' equity	(69,627)	(60,152)

For the Six Months Ended June 30,	2015	2014
Rents and interest and other income	$6,359	$5,894
Depreciation	(78)	(138)
Operating expenses	(1,810)	(3,093)
Interest expense	(1,448)	(3,447)
Income (loss) from continuing operations	3,023	(784)
Income (loss) from discontinued operations	—	—
Net income (loss)	$3,023	$(784)
Company's proportionate share of income (loss)	$30	$(16)

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NOTE 5. NOTES PAYABLE

Below is a summary of our notes and interest payable as of June 30, 2015 (dollars in thousands):

	Notes Payable	Accrued Interest	Total Debt
Apartments	$443,429	$1,316	$444,745
Commercial	117,392	494	117,886
Land	56,917	116	57,033
Real estate subject to sales contract	16,547	1,705	18,252
Mezzanine financing	123,900	—	123,900
Other	4,530	—	4,530
Total	$762,715	$3,631	$766,346
Unamortized deferred borrowing costs	(19,962)	—	(19,962)
Total	$742,753	$3,631	$746,384

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

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

On January 28, 2015, the Company modified the existing mortgage on a 200-unit complex located in Texas, to reduce the interest rate. The modified note accrues interest at 3.24% and payments of interest and principal are due monthly, maturing August 1, 2050.

On January 28, 2015, the Company modified the existing mortgage on a 240-unit complex located in Mississippi, to reduce the interest rate. The modified note accrues interest at 3.24% and payments of interest and principal are due monthly, maturing December 1, 2051.

On April 23, 2015, the Company refinanced the existing mortgage on a 250-unit complex located in Arkansas, for a new mortgage of $21.0 million. We paid off the existing mortgage of $15.7 million and $0.6 million in closing costs. The note accrues interest at 2.74% and payments of interest and principal are due monthly, maturing May 1, 2050.

On April 29, 2015, the Company refinanced the existing mortgage on a 240-unit complex located in Texas, for a new mortgage of $15.4 million. We paid $0.7 million in closing costs. The note accrues interest at 3.28% and payments of interest and principal are due monthly, maturing March 31, 2051.

On May 28, 2015, the Company secured additional financing of $120.0 million from an independent third party. At closing $84.4 million was advanced to the Company. The financing can be used for general corporate purposes, acquisition of multi-family apartment complexes and to reduce debt. The note has a term of five years at an interest rate of 30 day Libor plus 10.75%. The note is interest only, payable monthly, with the principal due at the end of the five years. The loan is secured by various equity interests in certain residential apartments. The note contains customary restrictions, representations, covenants, corporate and officer guarantees, events of default and require the Company to meet certain financial covenants. The Company believes it is in compliance with these financial covenants at June 30, 2015.

Simultaneous with the closing of the above financing, the Company amended its existing financing of $40.0 million from an independent third party. The note has a term of five years at an interest rate of 12.0%. The note is interest only for the first year with quarterly principal payments due of $0.5 million starting April 1, 2015. As of June 30, 2015, the outstanding balance on the loan was $39.5 million. The loan is secured by various equity interests in residential apartments and can be prepaid at a penalty rate of 4% for year 1 with the penalty declining by 1% each year thereafter. The note contains customary restrictions, representations, covenants, corporate and officer guarantees, events of default and require the Company to meet certain financial covenants. The Company believes it is in compliance with these financial covenants at June 30, 2015.

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

In conjunction with the development of various apartment projects and other developments, we drew down $1.7 million in construction loans during the six months ended June 30, 2015.

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

NOTE 6. RELATED PARTY TRANSACTIONS

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of June 30, 2015 (dollars in thousands):

	Pillar	ARL	**Total**
Related party receivable, December 31, 2014	$—	$58,404	$58,404
Cash transfers	38,073	—	38,073
Advisory fees	(3,893)	—	(3,893)
Net income fee	(90)	—	(90)
Fees and commissions	(2,391)	—	(2,391)
Cost reimbursements	(1,457)	—	(1,457)
Interest income	—	1,297	1,297
Expenses paid by advisor	(4,993)	—	(4,993)
Financing (mortgage payments)	3,381	—	3,381
Sales/purchases transactions	5,749	—	5,749
Purchase of obligations	(34,379)	34,379	—
Related party receivable, June 30, 2015	$—	$94,080	$94,080

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

NOTE 7. OPERATING SEGMENTS

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

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

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

Presented below is our reportable segments' operating income for the three and six months ended June 30, 2015 and 2014, including segment assets and expenditures (dollars in thousands):

For the Three Months Ended June 30, 2015	Commercial Properties	Apartments	Land	Other	Total
Rental and other property revenues	$ 6,678	$ 17,070	$—	$ 8	$23,756
Property operating expenses	(3,134)	(7,693)	(129)	27	(10,929)
Depreciation	(2,197)	(2,910)			