

AMERICAN REALTY INVESTORS INC

Form 10-Q

November 14, 2012

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 September 30, 2012

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 001-15663

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

Nevada
(State or Other Jurisdiction of
Incorporation or Organization)

75-2847135
(I.R.S. Employer
Identification No.)

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

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

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

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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 definition of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒

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

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

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

11,525,389
(Outstanding at November 5, 2012)

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2012 (dollars in thousands, except share and par value amounts)	December 31, 2011
Assets		
Real estate, at cost	\$ 1,056,941	\$ 1,120,122
Real estate held for sale at cost, net of depreciation (\$0 for 2012 and \$1,752 for 2011)	-	15,015
Real estate subject to sales contracts at cost, net of depreciation (\$15,290 and \$9,790 in 2012 and 2011)	46,601	49,982
Less accumulated depreciation	(159,747)	(158,489)
Total real estate	943,795	1,026,630
Notes and interest receivable		
Performing (including \$110,987 and \$104,969 in 2012 and 2011 from related parties)	117,767	110,136
Non-performing	4,256	4,787
Less allowance for estimated losses (including \$18,962 and \$8,962 in 2012 and 2011 from related parties)	(21,704)	(13,383)
Total notes and interest receivable	100,319	101,540
Cash and cash equivalents	6,738	20,312
Investments in unconsolidated subsidiaries and investees	7,625	10,746
Related party receivable	1,063	-
Other assets (including \$21 in 2012 and \$11 in 2011 from related parties)	74,050	76,243
Total assets	\$ 1,133,590	\$ 1,235,471
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$ 789,623	\$ 855,619
Notes related to assets held for sale	-	13,830
Notes related to subject to sales contracts	53,442	44,516
Stock-secured notes payable and margin debt	26,737	26,898
Related party payables	-	10,294
Deferred gain (including \$74,846 and \$71,964 in 2012 and 2011 from sales to related parties)	76,691	78,750
Accounts payable and other liabilities (including \$2,007 and \$1,822 in 2012 and 2011 to related parties)	95,886	110,307
	1,042,379	1,140,214
Shareholders' equity:		
	4,908	4,908

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Preferred stock, Series A: \$2.00 par value, authorized 15,000,000 shares, issued and outstanding 3,353,954 shares in 2012 and 2011 (liquidation preference \$10 per share), including 900,000 shares in 2012 and 2011 held by subsidiaries		
Common stock, \$.01 par value, authorized 100,000,000 shares; issued 11,941,174 shares and outstanding 11,525,389 shares in 2012 and 2011	115	115
Treasury stock at cost; 415,785 shares in 2012 and 2011 and 229,214 and 236,587 shares held by TCI as of 2012 and 2011	(6,395)	(6,395)
Paid-in capital	106,396	105,388
Retained earnings	(48,559)	(47,486)
Accumulated other comprehensive income	(786)	(786)
Total American Realty Investors, Inc. shareholders' equity	55,679	55,744
Non-controlling interest	35,532	39,513
Total equity	91,211	95,257
Total liabilities and equity	\$ 1,133,590	\$ 1,235,471

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

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

	For the Three Months Ended September 30, 2012	2011	For the Nine Months Ended September 30, 2012	2011
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(dollars in thousands, except share and per share amounts)

Revenues:

Rental and other property revenues
(including \$164 and \$0 for the
three months and
\$499 and \$0 for the nine months
ended 2012 and 2011 respectively
from related parties)

	\$ 28,918	\$ 29,109	\$ 89,515	\$ 85,589
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Expenses:

Property operating expenses
(including \$305 and \$274 for the
three months and \$855
and \$872 for the nine months
ended 2012 and 2011 respectively
from related parties)

	16,045	15,990	47,132	46,657
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Depreciation and amortization

	5,495	5,218	16,317	15,380
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General and administrative
(including \$769 and \$1,011 for the
three months and \$2,587

and \$3,440 for the nine months
ended 2012 and 2011 respectively
from related parties)

	1,546	3,641	5,052	10,556
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Provision on impairment of notes
receivable and real estate assets

	-	-	-	5,622
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Advisory fee to related party

	2,215	3,241	7,573	10,225
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Total operating expenses

	25,301	28,090	76,074	88,440
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Operating income (loss)

	3,617	1,019	13,441	(2,851)
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Other income (expense):

Interest income (including \$2,169
and \$448 for the three months and
\$9,797 and \$2,071

for the nine months ended 2012
and 2011 respectively from related
parties)

	2,280	1,039	10,342	2,910
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Other income (including \$1,500
and \$0 for the three months and
\$4,500 and \$0 for the

nine months ended 2012 and 2011
respectively from related parties)

	1,535	115	5,334	1,881
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Mortgage and loan interest

	(9,790)	(13,813)	(44,009)	(43,710)
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(including \$903 and \$48 for the

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three months and \$2,756
and \$1,628 for the nine months
ended 2012 and 2011 respectively
from related parties)

Loss on sale of investments	-	91	(361)	91
Earnings from unconsolidated subsidiaries and investees	134	(30)	284	(104)
Total other expenses	(5,841)	(12,598)	(28,410)	(38,932)
Loss before gain on land sales, non-controlling interest, and taxes	(2,224)	(11,579)	(14,969)	(41,783)
Gain (loss) on land sales	2,898	(942)	6,615	18,431
Income (loss) from continuing operations before tax	674	(12,521)	(8,354)	(23,352)
Income tax benefit (expense)	(13)	2,815	2,535	5,166
Net income (loss) from continuing operations	661	(9,706)	(5,819)	(18,186)
Discontinued operations:				
Loss from discontinued operations	(621)	(212)	(1,596)	(5,312)
Gain on sale of real estate from discontinued operations	585	8,256	8,840	20,073
Income tax benefit (expense) from discontinued operations	13	(2,815)	(2,535)	(5,166)
Net income (loss) from discontinued operations	(23)	5,229	4,709	9,595
Net income (loss)	638	(4,477)	(1,110)	(8,591)
Net (income) loss attributable to non-controlling interest	(74)	4,830	37	14,175
Net income (loss) attributable to American Realty Investors, Inc.	564	353	(1,073)	5,584
Preferred dividend requirement	(613)	(613)	(1,839)	(1,843)
Net income (loss) applicable to common shares	\$ (49)	\$ (260)	\$ (2,912)	\$ 3,741
Earnings per share - basic				
Loss from continuing operations	\$ -	\$ (0.48)	\$ (0.66)	\$ (0.51)
Income from discontinued operations	-	0.45	0.41	0.83
Net income (loss) applicable to common shares	\$ -	\$ (0.03)	\$ (0.25)	\$ 0.32
Earnings per share - diluted				
Loss from continuing operations	\$ -	\$ (0.48)	\$ (0.66)	\$ (0.51)
Income from discontinued operations	-	0.45	0.41	0.83
Net income (loss) applicable to common shares	\$ -	\$ (0.03)	\$ (0.25)	\$ 0.32
Weighted average common share used in computing earnings per share	11,525,389	11,525,389	11,525,389	11,514,749

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Weighted average common share
used in computing diluted earnings
per share

11,525,389	11,525,389	11,525,389	11,514,749
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Amounts attributable to American
Realty Investors, Inc.

Loss from continuing operations	\$ 587	\$ (4,876)	\$ (5,782)	\$ (4,011)
Income (loss) from discontinued operations	(23)	5,229	4,709	9,595
Net income (loss)	\$ 564	\$ 353	\$ (1,073)	\$ 5,584

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2012
(unaudited)
(dollars in thousands)

			Series A Preferred	Common Stock Shares	Amount	Treasury Stock	Paid-in Capital	Accumulated Retained Earnings	Other Comprehensive Income (Loss)	Non- controlling Interest
	Total Equity	Comprehensive Loss	Stock	Shares	Amount	Stock	Capital	Earnings	(Loss)	Interest
Balance, December 31, 2011	\$95,257	\$(137,440)	\$4,908	11,941,174	\$115	\$(6,395)	\$105,388	\$(47,486)	\$(786)	\$39,513
Net income (loss)	(1,110)	(1,110)	-	-	-	-	-	(1,073)	-	(37)
Sale of controlling interest	1,149	-	-	-	-	-	-	-	-	1,149
Acquisition of non-controlling interest	(523)	-	-	-	-	-	1,660	-	-	(2,183)
Sale of non-controlling interest	(1,468)	-	-	-	-	-	1,434	-	-	(2,902)
Distribution of non-controlling interest	(255)	-	-	-	-	-	(247)	-	-	(8)
Series A preferred stock cash dividend (\$1.00 per share)	(1,839)	-	-	-	-	-	(1,839)	-	-	-
Balance, September 30, 2012	\$91,211	\$(138,550)	\$4,908	11,941,174	\$115	\$(6,395)	\$106,396	\$(48,559)	\$(786)	\$35,532

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

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

	For the Nine Months Ended September 30,	
	2012	2011
	(dollars in thousands)	
Net loss	\$ (1,110)	\$ (8,591)
Other comprehensive loss		
Unrealized loss on foreign currency translation	-	-
Unrealized gain (loss) on investment securities	-	-
Total other comprehensive loss	-	-
Comprehensive loss	(1,110)	(8,591)
Comprehensive (income) loss attributable to non-controlling interest	37	14,175
Comprehensive income (loss) attributable to American Realty Investors, Inc.	\$ (1,073)	\$ 5,584

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

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

	2012	For the Nine Months Ended September 30,	2011
		(dollars in thousands)	
Cash Flow From Operating Activities:			
Net loss	\$ (1,110)		\$ (8,591)
Adjustments to reconcile net loss applicable to common shares to net cash used in operating activities:			
Gain on sale of land	(6,615)		(18,431)
Gain on sale of income-producing properties	(8,840)		(20,073)
Depreciation and amortization	16,735		19,747
Provision for impairment of notes receivable and real estate assets	-		6,503
Amortization of deferred borrowing costs	2,360		2,517
Earnings from unconsolidated subsidiaries and investees	(284)		104
(Increase) decrease in assets:			
Accrued interest receivable	(2,889)		(848)
Other assets	(1,680)		38
Prepaid expense	(182)		2,394
Escrow	2,858		10,321
Earnest money	235		1,414
Rent receivables	444		3,232
Related party receivable	(1,063)		(12,499)
Increase (decrease) in liabilities:			
Accrued interest payable	(5,702)		4,681
Related party payables	(10,294)		(12,219)
Other liabilities	(16,644)		6,144
Net cash used in operating activities	(32,671)		(15,566)
Cash Flow From Investing Activities:			
Proceeds from notes receivables	16,055		14,546
Origination of notes receivable	(10,266)		(632)
Acquisition of land held for development	(8,503)		-
Proceeds from sales of income-producing properties	56,623		131,710
Proceeds from sale of land	41,041		141,283
Proceeds from sale of investment in unconsolidated real estate entities	-		(9)
Proceeds from sale of investments	132		-
Investment in unconsolidated real estate entities	3,109		543
Improvement of land held for development	(190)		(2,703)
Improvement of income-producing properties	(2,481)		(2,610)
Acquisition of non-controlling interest	(357)		(135)

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Sale of non-controlling interest	(1,468)	108
Sale of controlling interest	1,147	2,275
Construction and development of new properties	(4,771)	(40,336)
Net cash provided by investing activities	90,071	244,040
Cash Flow From Financing Activities:		
Proceeds from notes payable	139,604	151,309
Recurring amortization of principal on notes payable	(18,944)	(13,860)
Debt assumption by buyer, part of seller proceeds	(13,794)	(217,156)
Payments on maturing notes payable	(172,225)	(152,100)
Stock-secured borrowings and margin debt	-	2,718
Deferred financing costs	(3,521)	(35)
Distributions to non-controlling interests	(255)	(765)
Preferred stock dividends - Series A	(1,839)	(1,843)
Repurchase of common stock/treasury stock	-	(62)
Issuance of common stock	-	30
Conversion of preferred stock into common stock	-	1
Net cash used in financing activities	(70,974)	(231,763)
Net decrease in cash and cash equivalents	(13,574)	(3,289)
Cash and cash equivalents, beginning of period	20,312	12,649
Cash and cash equivalents, end of period	\$ 6,738	\$ 9,360
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 32,124	\$ 47,231
Schedule of noncash investing and financing activities:		
Notes receivable received from related party	\$ 9,279	\$ -

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

As used herein, the terms “ARL”, “the Company”, “we”, “our” or “us” refer to American Realty Investors, Inc., a Nevada corporation, which was formed in November 1999. In August 2000, the Company acquired American Realty Trust, Inc. (“ART”), a Georgia corporation and National Realty, L.P. (“NRLP”), a Delaware partnership.

The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange (“NYSE”) under the symbol (“ARL”). Approximately 88.2% of ARL’s stock is owned by related parties. ARL owns approximately 84.7% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc. (“TCI”), a Nevada corporation, which has its common stock listed and traded on the New York Stock Exchange (“NYSE”) under the symbol (“TCI”). ARL is a “C” corporation for U.S. federal income tax purposes and has consolidated TCI’s accounts and operations since March 2003.

TCI, a subsidiary of ARL, 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 American Stock Exchange (“AMEX”) under the symbol (“IOT”).

ARL invests in real estate through direct ownership, leases and partnerships and also invests in mortgage loans on real estate. Prime Income Asset Management, LLC (“Prime”) served as the Company’s external Advisor and Cash Manager until April 30, 2011. Prime also served as an Advisor and Cash Manager to TCI and IOT. Effective April 30, 2011, Pillar Income Asset Management, Inc. (“Pillar”) became the Company’s external Advisor and Cash Manager under similar terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to TCI and IOT. Regis Realty Prime, LLC (“Regis”) manages our commercial properties and provides brokerage services. ARL engages third-party companies to lease and manage its apartment properties. We have no employees.

Properties

We own or had interests in a total property portfolio of 62 income-producing properties as of September 30, 2012. The properties consisted of:

• 14 commercial properties consisting of 10 office buildings, one industrial warehouse, and three retail centers comprising in aggregate approximately 3.7 million rentable square feet;

- 48 apartment communities totaling 8,873 units, excluding apartments being developed; and
- 4,678 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We completed construction on five apartment projects in 2011 and are in the predevelopment process on several residential apartment communities. At September 30, 2012, we had no 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 required equity contributions while the third-party developer is responsible for obtaining construction financing, hiring a general

contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our consolidated financial statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer's partnership interests in exchange for any remaining unpaid developer fees.

A maritime harbor town is being constructed on the 420 acre site of the former naval base of Olpenitz between the mouth of the River Schlei and the Baltic Sea in the state of Schleswig-Holstein in North Germany. The project is located less than 30 miles from the Danish border. The town will be comprised of a marina offering several thousand moorings, premium vacation homes each with their own landing stage as well as exclusive hotels, restaurants, shops and a range of leisure activities from sailing to golfing to cross-country skiing. At the current time over 50 lots in Phase One, of an initial 180, have been sold and are in various stages of construction.

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, or 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 nine months ended September 30, 2012 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, 2011 was derived from the audited financial statements at that date, but does not include all of the information and disclosures required by GAAP for complete financial statements. For further information, refer to the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Certain 2011 financial statement amounts have been reclassified to conform to the 2012 presentation, including adjustments for discontinued operations.

Principles of consolidation

The accompanying 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"). VIE's 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 VIE's 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 Gruppa Florentina, LLC, is accounted for under the equity method. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when they were sold to a third party.

Real estate, depreciation, and impairment

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

asset) over its estimated holding period are in excess of the asset's net book value at the balance sheet date. If any real estate asset held for investment is considered impaired, a loss is provided to reduce the carrying value of the asset to its estimated fair value.

Real estate held for sale

We periodically classify real estate assets as "held for sale". An asset is classified as held for sale after the approval of our board of directors and after an active program to sell the asset has commenced. 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 to no longer market as an asset for sale, the asset is classified as an operating asset and depreciation expense is reinstated. The operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying Consolidated Statements of Operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. This classification of operating results as discontinued operations applies retroactively for all periods presented. Additionally, gains and losses on assets designated as held for sale are classified as part of discontinued operations.

Cost capitalization

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

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

Fair value measurement

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

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

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.

Related parties

We apply ASC Topic 805, “Business Combinations”, to evaluate business relationships. Related parties include affiliates of the entity, entities for which investments in their equity securities would be required, trusts for the benefits of employees, principal owners of the entities and members of their immediate families, management 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 management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

Newly issued accounting standards

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

NOTE 2. REAL ESTATE ACTIVITY

The highlights of our significant real estate transactions for the nine months ended September 30, 2012 are listed below:

On January 3, 2012, we recognized the March 23, 2011 sale of 82.2 acres of land known as Denton Coonrod land located in Denton County, Texas to Cross County National Associates, LP, a related party, for a sales price of \$1.8 million. The existing mortgage of \$0.8 million, secured by the property, was paid in full when ownership transferred to the existing lender. We recorded a gain on sale of \$0.04 million on the land parcel sale.

On January 17, 2012, we sold 100% of our stock in American Realty Trust, Inc. for a sales price of \$10.0 million. We provided \$10.0 million in seller-financing with a five-year note receivable. The note accrues interest at 3.00% and is payable at maturity on January 17, 2017. The note is fully reserved by the Company. Subsequent to the sale, ART filed for Chapter Eleven bankruptcy protection.

On January 30, 2012, we refinanced the existing mortgage on Parc at Maumelle apartments, a 240-unit complex located in Little Rock, Arkansas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.1 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 3.00% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2052.

On February 2, 2012, TCI and its subsidiary, 1340 Poydras, LLC, executed a guarantor settlement and consent agreement with the lender for the Amoco building, Petra CRE CDO 2007-1, Ltd ("Petra") to transfer ownership of the Amoco building to a new entity, 1340 Owner, LLC, which is affiliated with the existing lender, Petra. Regis will continue to manage the property while under Petra's ownership and TCI will have an option to repurchase the property during the option term which shall end two years following the commencement of the agreement. We have deferred the recognition of the sale in accordance with ASC 360-20 due to our continuing involvement related to the obligations under the note and guaranty agreements and the repurchase option.

On February 7, 2012, we recognized the September 1, 2011 sale of 22.92 acres of land known as Andrew B land, Denton County, Texas to TCI Luna Ventures, LLC, a related party, for a sales price of \$1.3 million. We received a credit of \$2.1 million to satisfy a portion of the multi-tract collateral debt when ownership transferred to the existing lender. We recorded a gain on sale of \$1.2 million on the land parcel sale.

On February 23, 2012, we sold a 220-unit apartment complex known as Wildflower Villas apartments located in Temple, Texas for a sales price of \$19.6 million. The buyer assumed the existing debt of \$13.7 million secured by the property. We recorded a gain on sale of \$3.6 million on the apartment sale.

On February 27, 2012, we re-purchased 100% interest in Cross County National Associates, LP from ABC Land Real Estate, LLC and ABC Land & Development, Inc., both related parties under common control, for a sales price of \$9.5 million. This entity owns a 307,266 square foot retail center known as Cross County Mall located in Mattoon, Illinois. We assumed the existing mortgage of \$9.2 million, secured by the property. On March 22, 2011, we sold our ownership in Cross County National Associates, LP to ABC Land Real Estate, LLC and ABC Land & Development, Inc., both related parties under common control, for an amount equal to the re-purchase price. We did not recognize the March 22, 2011 sale in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost. Upon re-purchasing the ownership interests in the current period, the seller-financing note of \$0.3 million was cancelled. There is no change in the financial statements related to the March 22, 2011 sale or the subsequent re-purchase.

On February 29, 2012, we refinanced the existing mortgage on Huntington Ridge apartments, a 198-unit complex located in DeSoto, Texas, for a new mortgage of \$15.0 million. We paid off the existing mortgage of \$14.6 million and paid \$1.2 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Laguna Vista apartments, a 206-unit complex located in Dallas, Texas, for a new mortgage of \$17.7 million. We paid off the existing mortgage of \$17.0 million and paid \$1.1 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Savoy of Garland apartments, a 144-unit complex located in Garland, Texas, for a new mortgage of \$10.3 million. We paid off the existing mortgage of \$10.2 million and paid \$0.9 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On March 1, 2012, we sold 100% of our interests in LaDue, LLC to ABC Land & Development, Inc., a related party, for a sales price of \$1.9 million. This entity owns 8.01 acres of land known as LaDue land located in Dallas County, Texas. We provided \$1.3 million in seller-financing with a five-year note receivable. The note accrues interest at 5% and is payable at maturity on March 1, 2017. The buyer assumed the existing mortgage of \$0.6 million, secured by the property. We have deferred the recognition of the sale in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost.

On March 1, 2012, the construction loan in the amount of \$11.1 million that was taken out on July 30, 2010 to fund the development of Sonoma Court apartments, a 124-unit complex, closed into permanent financing. The note accrues interest at 5.35% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on November 1, 2051.

On March 5, 2012, we recognized the September 1, 2011 sale of 7.39 acres of land known as DeSoto Ranch land located in DeSoto, Texas to TCI Luna Ventures, LLC, a related party, for a sales price of \$1.3 million. We received a credit of \$1.0 million to satisfy a portion of the multi-tract collateral debt when ownership transferred to the existing lender. We recorded a gain on sale of \$0.1 million on the land parcel sale.

On March 27, 2012, we sold 319.07 acres of land known as Waco Ritchie land located in Waco, Texas for a sales price of \$1.9 million. The existing mortgage of \$1.5 million, secured by the property, was paid in full. We recorded a loss on sale of \$0.8 million on the land parcel sale.

On March 28, 2012, we sold 29.59 acres of land known as Elm Fork land located in Carrollton, Texas for a sales price of \$1.9 million. The existing mortgage of \$1.9 million, secured by the property, was paid down by \$1.8 million. We recorded a loss on sale of \$1.3 million on the land parcel sale.

On March 28, 2012, the construction loan in the amount of \$24.2 million that was taken out on February 18, 2010 to fund the development of Blue Ridge apartments, a 290-unit complex, closed into permanent financing. The note accrues interest at 5.37% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on October 1, 2051.

On April 1, 2012, we purchased 1,000 shares of stock of Kelly Lot Development, Inc. from Tacco Financial, Inc., a related party, for \$5.6 million. This entity owns six land parcels, comprising approximately 52.59 acres of undeveloped land located in Dallas County, Texas, Kaufman County, Texas, Nashville, Tennessee and Tarrant County, Texas, known as Kelly Lots land, Travis Ranch land, Nashville land, Cooks Lane land, Seminary West land and Vineyards land. We assumed the existing mortgages of \$0.5 million and \$0.4 million, secured by the property. The loans accrue interest at 15.00% and are payable at maturity on May 1, 2013 and November 1, 2013, respectively.

On April 3, 2012, we recognized the September 1, 2011 sale of 5.22 acres of land known as Andrew C land located in Denton, Texas to TCI Luna Ventures, LLC, a related party, for a sales price of \$0.4 million. We received a credit of \$0.5 million to satisfy a portion of the multi-tract collateral debt when ownership transferred to the existing lender. We recorded a gain on sale of \$0.2 million on the land parcel sale.

On April 5, 2012, we sold Clarke Garage, a 6,869 square foot parking garage, located in New Orleans, Louisiana for a sales price of \$6.0 million. All of the sale proceeds went to pay down existing mortgages, secured by the property. We recorded a loss on sale of \$0.3 million on the parking garage sale.

On April 13, 2012, we recognized the August 20, 2010 sale of our investment in American Mart Hotel Corporation to ABC Land and Development, Inc., a related party, for a sales price of \$3.1 million. This entity owns the Comfort Inn Hotel, a 161-room hotel, located in Denver, Colorado. The buyer assumed the existing mortgage of \$3.0 million, secured by the property. We recorded a gain on sale of \$3.1 million when the building was sold to a third party.

On April 30, 2012, we refinanced the existing mortgage on Parc at Metro Center apartments, a 144-unit complex located in Nashville, Tennessee, for a new mortgage of \$11.0 million. We paid off the existing mortgage of \$10.5 million and paid \$0.7 million in closing costs and escrow reserves. The note accrues interest at 2.95% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on May 1, 2052.

On May 16, we sold 0.42 acres of land known as 1013 Common Street located in New Orleans, Louisiana for a sales price of \$650,000. All of the sale proceeds went to pay down the existing mortgage, secured by the property.

On May 17, 2012, we sold a 220-unit apartment complex known as Portofino at Mercer Crossing apartments located in Farmers Branch, Texas for a sales price of \$26.0 million. The existing mortgage of \$19.9 million, secured by the property, was paid in full. We recorded a gain on sale of \$2.0 million on the apartment sale.

On May 25, 2012, we refinanced the existing mortgage on Pecan Pointe apartments, a 232-unit complex located in Temple, Texas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.4 million and paid \$1.3 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and

principal are due monthly based upon a 40-year amortization schedule, maturing on June 1, 2052.

On May 30, 2012, we refinanced the existing mortgage on Blue Lake Villas II apartments, a 70-unit complex located in Waxahachie, Texas, for a new mortgage of \$4.1 million. We paid off the existing mortgage of \$3.9 million and paid \$0.2 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on June 1, 2052.

On June 1, 2012, we purchased 19.29 acres of Summer Breeze land located in Odessa, Texas, for \$2.0 million. On June 12, 2012, we sold 13.31 acres of this land parcel to a third party.

On June 8, 2012, we sold 72.22 acres of land known as McKinney Ranch land located in McKinney, Texas for a sales price of \$5.4 million. We paid \$5.4 million on the existing mortgage to satisfy a portion of the multi-tract collateral debt of \$7.6 million, secured by the property. We recorded a gain on sale of \$1.0 million on the land parcel sale.

On June 19, 2012, the construction loan in the amount of \$16.4 million that was taken out on September 14, 2010 to fund the development of Lodge at Pecan Creek apartments, a 192-unit complex, closed into permanent financing. The note accrues interest at 5.05% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On June 22, 2012, we sold 305 Baronne, a 37,081 square foot building, located in New Orleans, Louisiana for a sales price of \$825,000. We paid \$0.7 million on an existing mortgage, secured by the property. We recorded a loss on sale of \$0.4 million on the building sale.

On June 28, 2012, we refinanced the existing mortgage on Lake Forest apartments, a 222-unit complex located in Houston, Texas, for a new mortgage of \$12.8 million. We paid off the existing mortgage of \$12.0 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

On June 28, 2012, we refinanced the existing mortgage on Mission Oaks apartments, a 228-unit complex located in San Antonio, Texas, for a new mortgage of \$15.6 million. We paid off the existing mortgage of \$14.9 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.95% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

On June 28, 2012, we refinanced the existing mortgage on Paramount Terrace apartments, a 181-unit complex located in Amarillo, Texas, for a new mortgage of \$3.2 million. We paid off the existing mortgage of \$2.8 million and paid \$0.4 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2045.

On June 28, 2012, we refinanced the existing mortgage on Sugar Mill apartments, a 160-unit complex located in Addis, Louisiana, for a new mortgage of \$12.0 million. We paid off the existing mortgage of \$11.8 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

On June 29, 2012, we sold 2.59 acres of land known as Vineyards land located in Grapevine, Texas for a sales price of \$2.4 million. The existing mortgage of \$0.4 million, secured by the property, was paid in full. We recorded a gain on sale of \$1.4 million on the land parcel sale.

On June 29, 2012, we sold 4.33 acres of land known as Vineyards land located in Grapevine, Texas for a sales price of \$3.9 million. We recorded a gain on sale of \$2.2 million on the land parcel sale.

On July 1, 2012, we recorded the June 12, 2012 sale of 13.31 acres of land known as Summer Breeze land located in Odessa, Texas, for \$2.2 million. We provided \$2.2 million in seller-financing with a 15-month note receivable. The note accrues interest at 5% and is payable at maturity on September 8, 2013. We have deferred the recognition of the gain in accordance with ASC 360-20 due to the buyer's inadequate initial investment.

On July 11, 2012, we sold Dunes Plaza, a 220,439 square foot retail center and 14.60 acres of land, located in Michigan City, Indiana, for a sales price of \$3.0 million. We paid \$2.2 million on an existing mortgage, secured by the property and \$0.8 million in closing costs and unpaid real estate taxes. We recorded a gain on sale of \$0.1 million on the building sale.

On August 10, 2012, we purchased 100% of the membership interests in LaDue, LLC from ABC Land & Development, Inc., a related party, for \$1.9 million to be paid via assumption of debt \$0.6 million, secured by the property, and cancellation of a five-year seller-financed note of \$1.3 million. This entity owns 8.01 acres of land known as LaDue land located in Dallas County, Texas. TCI originally sold the membership interests in LaDue, LLC on March 1, 2012.

On September 6, 2012, we sold 19.82 acres of land known as McKinney Ranch land located in McKinney, Texas for a sales price of \$3.0 million. The existing mortgage of \$2.6 million, secured by the property, was paid in full. We recorded a gain on sale of \$0.2 million on the land parcel sale.

On September 11, 2012, we sold 7.977 acres of land known as Kinwest Manor land located in Farmers Branch, Texas for a sales price of \$2.3 million. The existing multi-collateral mortgage was paid down by \$1.2 million. We recorded a loss on sale of \$14,000 on the land parcel sale.

On September 12, 2012, we sold 9.39 acres of land known as Lacy Longhorn land located in Farmers Branch, Texas for a sales price of \$3.1 million. All of the sale proceeds were used to pay down a portion of the multi-tract collateral debt, secured by the property. We recorded a gain on sale of \$2.1 million on the land parcel sale.

On September 12, 2012, we sold two land parcels, comprising approximately 7.39 acres of undeveloped land located in Dallas, Texas and Farmers Branch, Texas, known as Lacy Longhorn land and Manhattan 2 land, for a sales price of \$2.4 million. Seller financing was provided for \$1.9 million. We recorded a gain on sale of \$1.3 million on the land parcels sale.

On September 24, 2012, we sold 3.89 acres of land known as Copperridge land located in Dallas, Texas for a sales price of \$3.2 million. The existing mortgage of \$2.3 million, secured by the property, was paid in full. We recorded a loss on sale of \$0.7 million on the land parcel sale.

On September 28, 2012, we sold 40.49 acres of land known as Marine Creek land located in Fort Worth, Texas for a sales price of \$1.8 million. All of the sale proceeds were used to pay off the multi-tract collateral debt, secured by the property. We recorded a gain on sale of \$35,000 on the land parcel sale.

In December 2010, there were various commercial and land holdings sold to FRE Real Estate, Inc., a related party. During the first three months of 2011, many of these transactions were rescinded as of the original transaction date and were subsequently sold to related parties under the same ownership as FRE Real Estate, Inc. As of September 30, 2012, there is one commercial building, Thermalloy that remains in FRE Real Estate, Inc. We have deferred the recognition of the sales in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost.

We continue to invest in the development of apartments and various projects. During the nine months ended September 30, 2012, we have expended \$4.8 million on construction and development.

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 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.

The company has various notes receivable from Unified Housing Foundation, Inc. (“UHF”). UHF is determined to be a related party to the company due to our significant investment in the performance of the collateral secured under the notes receivable and its consulting agreement with TCI.

Our mortgage notes receivable consist of first, wraparound and junior mortgage loans (dollars in thousands):

Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
Miscellaneous non-related party notes	Various	Various	\$ 4,097	Various security interests
Miscellaneous related party notes (1)	Various	Various	2,320	Various security interests
One Realco Corporation (2)	01/17	3.00%	10,000	Unsecured
Realty Advisors Management, Inc. (1)	12/16	4.00%	20,387	Unsecured
S Breeze I-V, LLC	09/13	5.00%	2,667	6% Class A and 25% Class B Limited Partner Interests
Unified Housing Foundation, Inc. (Cliffs of El Dorado) (1)	12/27	5.25%	2,097	100% Interest in Unified Housing of McKinney, LLC
Unified Housing Foundation, Inc. (Echo Station) (1)	12/27	5.25%	1,481	100% Interest in Unified Housing of Temple, LLC
Unified Housing Foundation, Inc. (Inwood on the Park) (1)	12/27	5.25%	5,059	100% Interest in Unified Housing Inwood, LLC
Unified Housing Foundation, Inc. (Kensington Park) (1)	12/27	5.25%	3,936	100% Interest in Unified Housing Kensington, LLC
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/27	5.25%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/27	5.25%	9,096	Membership interest in Housing for Seniors of Humble, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/27	5.25%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/27	5.25%	4,663	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/27	5.25%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/27	5.25%	6,000	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing) (1)	12/27	5.25%	2,272	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/27	5.25%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/27	5.25%	4,812	100% Interest in Unified Housing of Sendero

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				Ridge, LLC
Unified Housing Foundation, Inc. (Timbers of Terrell) (1)	12/27	5.25%	1,323	100% Interest in Unified Housing of Terrell, LLC
Unified Housing Foundation, Inc. (Tivoli) (1)	12/27	5.25%	7,966	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. (Reserve at White Rock Phase I) (1)	12/27	5.25%	2,485	100% Interest in Unified Housing of Harvest Hill I, LLC
Unified Housing Foundation, Inc. (Reserve at White Rock Phase II) (1)	12/27	5.25%	2,555	100% Interest in Unified Housing of Harvest Hill, LLC
Unified Housing Foundation, Inc. (Trails at White Rock) (1)	12/27	5.25%	3,815	100% Interest in Unified Housing of Harvest Hill III, LLC
Unified Housing Foundation, Inc.(1)	12/12	5.00%	6,000	Unsecured
Accrued interest			2,255	
Total Performing			\$ 117,767	
Non-Performing				
loans:				
130 Windmill Farms, L.P.	10/11	7.00%	\$ 507	Unsecured
Leman Development, Ltd.	07/11	7.00%	1,500	Unsecured
Miscellaneous non-related party notes	Various	Various	772	Various secured interest
Tracy Suttles (2)	12/11	0.00%	1,077	Unsecured
Accrued interest			400	
Total			\$ 4,256	
Non-Performing				
Allowance for estimated losses			(21,704)	
Total			\$ 100,319	

(1) Related party
notes

(2) An allowance was taken for estimated
losses at full value of note

NOTE 4. INVESTMENT IN UNCONSOLIDATED JOINT VENTURES AND INVESTEEES

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

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

	Percentage ownership as of			
	September 30, 2012		September 30, 2011	
Garden Centura, L.P. (2)	0.00	%	5.00	%
Gruppa Florentina, LLC (1)	20.00	%	20.00	%
LK-Four Hickory, LLC (3)	0.00	%	28.57	%

(1) Other Investees

(2) Other Investees. Investment in Garden Centura, L.P. sold on December 28, 2011.

(3) Other Investees. Investment in LK-Four Hickory, LLC sold on January 17, 2012.

Our partnership interest in Garden Centura, L.P. in the amount of 5% was accounted for under the equity method because we exercise significant influence over the operations and financial activities. We guaranteed the notes payable and controlled the day-to-day activities. Accordingly, the investment was carried at cost, adjusted for the companies' proportionate share of earnings or losses. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when the investments were sold.

The following is a summary of the financial position and results of operations from our investees:

	For the Nine Months Ended	
	September 30,	
	2012	2011
Other Investees		
Real estate, net of accumulated depreciation	\$ 11,798	\$ 116,596
Notes receivable	6,046	5,538
Other assets	31,903	43,890
Notes payable	(13,864)	(87,594)
Other liabilities	(6,868)	(15,513)
Shareholders' equity/partners capital	(29,015)	(62,917)
Revenue	\$ 30,546	\$ 41,453
Depreciation	(901)	(4,887)
Operating expenses	(27,478)	(33,894)
Gain on land sales	-	-
Interest expense	(798)	(3,770)
Income (loss) from continuing operations	\$ 1,369	\$ (1,098)
Income from discontinued operations	-	-
Net income (loss)	\$ 1,369	\$ (1,098)
Company's proportionate share of earnings (losses) (1)	\$ 274	\$ (28)

NOTE 5. NOTES PAYABLE

On January 30, 2012, we refinanced the existing mortgage on Parc at Maumelle apartments, a 240-unit complex located in Little Rock, Arkansas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.1 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 3.00% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Huntington Ridge apartments, a 198-unit complex located in DeSoto, Texas, for a new mortgage of \$15.0 million. We paid off the existing mortgage of \$14.6 million and paid \$1.2 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Laguna Vista apartments, a 206-unit complex located in Dallas, Texas, for a new mortgage of \$17.7 million. We paid off the existing mortgage of \$17.0 million and paid \$1.1 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Savoy of Garland apartments, a 144-unit complex located in Garland, Texas, for a new mortgage of \$10.3 million. We paid off the existing mortgage of \$10.2 million and paid \$0.9 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On March 1, 2012, the construction loan in the amount of \$11.1 million that was taken out on July 30, 2010 to fund the development of Sonoma Court apartments, a 124-unit complex, closed into permanent financing. The note accrues interest at 5.35% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on November 1, 2051.

On March 28, 2012, the construction loan in the amount of \$24.2 million that was taken out on February 18, 2010 to fund the development of Blue Ridge apartments, a 290-unit complex, closed into permanent financing. The note accrues interest at 5.37% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on October 1, 2051.

On April 30, 2012, we refinanced the existing mortgage on Parc at Metro Center apartments, a 144-unit complex located in Nashville, Tennessee, for a new mortgage of \$11.0 million. We paid off the existing mortgage of \$10.5 million and paid \$0.7 million in closing costs and escrow reserves. The note accrues interest at 2.95% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on May 1, 2052.

On May 25, 2012, we refinanced the existing mortgage on Pecan Pointe apartments, a 232-unit complex located in Temple, Texas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.4 million and paid \$1.3 million in closing costs and escrow reserves. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on June 1, 2052.

On May 30, 2012, we refinanced the existing mortgage on Blue Lake Villas II apartments, a 70-unit complex located in Waxahachie, Texas, for a new mortgage of \$4.1 million. We paid off the existing mortgage of \$3.9 million and paid \$0.2 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on June 1, 2052.

On June 19, 2012, the construction loan in the amount of \$16.4 million that was taken out on September 14, 2010 to fund the development of Lodge at Pecan Creek apartments, a 192-unit complex, closed into permanent financing. The note accrues interest at 5.05% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On June 28, 2012, we refinanced the existing mortgage on Lake Forest apartments, a 222-unit complex located in Houston, Texas, for a new mortgage of \$12.8 million. We paid off the existing mortgage of \$12.0 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

On June 28, 2012, we refinanced the existing mortgage on Mission Oaks apartments, a 228-unit complex located in San Antonio, Texas, for a new mortgage of \$15.6 million. We paid off the existing mortgage of \$14.9 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.95% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

On June 28, 2012, we refinanced the existing mortgage on Paramount Terrace apartments, a 181-unit complex located in Amarillo, Texas, for a new mortgage of \$3.2 million. We paid off the existing mortgage of \$2.8 million and paid \$0.4 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2045.

On June 28, 2012, we refinanced the existing mortgage on Sugar Mill apartments, a 160-unit complex located in Addis, Louisiana, for a new mortgage of \$12.0 million. We paid off the existing mortgage of \$11.8 million and paid \$1.0 million in closing costs and escrow reserves. The note accrues interest at 2.85% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on July 1, 2052.

In conjunction with the development of various apartment projects and other developments, we drew down \$2.2 million in construction loans during the nine months ended September 30, 2012.

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. STOCK-SECURED NOTES PAYABLE

The Company has margin arrangements with various financial institutions and brokerage firms, which provide for borrowings of up to 50.0% of the market value of marketable equity securities. We also have other notes payable secured by stock. The borrowings under such margin arrangements and notes are secured by the equity securities of IOT, TCI, and ARL's trading portfolio securities, and bear interest rates ranging from 4.00% to 10.00% per annum. Stock-secured notes payable and margin borrowings were \$26.7 million at September 30, 2012.

NOTE 7. RELATED PARTY TRANSACTIONS

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of September 30, 2012 (dollars in thousands):

	Pillar
Balance, December 31, 2011	\$ (10,294)
Cash transfers	13,486
Advisory fees	(7,573)
Commissions to Pillar/Regis	(5,040)
Cost reimbursements	(2,452)
Interest income from advisor	319
POA fees	(140)
Net income fee	(141)
Expenses paid by Advisor	(2,132)
Financing (mortgage payments)	1,567
Note receivable sale	5,338
Sales/Purchases transactions	1,393
Intercompany property transfers	6,732
Balance, September 30, 2012	\$ 1,063

During the ordinary course of business, we have related party transactions that include, but are not limited to rent 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 financial statements.

NOTE 8. OPERATING SEGMENTS

Our segments are based on our method of internal reporting which classifies our operations by property type. Our property types are grouped into commercial, apartments, hotels, land and other 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 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, net income and incentive fees, general and administrative, non-controlling

interests and net loss from discontinued operations before gains on sale of real estate.

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Presented below is our reportable segments' operating income for the three and nine months ended September 30, 2012 and 2011, including segment assets and expenditures (dollars in thousands):

For the Three Months Ended

September 30, 2012	Commercial	Apartments	Hotels	Land	Other	Total
Operating revenue	\$7,393	\$21,519	\$-	\$-	\$6	\$28,918
Operating expenses	5,172	10,714	-	160	(1)	16,045
Depreciation and amortization	1,647	3,914	-	-	(66)	5,495
Mortgage and loan interest	493	5,675	-	1,698	1,924	9,790
Interest income	-	-	-	-	2,280	2,280
Gain on land sales	-	-	-	2,898	-	2,898
Segment operating income	\$81	\$1,216	\$-	\$1,040	\$429	\$2,766
Capital expenditures	1,404	269	-	-	-	1,673
Assets	166,696	558,519	-	218,580	-	943,795

Property Sales

Sales price	\$3,000	\$-	\$-	\$17,410	\$-	\$20,410
Cost of sale	2,331	84	-	15,127	-	17,542
Deferred current gain	-	-	-	(615)	-	(615)
Gain (loss) on sale	\$669	\$(84)	\$-	\$2,898	\$-	\$3,483

For the Three Months Ended

September 30, 2011	Commercial	Apartments	Hotels	Land	Other	Total
Operating revenue	\$8,900	\$19,956	\$-	\$81	\$172	\$29,109
Operating expenses	5,282	10,278	-	466	(36)	15,990
Depreciation and amortization	1,612	3,680	-	-	(74)	5,218
Mortgage and loan interest	2,992	6,381	-	2,540	1,900	13,813
Interest income	-	-	-	-	1,039	1,039
Gain on land sales	-	-	-	(942)	-	(942)
Segment operating loss	\$(986)	\$(383)	\$-	\$(3,867)	\$(579)	\$(5,815)
Capital expenditures	1,601	10	-	-	-	1,611
Assets	178,021	561,555	-	299,960	-	1,039,536

Property Sales

Sales price	\$33,040	\$28,690	\$27,319	\$52,565	\$-	\$141,614
Cost of sale	29,402	14,601	27,358	53,507	-	124,868
Deferred current gain	-	7,407	-	-	-	7,407
Recognized prior deferred gain	-	-	-	-	(2,025)	(2,025)
Gain (loss) on sale	\$3,638	\$6,682	\$(39)	\$(942)	\$(2,025)	\$7,314

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

	For Three Months Ended September 30,	
For the Three Months Ended September 30, 2012	2012	2011
Segment operating income (loss)	\$ 2,766	\$ (5,815)

Other non-segment items of income (expense)		
General and administrative	(1,546)	(3,641)
Advisory fees	(2,215)	(3,241)
Other income	1,535	115
Loss on sale of investments	-	91
Equity in earnings of investees	134	(30)
Income tax benefit (expense)	(13)	2,815
Income (loss) from continuing operations	\$ 661	\$ (9,706)

The table below reconciles the segment information to the corresponding amounts in the Consolidated Balance Sheets:

	September 30,	
	2012	2011
Segment assets	\$ 943,795	\$ 1,039,536
Investments in real estate partnerships	7,625	12,499
Other assets and receivables	182,170	191,430
Assets held for sale	-	80,666
Total assets	\$ 1,133,590	\$ 1,324,131

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For the Nine Months Ended

September 30, 2012	Commercial	Apartments	Hotels	Land	Other	Total
Operating revenue	\$ 26,152	\$63,282	\$-	\$-	\$81	\$89,515
Operating expenses	15,441	30,684	-	732	275	47,132
Depreciation and amortization	4,871	11,650	-	-	(204)	16,317
Mortgage and loan interest	4,194	28,850	-	4,975	5,990	44,009
Interest income	-	-	-	-	10,342	10,342
Gain on land sales	-	-	-	6,615	-	6,615
Segment operating gain (loss)	\$ 1,646	\$ (7,902)	\$-	\$908	\$4,362	\$ (986)
Capital expenditures	2,281	504	-	40	-	2,825
Assets	166,696	558,519	-	218,580	-	943,795

Property Sales

Sales price	\$ 9,825	\$45,610	\$3,369	\$38,324	\$-	\$97,128
Cost of sale	9,645	40,067	252	32,324	-	82,288
Deferred current gain	-	-	-	(615)	-	(615)
Gain on sale	\$ 180	\$5,543	\$3,117	\$6,615	\$-	\$15,455

For the Nine Months Ended

September 30, 2011	Commercial	Apartments	Hotels	Land	Other	Total
Operating revenue	\$ 29,101	\$55,780	\$-	\$550	\$158	\$85,589
Operating expenses	16,204	28,609	-	1,594	250	46,657
Depreciation and amortization	5,242	10,386	-	-	(248)	15,380
Mortgage and loan interest	7,601	21,104	-	9,126	5,879	43,710
Interest income	-	-	-	-	2,910	2,910
Gain on land sales	-	-	-	18,431	-	18,431
Segment operating income (loss)	\$ 54	\$ (4,319)	\$-	\$8,261	\$ (2,813)	\$ 1,183
Capital expenditures	1,650	439	-	37	-	2,126
Assets	178,021	561,555	-	299,960	-	1,039,536

Property Sales

Sales price	\$ 142,451	\$28,690	\$29,844	\$180,112	\$-	\$381,097
Cost of sale	151,695	14,601	26,224	176,550	-	369,070
Deferred current gain	-	7,407	-	-	-	7,407
Recognized prior deferred gain	9,143	963	-	14,869	8,909	33,884
Gain (loss) on sale	\$ (101)	\$7,645	\$3,620	\$18,431	\$8,909	\$38,504

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

	For Nine Months Ended	
	September 30,	
	2012	2011
Segment operating gain (loss)	\$ (986)	\$ 1,183
Other non-segment items of income (expense)		
General and administrative	(5,052)	(10,556)

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Advisory fees	(7,573)	(10,225)
Provision on impairment of notes receivable and real estate assets	-	(5,622)
Other income	5,334	1,881
Equity in earnings of investees	284	(104)
Gain (loss) on sale of investment	(361)	91
Income tax benefit	2,535	5,166
Loss from continuing operations	\$ (5,819)	\$ (18,186)

The table below reconciles the segment information to the corresponding amounts in the Consolidated Balance Sheets:

	September 30,	
	2012	2011
Segment assets	\$ 943,795	\$ 1,039,536
Investments in real estate partnerships	7,625	12,499
Other assets	182,170	191,430
Assets held for sale	-	80,666
Total assets	\$ 1,133,590	\$ 1,324,131

NOTE 9. DISCONTINUED OPERATIONS

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

Discontinued operations relates to properties that were either sold or held for sale as of the period ended September 30, 2012. Included in discontinued operations are a total of six and 26 properties as of 2012 and 2011, respectively. Properties sold in 2012 have been reclassified to discontinued operations for current and prior year reporting periods. In 2012, we sold two apartment complexes (Portofino and Wildflower Villas), three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza), and one hotel (Comfort Inn). In 2011, we sold two apartment complexes (Spyglass and Westwood), 12 commercial properties (Addison Hanger I, Addison Hanger II, Alpenloan, Cooley Building, Fenton Center, One Hickory, Parkway North, Signature, Teleport Blvd, Two Hickory, Westgrove Air Plaza, and Willowbrook Village), four hotels (Piccadilly Airport, Piccadilly Chateau, Piccadilly Shaw and Piccadilly University), 13 acres of land with a storage warehouse (Eagle Crest), and one trade show and exhibit hall (Denver Merchandise Mart). The gain on sale of the properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for the properties sold and held for sale (dollars in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue				
Rental	\$(203)	\$6,663	\$2,658	\$29,195
	\$(203)	\$6,663	\$2,658	\$29,195
Expenses				
Property operations	(4)	(4,368)	(2,358)	(20,124)
Other income	-	-	3	1
Interest	-	(1,432)	(638)	(7,805)
General and administrative	(367)	(414)	(841)	(1,325)
Depreciation	-	(661)	(420)	(4,371)
Provision on impairment of real estate assets	-	-	-	(883)
	\$(371)	\$(6,875)	\$(4,254)	\$(34,507)
Net loss from discontinued operations before gains on sale of real estate, taxes, and fees	(574)	(212)	(1,596)	(5,312)
Gain on sale of discontinued operations	585	8,256	8,840	20,073
Earnings from unconsolidated subsidiaries and investees	(47)	-	-	-
Income (loss) from discontinued operations before tax	\$(36)	\$8,044	\$7,244	\$14,761
Income tax benefit (expense)	13	(2,815)	(2,535)	(5,166)
Net income (loss) from discontinued operations	\$(23)	\$5,229	\$4,709	\$9,595

Our application of ASC Topic 360 results in the presentation of the net operating results of these qualifying properties sold or held for sale during 2012 as income from discontinued operations. This does not have an impact on net income available to common shareholders and only impacts the presentation of these properties within the Consolidated Statements of Operations.

NOTE 10. COMMITMENTS AND CONTINGENCIES AND LIQUIDITY

In conjunction with its sale of Four Hickory in November 2007, the Company agreed to fund approximately \$1.0 million to satisfy its commitment to compensate LK-Four Hickory, LLC for move-in discounts and other concessions to existing tenants at the time of sale. The Company also has certain agreements with LK-Four Hickory, LLC to fund projection shortfalls, which, to date, we have not had to provide any additional funding. In addition, related parties of the Company have active lease agreements with LK-Four Hickory, LLC.

On December 17, 2007, both Limkwang Nevada, Inc., the majority owner of LK-Four Hickory, LLC, and ARL unconditionally guaranteed the punctual payment when due, whether at stated maturity, by acceleration or hereafter, including all fees and expenses incurred by the bank on collection of a \$28.0 million note payable for LK-Four Hickory, LLC.

Liquidity. Management believes that ARL will generate excess cash flow from property operations in 2012; such excess, however, will not be sufficient to discharge all of ARL's obligations as they became due. Management intends to sell land and income-producing real estate, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

Partnership Buyouts. ARL is the limited partner in various partnerships related to the construction of residential properties. As permitted in the respective partnership agreements, ARL 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.

Litigation. American Realty Trust, Inc (“ART”) and its subsidiary ART Midwest, Inc have been embroiled in a lawsuit with a Mr. David Clapper and companies related to Mr. Clapper (“The Clapper Entities”) since 1999. The origins of the matter began in 1998 in a transaction whereby ART Midwest was to acquire eight apartments from the Clapper Entities. Through the years there have been rulings both for and against ART in this matter; however, in October 2011 a final ruling was issued whereby the Clapper Entities were awarded approximately \$74 million, including \$26 million in damages and \$48 million in interest. This ruling was against ART and its subsidiary ART Midwest and not the Company or any other subsidiary of the Company.

ART believes there were serious errors in the judge’s ruling and has filed an appeal of the judge’s ruling. ART further believes that should the Clapper Entities ultimately prevail that it has claims against a third party who was involved in this matter. These claims cannot be pursued until the main case with the Clapper Group is ultimately resolved.

Should the Clapper Group ultimately prevail, the only defendants in this matter are ART and ART Midwest, Inc., whose total assets and net worth as of December 31, 2011 were approximately \$10 million. Neither the Company nor any of its subsidiaries other than ART have guaranteed or indemnified either ART or ART Midwest, Inc.

As of December 31, 2011 the Company reserved \$10 million which represents 100% of both the asset and book value of ART. In January 2012, the Company sold ART and its subsidiaries for a \$10 million note. The note is fully reserved by the Company. Subsequent to the sale, ART filed for Chapter Eleven bankruptcy protection.

ARL, through a subsidiary, is developing a maritime harbor town on the 420 acre site of the former naval base of Olpenitz in Kappeln, Germany. At the current time over 50 lots in Phase One, of an initial 180, have been sold and are in various stages of construction. There have been disputes with our local partner related to his mismanagement of the project which resulted in our replacing him as the managing partner and led to filing for bankruptcy protection in Germany to completely remove him from the project. We believe that the value of the land and development in process will satisfy the existing creditors and return our investment. We are working on a plan for the bankruptcy court and expect to continue our involvement in the development of this project.

The ownership of property and provision of services to the public as tenants entails an inherent risk of liability. Although the Company and its subsidiaries are involved in various items of litigation incidental to and in the ordinary course of its business, in the opinion of Management, the outcome of such litigation will not have a material adverse impact upon the Company’s financial condition, results of operation or liquidity.

NOTE 11. EARNINGS PER SHARE

Earnings per share, “EPS”, have been computed pursuant to the provisions of ASC Topic 260 “Earnings Per Share”. The computation of basic EPS is calculated by dividing net income available to common shareholders from continuing operations, adjusted for preferred dividends, by the weighted-average number of common shares outstanding during the period. Shares issued during the period shall be weighted for the portion of the period that they were outstanding. As of September 30, 2012, we have 3,353,954 shares of Series A 10.0% Cumulative Convertible Preferred Stock, which are outstanding. These shares may be converted into common stock at 90.0% of the average daily closing price of the common stock for the prior 20 trading days. These are considered in the computation of diluted earnings per share if the effect of applying the if-converted method is dilutive. As of September 30, 2012, we have 1,000 shares of stock options outstanding, which will expire January 1, 2015 if not exercised. The outstanding options are considered in the computation of diluted earnings per share if the effect of applying the “treasury stock” method is dilutive. As of September 30, 2012, the preferred stock and the stock options were anti-dilutive and thus not included in the EPS calculation.

NOTE 12. SUBSEQUENT EVENTS

None.

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

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

This Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws, principally, but not only, under the captions "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". We caution investors that any forward-looking statements in this report, or which management may make orally or in writing from time to time, are based on management's beliefs and on assumptions made by, and information currently available to, management. When used, the words "anticipate", "believe", "expect", "intend", "may", "might", "plan", "estimate", "project", "should", "will", "result" and similar expressions relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors, that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution you that, while forward-looking statements reflect our good faith beliefs when we make them, they are not guarantees of future performance and are impacted by actual events when they occur after we make such statements. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

- general risks affecting the real estate industry (including, without limitation, the inability to enter into or renew leases, dependence on tenants' financial condition, and competition from other developers, owners and operators of real estate);
- risks associated with the availability and terms of construction and mortgage financing and the use of debt to fund acquisitions and developments;
- demand for apartments and commercial properties in the Company's markets and the effect on occupancy and rental rates;
- the Company's ability to obtain financing, enter into joint venture arrangements in relation to or self-fund the development or acquisition of properties;
- risks associated with the timing and amount of property sales and the resulting gains/losses associated with such sales;
- failure to manage effectively our growth and expansion into new markets or to integrate acquisitions successfully;
- risks and uncertainties affecting property development and construction (including, without limitation, construction delays, cost overruns, inability to obtain necessary permits and public opposition to such activities);
-

risks associated with downturns in the national and local economies, increases in interest rates, and volatility in the securities markets;

- costs of compliance with the Americans with Disabilities Act and other similar laws and regulations;
- potential liability for uninsured losses and environmental contamination;
- risks associated with our dependence on key personnel whose continued service is not guaranteed; and
- the other risk factors identified in this Form 10-Q, including those described under the caption “Risk Factors.”

The risks included here are not exhaustive. Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements, include among others, the factors listed and described at Part I, Item 1A. “Risk Factors” in the Company’s Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company’s Form 10-K for the fiscal year ended December 31, 2011.

Other sections of this report may also include suggested factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time-to-time and it is not possible for management to predict all such matters: nor can we assess the impact of all such matter on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as prediction of actual results. Investors should also refer to our quarterly reports on Form 10-Q for future periods and to other materials we may furnish to the public from time-to-time through Forms 8-K or otherwise as we file them with the SEC.

Overview

We are an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties, and land held for development. Our portfolio of income-producing properties includes residential apartment communities, office buildings, hotels, and other commercial properties. Our investment strategy includes acquiring existing income-producing properties as well as developing new properties on land already owned or acquired for a specific development project. We acquire land primarily in urban in-fill locations or high-growth suburban markets. We are an active buyer and seller of real estate and during the nine months of 2012 we sold \$95.8 million of land and income-producing properties. As of September 30, 2012, we owned 8,873 units in 48 residential apartment communities and 14 commercial properties comprising almost 3.7 million rentable square feet. In addition, we owned 4,678 acres of land held for development which includes a 420-acre holiday resort project in Germany currently in development.

We finance our acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties, and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. We finance our development projects principally with short-term, variable interest rate construction loans that are converted to long-term, fixed rate amortizing mortgages when the development project is completed and occupancy has been stabilized. We will, from time to time, also enter into partnerships with various investors to acquire income-producing properties or land and to sell interests in certain of our wholly owned properties. When we sell assets, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. We generate operating revenues primarily by leasing apartment units to residents; leasing office, retail and industrial space to commercial tenants; and renting hotel rooms to guests.

We have historically engaged in and may continue to engage in certain business transactions with related parties, including but not limited to asset acquisition and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in our best interest.

Prime Income Asset Management, LLC ("Prime") served as the Company's external Advisor and Cash Manager until April 30, 2011. Prime also served as an Advisor and Cash Manager to TCI and IOT. Effective April 30, 2011, Pillar Income Asset Management, Inc. ("Pillar") became the Company's external Advisor and Cash Manager under similar terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to TCI and IOT. Regis Realty Prime, LLC ("Regis") manages our commercial properties and provides brokerage services. ARL engages third-party companies to lease and manage its apartment properties.

Critical Accounting Policies

We present our financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). In June 2009, the Financial Accounting Standards Board ("FASB") completed its accounting guidance codification project. The FASB Accounting Standards Codification ("ASC") became effective for our financial statements issued subsequent to June 30, 2009 and is the single source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. As of the effective date, we no longer refer to the authoritative guidance dictating our accounting methodologies under the previous accounting standards hierarchy. Instead, we refer to the ASC guidance as the sole source of authoritative literature.

The accompanying Consolidated Financial Statements include our accounts, our 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 are included in consolidated net income. Our investment in Gruppa Florentina, LLC is accounted for under the equity method. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when they were sold to a third party

Real Estate

Upon acquisitions of real estate, we assess the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, “above-market” and “below-market” leases, origination costs, acquired in-place leases, other identified intangible assets and assumed liabilities in accordance with ASC Topic 805 “Business Combinations”, and allocate the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

We assess and consider fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates, as well as available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known and anticipated trends, and market and economic conditions. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant. We also consider an allocation of purchase price of other acquired intangibles, including acquired in-place leases that may have a customer relationship intangible value, including (but not limited to) the nature and extent of the existing relationship with the tenants, the tenants’ credit quality and expectations of lease renewals. Based on our acquisitions to date, our allocation to customer relationship intangible assets has been immaterial.

We record acquired “above-market” and “below-market” leases at their fair values (using a discount rate which reflects the risks associated with the leases acquired) equal to the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) management’s estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market fixed rate renewal options for below-market leases.

Other intangible assets acquired include amounts for in-place lease values that are based on our evaluation of the specific characteristics of each tenant’s lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider leasing commissions, legal and other related expenses.

Depreciation and Impairment

Real estate is stated at depreciated cost. The cost of buildings and improvements includes the purchase price of property, legal fees and other acquisition costs. Costs directly related to the development of properties are capitalized. Capitalized development costs include interest, property taxes, insurance, and other project costs incurred during the period of development.

Management reviews its long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates impairment in value. An impairment loss is recognized if the carrying amount of its assets is not recoverable and exceeds its fair value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The evaluation of anticipated cash flows is

highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods.

ASC Topic 360 “Property, Plant and Equipment” requires that qualifying assets and liabilities and the results of operations that have been sold, or otherwise qualify as held for sale, be presented as discontinued operations in all periods presented if the property operations are expected to be eliminated and we will not have significant continuing involvement following the sale. The components of the property’s net income that is reflected as discontinued operations include the net gain (or loss) upon the disposition of the property held for sale, operating results, depreciation and interest expense (if the property is subject to a secured loan). We generally consider assets to be held for sale when the transaction has been approved by our Board of Directors, or a committee thereof, and there are no known significant contingencies relating to the sale, such that the property sale within one year is considered probable. Following the classification of a property as held for sale, no further depreciation is recorded on the assets.

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgment. Our capitalization policy on development properties is guided by ASC Topic 835-20 “Interest – Capitalization of Interest” and ASC Topic 970 “Real Estate - General”. The costs of land and buildings under development include specifically identifiable costs. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. We cease capitalization when a building is considered substantially complete and ready for its intended use, but no later than one year from the cessation of major construction activity.

Investments in Unconsolidated Real Estate Ventures

Except for ownership interests in variable interest entities, we account for our investments in unconsolidated real estate ventures under the equity method of accounting because we exercise significant influence over, but do not control, these entities. These investments are recorded initially at cost, as investments in unconsolidated real estate ventures, and subsequently adjusted for equity in earnings and cash contributions and distributions. Any difference between the carrying amount of these investments on our balance sheet and the underlying equity in net assets is amortized as an adjustment to equity in earnings of unconsolidated real estate ventures over the life of the related asset. Under the equity method of accounting, our net equity is reflected within the Consolidated Balance Sheets, and our share of net income or loss from the joint ventures is included within the Consolidated Statements of Operations. The joint venture agreements may designate different percentage allocations among investors for profits and losses; however, our recognition of joint venture income or loss generally follows the joint venture's distribution priorities, which may change upon the achievement of certain investment return thresholds. For ownership interests in variable interest entities, we consolidate those in which we are the primary beneficiary.

Recognition of Rental Income

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. In accordance with ASC Topic 805 "Business Combinations", we recognize rental revenue of acquired in-place "above-market" and "below-market" leases at their fair values over the terms of the respective leases. On our Consolidated Balance Sheets, we include as a receivable the excess of rental income recognized over rental payments actually received pursuant to the terms of the individual commercial lease agreements.

Reimbursements of operating costs, as allowed under most of our commercial tenant leases, consist of amounts due from tenants for common area maintenance, real estate taxes and other recoverable costs, and are recognized as revenue in the period in which the recoverable expenses are incurred. We record these reimbursements on a "gross" basis, since we generally are the primary obligor with respect to purchasing goods and services from third-party suppliers, have discretion in selecting the supplier and have the credit risk with respect to paying the supplier.

Rental income for residential property leases is recorded when due from residents and is recognized monthly as earned, which is not materially different than on a straight-line basis as lease terms are generally for periods of one year or less. For hotel properties, revenues for room sales and guest services are recognized as rooms are occupied and services are rendered. An allowance for doubtful accounts is recorded for all past due rents and operating expense reimbursements considered to be uncollectible.

Revenue Recognition on the Sale of Real Estate

Sales and the associated gains or losses of real estate are recognized in accordance with the provisions of ASC Topic 360-20, "Property, Plant and Equipment – Real Estate Sale". The specific timing of a sale is measured against various criteria in ASC 360-20 related to the terms of the transaction and any continuing involvement in the form of management or financial assistance associated with the properties. If the sales criteria for the full accrual method are not met, we defer some or all of the gain recognition and account for the continued operations of the property by applying the finance, leasing, deposit, installment or cost recovery methods, as appropriate, until the sales criteria are met.

Non-performing Notes Receivable

We consider a note receivable to be non-performing when the maturity date has passed without principal repayment and the borrower is not making interest payments in accordance with the terms of the agreement.

Interest Recognition on Notes Receivable

For notes other than surplus cash notes, we record interest income as earned in accordance with the terms of the related loan agreements. Prior to January 1, 2012, on cash flow notes where payments are based upon surplus cash from operations, accrued but unpaid interest income was only recognized to the extent that cash was received. As of January 1, 2012, due to the consistency of cash received on the surplus cash notes, we are recording interest as earned.

Allowance for Estimated Losses

We assess the collectability of notes receivable on a periodic basis, of which the assessment consists primarily of an evaluation of cash flow projections of the borrower to determine whether estimated cash flows are sufficient to repay principal and interest in accordance with the contractual terms of the note. We recognize impairments on notes receivable when it is probable that principal and interest will not be received in accordance with the contractual terms of the loan. The amount of the impairment to be recognized generally is based on the fair value of the partnership's real estate that represents the primary source of loan repayment. See Note 3 "Notes and Interest Receivable" for details on our notes receivable.

Fair Value of Financial Instruments

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.

Related parties

We apply ASC Topic 805, “Business Combinations”, to evaluate business relationships. Related parties include affiliates of the entity, entities for which investments in their equity securities would be required, trusts for the benefits of employees, principal owners of the entities and members of their immediate families, management 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 management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.

Results of Operations

The discussion of our results of operations is based on management’s review of operations, which is based on our segments. Our segments consist of apartments, commercial buildings, hotels, land and other. For discussion purposes, we break these segments down into the following sub-categories; same property portfolio, acquired properties, and developed properties in the lease-up phase. The same property portfolio consists of properties that were held by us for the entire period for both years being compared. The acquired property portfolio consists of properties that we acquired but have not been held for the entire period for both periods being compared. Developed properties in the lease-up phase consist of completed projects that are being leased up. As we complete each phase of the project, we lease-up that phase and include those revenues in our continuing operations. Once a developed property becomes leased up and is held the entire period for both periods under comparison, it is considered to be included in the same property portfolio. Income-producing properties that we have sold during the year are reclassified to discontinued operations for all periods presented.

The following discussion is based on our Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011 as included in Part I, Item 1. “Financial Statements” of this report. The prior year’s

property portfolios have been adjusted for subsequent sales. Continuing operations relates to income-producing properties that were held during those years as adjusted for sales in the subsequent years.

At September 30, 2012 and 2011, we owned or had interests in a portfolio of 62 and 71 income-producing properties, respectively. For discussion purposes, we broke this out between continuing operations and discontinued operations. The total property portfolio represents all income-producing properties held as of September 30 for the period presented. Discontinued operations represent properties that were held as of period end for the periods presented, but sold in the next quarter. Continuing operations represents all properties that have not been reclassified to discontinued operations as of September 30, 2012 for the periods presented. The table below shows the number of income-producing properties held at the quarter ended:

	September 30,	
	2012	2011
Continuing operations	62	62
Discontinued operations	0	9
Total property portfolio	62	71

Comparison of the three months ended September 30, 2012 to the same period ended 2011

For the three months ended September 30, 2012, we reported a net loss applicable to common shares of \$0.05 million or \$0.00 per diluted earnings per share, as compared to a net loss applicable to common shares of \$0.3 million or \$0.03 per diluted earnings per share for the same period ended 2011.

Expenses

General and administrative expenses were \$1.5 million for the three months ended September 30, 2012. This represents a decrease of \$2.1 million, as compared to the prior period expenses of \$3.6 million. The majority of the reduction in general and administrative expenses is related to land and corporate expenses as professional services decreased by \$1.8 million and cost reimbursements to our Advisor decreased by \$0.3 million.

Advisory fees were \$2.2 million for the three months ended September 30, 2012. This represents a decrease of \$1.0 million, as compared to the prior period Advisory fees of \$3.2 million. The advisory fee is calculated as a percentage of total gross assets and as we sell land and income-producing properties, this fee is reduced in correlation to the decrease in assets.

Other income (expense)

Interest income was \$2.3 million for the three months ended September 30, 2012. This represents an increase of \$1.3 million, as compared to the prior period interest income of \$1.0 million. The majority of the increase is due to the cash received on the cash flow notes from Unified Housing Foundation, Inc. related to the mid-year surplus cash calculation.

Other income was \$1.5 million for the three months ended September 30, 2012. This represents an increase of \$1.4 million, as compared to the prior period other income of \$0.1 million. This relates to the development agreement between UHF and TCI for consulting services related to the development of apartment projects.

Mortgage and loan interest expense was \$9.8 million for the three months ended September 30, 2012. This represents a decrease of \$4.0 million, as compared to the prior period interest expense of \$13.8 million. This change, by segment, is a decrease in our apartment portfolio of \$0.7 million, a decrease in our commercial portfolio of \$2.5 million, and a decrease in our land and other portfolios of \$0.8 million. Within the apartment portfolio, the same properties decreased \$1.6 million and the developed properties increased \$0.9 million due to properties in the lease-up phase. For the developed properties, once construction is completed, interest expense is no longer capitalized. Within the commercial portfolio, the same properties decreased by \$2.5 million. This decrease is related to a commercial loan that was in default in 2011 and was accruing interest at the default interest rate. The loan is no longer in default and is no longer being charged a default rate of interest in the current period. The decrease in the land and other portfolios was due to land sales.

Gain on land sales increased for the three months ended September 30, 2012, as compared to the prior period. In the current period, we sold 102.28 acres of land in seven separate transactions for an aggregate sales price of \$16.1 million and recorded a gain of \$2.9 million. In the prior period, we sold 3,068.60 acres of land in eight separate transactions for an aggregate sales price of \$52.6 million and recorded a loss of \$0.9 million.

Included in discontinued operations are a total of six and 26 properties as of 2012 and 2011, respectively. Properties sold in 2012 have been reclassified to discontinued operations for the current and prior reporting periods. In 2012, we sold two apartment complexes (Portofino and Wildflower Villas), three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza), and one hotel (Comfort Inn). In 2011, we sold two apartment complexes (Spyglass and

Westwood), 12 commercial properties (Addison Hanger I, Addison Hanger II, Alpenloan, Cooley Building, Fenton Center, One Hickory, Parkway North, Signature, Teleport Blvd, Two Hickory, Westgrove Air Plaza and Willowbrook Village), four hotels (Piccadilly Airport, Piccadilly Chateau, Piccadilly Shaw and Piccadilly University), 13 acres of land with a storage warehouse (Eagle Crest), and one trade show and exhibit hall (Denver Merchandise Mart). The gain on sale of the income-producing properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for these properties sold and held for sale (dollars in thousands):

	For the Three Months Ended September 30,	
	2012	2011
Revenue		
Rental	\$ (203)	\$ 6,663
	\$ (203)	\$ 6,663
Expenses		
Property operations	(4)	(4,368)
Interest	-	(1,432)
General and administrative	(367)	(414)
Depreciation	-	(661)
	\$ (371)	\$ (6,875)
Net loss from discontinued operations before gains on sale of real estate, taxes, and fees	(574)	(212)
Gain on sale of discontinued operations	585	8,256
Earnings from unconsolidated subsidiaries and investees	(47)	-
Income (loss) from discontinued operations before tax	\$ (36)	\$ 8,044
Income tax benefit (expense)	13	(2,815)
Net income (loss) from discontinued operations	\$ (23)	\$ 5,229

Comparison of the nine months ended September 30, 2012 to the same period ended 2011

For the nine months ended September 30, 2012, we reported a net loss applicable to common shares of \$2.9 million or \$0.25 per diluted earnings per share, as compared to net income applicable to common shares of \$3.7 million or \$0.32 per diluted earnings per share for the same period ended 2011.

Revenues

Rental and other property revenues were \$89.5 million for the nine months ended September 30, 2012. This represents an increase of \$3.9 million, as compared to the prior period revenues of \$85.6 million. This change, by segment, is an increase in the apartment portfolio of \$7.5 million, offset by a decrease in the commercial portfolio of \$3.0 million and decrease in the land and other portfolios of \$0.6 million. Within the apartment portfolio, there was an increase of \$5.3 million due to the developed properties in the lease-up phase and an increase of \$2.2 million in the same property portfolio. Our apartment portfolio continues to thrive in the current economic conditions with occupancies averaging over 95%. Within the commercial portfolio, the same property portfolio decreased by \$3.0 million, primarily due to miscellaneous non-recurring revenue received in the prior period. We continue to market our properties aggressively to attract new tenants and strive for continuous improvement of our properties in order to maintain our existing tenants.

Expenses

General and administrative expenses were \$5.1 million for the nine months ended September 30, 2012. This represents a decrease of \$5.5 million, as compared to the prior period expenses of \$10.6 million. The majority of the reduction in general and administrative expenses is related to land and corporate expenses as professional services decreased by \$4.6 million and cost reimbursements to our Advisor decreased by \$0.9 million.

There was no additional provision for impairment recorded for the nine months ended September 30, 2012.

Advisory fees were \$7.6 million for the nine months ended September 30, 2012. This represents a decrease of \$2.6 million, as compared to the prior period Advisory fees of \$10.2 million. The advisory fee is calculated as a percentage of total gross assets and as we sell land and income-producing properties, this fee is reduced in correlation to the decrease in assets.

Other income (expense)

Interest income was \$10.3 million for the nine months ended September 30, 2012. This represents an increase of \$7.4 million, as compared to the prior period interest income of \$2.9 million. The majority of the increase is due to the cash receipts on the cash flow notes from Unified Housing Foundation, Inc. related to the mid-year surplus cash calculation.

Other income was \$5.3 million for the nine months ended September 30, 2012. This represents an increase of \$3.4 million, as compared to the prior period other income of \$1.9 million. This relates to the development agreement between UHF and TCI for consulting services related to the development of apartment projects.

Gain on land sales decreased for the nine months ended September 30, 2012, as compared to the prior period. In the current period, we sold 684.58 acres of land in 16 separate transactions for an aggregate sales price of \$35.1 million and recorded a gain of \$6.6 million. In the prior period, we sold 4,360.24 acres of land in 39 separate transactions for an aggregate sales price of \$163.5 million and recorded a gain of \$18.4 million.

Included in discontinued operations are a total of six and 26 properties as of 2012 and 2011, respectively. Properties sold in 2012 have been reclassified to discontinued operations for the current and prior reporting periods. In 2012, we sold two apartment complexes (Portofino and Wildflower Villas), three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza), and one hotel (Comfort Inn). In 2011, we sold two apartment complexes (Spyglass and Westwood), 12 commercial properties (Addison Hanger I, Addison Hanger II, Alpenloan, Cooley Building, Fenton Center, One Hickory, Parkway North, Signature, Teleport Blvd, Two Hickory, Westgrove Air Plaza and Willowbrook Village), four hotels (Piccadilly Airport, Piccadilly Chateau, Piccadilly Shaw and Piccadilly University), 13 acres of land with a storage warehouse (Eagle Crest), and one trade show and exhibit hall (Denver Merchandise Mart). The gain on sale of the income-producing properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for these properties sold and held for sale (dollars in thousands):

	For the Nine Months Ended September 30,	
	2012	2011
Revenue		
Rental	\$ 2,658	\$ 29,195
	\$ 2,658	\$ 29,195
Expenses		
Property operations	(2,358)	(20,124)
Other income	3	1
Interest	(638)	(7,805)
General and administrative	(841)	(1,325)
Depreciation	(420)	(4,371)
Provision on impairment of real estate assets	-	(883)
	\$ (4,254)	\$ (34,507)
Net loss from discontinued operations before gains on sale of real estate, taxes, and fees	(1,596)	(5,312)
Gain on sale of discontinued operations	8,840	20,073
Income from discontinued operations before tax	\$ 7,244	\$ 14,761
Income tax expense	(2,535)	(5,166)
Net income from discontinued operations	\$ 4,709	\$ 9,595

Liquidity and Capital Resources

Our principal liquidity needs are:

- fund normal recurring expenses;
- meet debt service and principal repayment obligations including balloon payments on maturing debt;

- fund capital expenditures, including tenant improvements and leasing costs;
- fund development costs not covered under construction loans; and
 - fund possible property acquisitions.

Our principal sources of cash have been and will continue to be:

- property operations;
- proceeds from land and income-producing property sales;
- collection of mortgage notes receivable;
- collection of receivables from related party companies;
- refinancing of existing debt; and
- additional borrowing, including mortgage notes payable and lines of credit.

We draw on multiple financing sources to fund our long-term capital needs. We generally fund our development projects with construction loans. Management anticipates that our available cash from property operations may not be sufficient to meet all of our cash requirements. Management intends to selectively sell land and income-producing assets, refinance or extend real estate debt and seek additional borrowing secured by real estate to meet its liquidity requirements. Although the past cannot predict the future, historically, management has been successful at extending a portion of our current maturity obligations and selling assets as necessary to meet current obligations.

Cash flow summary

The following summary discussion of our cash flows is based on the statements of cash flows as presented in Part I Item 1. "Financial Statements" and is not meant to be an all inclusive discussion of the changes in our cash flow (dollars in thousands):

	September 30,		
	2012	2011	Variance
Net cash used in operating activities	\$ (32,671)	\$ (15,566)	\$ (17,105)
Net cash provided by investing activities	\$ 90,071	\$ 244,040	\$ (153,969)
Net cash used in financing activities	\$ (70,974)	\$ (231,763)	\$ 160,789

Our primary use of cash for operations is daily operating costs, general and administrative, advisory fees and land holding costs. Our primary source of cash from operating activities is rental income on properties. In addition, we invest surplus cash with our Advisor.

Our primary cash outlays for investing activities are for construction and development, acquisition of land and income-producing properties, and capital improvements to existing properties. Our primary sources of cash from investing activities are from the proceeds on the sale of land and income-producing properties. We originated \$10.3 million in note receivables during the current period. In addition, we received less proceeds on the sale of land and income-producing properties. The majority of the sales proceeds were used to cover loan obligations. Sales proceeds are gross of the loan payoffs and assumptions.

Our primary sources of cash from financing activities are from proceeds on notes payables. Our primary cash outlays are for recurring debt payments and payments on maturing notes payable. Proceeds from notes payable associated with the new loans and refinancing provided \$139.6 million. We used \$18.9 million to make recurring note payments and \$172.2 million for maturing notes, including payoffs required on sold and refinanced properties. The debt assumption of \$13.8 million relates to the sales of income-producing properties.

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, we 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 our business, assets or results of operations.

Inflation

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

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. ARL had a loss for federal income tax purposes after the use of net operating loss carryforwards in the first nine months of 2012 and a loss in 2011 and 2010, therefore, it recorded no provision for income taxes.

At September 30, 2012, ARL had a net deferred tax asset of \$97.3 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that ARI will realize the benefit of the deferred tax assets, a 100% valuation allowance has been established.

During the third quarter 2012, Realty Advisors Management, Inc. and its subsidiaries acquired stock of ARL such that more than 80% of ARL was owned by Realty Advisors Management, Inc. As a result, ARL joined the Realty Advisors Management, Inc. consolidated group for federal income tax reporting

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At September 30, 2012, our exposure to a change in interest rates on our debt is as follows (dollars in thousands, except per share):

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
Notes payable:			
Variable rate	\$ 139,269	4.60 %	\$ 1,393
Total decrease in ARL's annual net income			1,393
Per share			\$ 0.12

ITEM 4. CONTROLS AND PROCEDURES

Based on an evaluation by our management (with the participation of our Principal Executive Officer and Principal Financial Officer), as of the end of the period covered by this report, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, to allow timely decisions regarding required disclosures.

There has been no change in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On September 1, 2000, the Board of Directors approved a share repurchase program authorizing the repurchase of up to a total of 1,000,000 shares of ARL Common Stock. This repurchase program has no termination date. In August 2010, the Board of Directors approved an increase in the share repurchase program for up to an additional 250,000 shares of Common Stock which results in a total authorization under the repurchase program for up to 1,250,000 shares. The following table represents shares repurchased on a monthly basis during the third quarter of 2012:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program
Balance at June 30, 2012			986,750	263,250
July 31, 2012	-	\$ -	986,750	263,250
August 31, 2012	-	\$ -	986,750	263,250
September 30, 2012	-	\$ -	986,750	263,250
Total	-			

ITEM 6. EXHIBITS

The following exhibits are filed herewith or incorporated by reference as indicated below:

Exhibit

Number Description of Exhibit

- 3.0 Certificate of Restatement of Articles of Incorporation of American Realty Investors, Inc. dated August 3, 2000 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
- 3.1 Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc. dated August 29, 2000 (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q dated September 30, 2000).
- 3.2 Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc. decreasing the number of authorized shares of and eliminating Series B Cumulative Convertible Preferred Stock dated August 23, 2003 (incorporated by reference to Exhibit 3.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
- 3.3 Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc., decreasing the number of authorized shares of and eliminating Series I Cumulative Preferred Stock dated October 1, 2003 (incorporated by reference to Exhibit 3.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
- 3.4 Bylaws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement on Form S-4 filed December 30, 1999).
- 4.1 Certificate of Designations, Preferences and Relative Participating or Optional or Other Special Rights, and Qualifications, Limitations or Restrictions Thereof of Series F Redeemable Preferred Stock of American Realty Investors, Inc., dated June 11, 2001 (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
- 4.2 Certificate of Withdrawal of Preferred Stock, Decreasing the Number of Authorized Shares of and Eliminating Series F Redeemable Preferred Stock, dated June 18, 2002 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002).
- 4.3 Certificate of Designation, Preferences and Rights of the Series I Cumulative Preferred Stock of American Realty Investors, Inc., dated February 3, 2003 (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002).
- 4.4 Certificate of Designation for Nevada Profit Corporations designating the Series J 8% Cumulative Convertible Preferred Stock as filed with the Secretary of State of Nevada on March 16, 2006 (incorporated by reference to Registrant current report on Form 8-K for event of March 16, 2006).

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Advisory Agreement between American Realty Investors, Inc. and Pillar Income Asset Management, Inc., dated April 30, 2011 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, dated May 2, 2011).

10.2 Second Amendment to Modification of Stipulation of Settlement dated October 17, 2001 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4, dated February 24, 2002).

31.1*Certification by the Principal Executive Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.

31.2*Certification by the Principal Financial Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.

32.1*Certification pursuant to 18 U.S.C. 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Interactive data files pursuant to Rule 405 of Regulation S-T.

*

Filed herewith

SIGNATURE PAGE

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.

AMERICAN REALTY INVESTORS, INC.

Date: November 14, 2012

By: /s/ Daniel J. Moos
Daniel J. Moos
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 14, 2012

By: /s/ Gene S. Bertcher
Gene S. Bertcher
Executive Vice President and Chief
Financial Officer
(Principal Financial Officer)

AMERICAN REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended September 30, 2012

Exhibit

Number

Description of Exhibits

- | | |
|-------|--|
| 31.1* | Certification by the Principal Executive Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended. |
| 31.2* | Certification by the Principal Financial Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended. |
| 32.1* | Certification pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

*

Filed herewith

