INLAND REAL ESTATE CORP
Form 10-Q
November 09, 2004

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

FORM 10-Q

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

For the quarterly period ended September 30, 2004

or

q 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 001-32185

INLAND REAL ESTATE CORPORATION

(Exact name of registrant as specified in its charter)

Maryland	36-3953261
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2901 Butterfield Road, Oak Brook, Illinois	60523
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: 630-218-8000

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes **Q** No **q**

As of November 8, 2004, there were 66,984,826 shares of common stock outstanding.

INLAND REAL ESTATE CORPORATION
(a Maryland corporation)

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Part I - Financial Information

Item 1. Financial Statements

INLAND REAL ESTATE CORPORATION
Consolidated Balance Sheets
September 30, 2004 (unaudited) and December 31, 2003 (audited)
(In thousands, except per share data)

Assets

		September 30, 2004 (unaudited)	December 31, 2003 (audited)
Investment properties:			
Land	$	354,855	346,088
Construction in progress		1,619	-
Building and improvements		948,767	920,543
		1,305,241	1,266,631
Less accumulated depreciation		169,535	147,342
Net investment properties		1,135,706	1,119,289
Cash and cash equivalents		39,067	58,388
Investment in securities (net of an unrealized gain of $229 and $1,502 at September 30, 2004 and December 31, 2003, respectively)		6,828	12,041
Assets held for sale (net of accumulated depreciation of $4,252 and $2,835 at September 30, 2004 and December 31, 2003, respectively)		20,898	14,444
Restricted cash		5,668	13,329
Accounts and rents receivable (net of provision for doubtful accounts of $2,595 and $2,966 at September 30, 2004 and December 31, 2003, respectively)		34,381	30,021
Investment in and advances to joint venture		1,785	8,392
Deposits and other assets		2,816	1,942
Acquired above market lease intangibles (net of accumulated amortization of $1,555 and $934 at September 30, 2004 and December 31, 2003, respectively)		6,053	5,773
Acquired in-place lease intangibles (net of accumulated amortization of $1,795 and $741 at September 30, 2004 and December 31, 2003, respectively)		18,747	10,414
Leasing fees (net of accumulated amortization of $1,799 and $1,368 at September 30, 2004 and December 31, 2003, respectively)		2,308	1,991
Loan fees (net of accumulated amortization of $6,796 and $5,096 at September 30, 2004 and December 31, 2003, respectively)		4,071	4,632
Total assets	$	1,278,328	1,280,656

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

INLAND REAL ESTATE CORPORATION
Consolidated Balance Sheets (continued)
September 30, 2004 (unaudited) and December 31, 2003 (audited)
(In thousands, except per share data)

Liabilities and Stockholders' Equity

		September 30, 2004 (unaudited)	December 31, 2003 (audited)
Liabilities:			
Accounts payable and accrued expenses	$	2,964	1,994
Acquired below market lease intangibles (net of accumulated amortization of $2,558 and $1,459 at September 30, 2004 and December 31, 2003, respectively)		8,220	8,155
Accrued interest		2,074	1,810
Accrued real estate taxes		27,312	25,493
Dividends payable		5,311	5,406
Security and other deposits		2,568	2,485
Mortgages payable		631,528	615,512
Line of credit		110,000	135,000
Prepaid rents and unearned income		3,009	3,151
Liabilities associated with assets held for sale, including mortgages payable		10,419	7,742
Other liabilities		1,223	2,440
Total liabilities		804,628	809,188
Minority interest		20,174	20,973
Redeemable common stock relating to Put Agreement at December 31, 2003 (3,932 Shares)		-	35,000
Stockholders' Equity:			
Preferred stock, $.01 par value, 6,000 Shares authorized; none issued and outstanding at September 30, 2004 and December 31, 2003		-	-
Common stock, $.01 par value, 100,000 Shares authorized; 66,903 and 61,660 Shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively		669	617
Additional paid-in capital (net of offering costs of $58,816 and redeemable common stock relating to Put Agreement of $35,000 at December 31, 2003)		641,683	592,169
Deferred stock compensation		(610)	(48)
Accumulated distributions in excess of net income		(188,445)	(178,745)
Accumulated other comprehensive income		229	1,502
Total stockholders' equity		453,526	415,495
Commitments and contingencies			
Total liabilities and stockholders' equity	$	1,278,328	1,280,656

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

INLAND REAL ESTATE CORPORATION
Consolidated Statements of Operations
For the three and nine months ended September 30, 2004 and 2003
(In thousands, except per share data)

(unaudited)

	Three months ended September 30, 2004	Three months ended September 30, 2003	Nine months ended September 30, 2004	Nine months ended September 30, 2003
Revenues				
Rental income	$ 34,475	31,003	100,470	91,550
Tenant recoveries	12,162	10,503	38,387	34,287
Lease termination income	90	-	708	369
Other property income	166	116	543	435
Total revenues	46,893	41,622	140,108	126,641
Expenses:				
Property operating expenses	5,847	4,736	18,354	15,169
Real estate tax expense	8,324	6,766	24,421	22,884
Bad debt expense	200	200	509	1,434
Depreciation and amortization expense	9,945	8,751	28,747	25,151
Stock exchange listing expenses	83	-	823	-
General and administrative expenses	1,979	1,474	5,936	4,285
Total expenses	26,378	21,927	78,790	68,923
Operating income	20,515	19,695	61,318	57,718
Other income	583	373	2,241	1,087
Interest expense	(10,507)	(9,884)	(31,819)	(29,119)
Gain from continuing operations	76	-	76	-
Minority interest	(206)	(34)	(641)	(392)
Equity in earnings of unconsolidated joint ventures	(328)	(56)	(328)	(188)
Income from continuing operations	10,133	10,094	30,847	29,106
Discontinued operations:				
Income from discontinued operations (including gain on sale of investment properties of $3,426 for the three months ended September 30, 2004 and $4,465 and $3 for the nine months ended September 30, 2004 and 2003, respectively)	3,741	837	6,188	1,911
Net income available to common stockholders	13,874	10,931	37,035	31,017
Other comprehensive income:				
Unrealized gain (loss) on investment securities	112	(64)	(1,273)	329
Comprehensive income	$ 13,986	10,867	35,762	31,346

The accompanying notes are an integral part of these financial statements

INLAND REAL ESTATE CORPORATION
Consolidated Statements of Operations
For the three and nine months ended September 30, 2004 and 2003
(Dollars in thousands, except per share data)
(unaudited)

		Three months ended September 30, 2004	Three months ended September 30, 2003	Nine months ended September 30, 2004	Nine months ended September 30, 2003
Basic and diluted earnings available to common shares per weighted-average common shares:					
Income from continuing operations	$	0.15	0.16	0.47	0.45
Discontinued operations		0.06	0.01	0.09	0.03
Net income available to common stockholders per weighted average common shares – basic and diluted	$	0.21	0.17	0.56	0.48
Weighted average number of common shares outstanding – basic		66,770	65,197	66,285	64,921
Weighted average number of common shares outstanding – diluted		66,820	65,201	66,335	64,925

The accompanying notes are an integral part of these financial statements

INLAND REAL ESTATE CORPORATION
Consolidated Statement of Stockholders' Equity
For the nine months ended September 30, 2004
(Dollars in thousands, except per share data)
(unaudited)

		2004
Number of shares		
Balance at beginning of period	$	61,660
Shares issued from DRP		1,479
Stock compensation		47
Reclassification of redeemable common stock relating to Put Agreement		3,932
Repurchase of shares		(215)

Balance at end of period	66,903
Common Stock	
Balance at beginning of period	617
Proceeds from DRP	15
Stock compensation	-
Reclassification of redeemable common stock relating to Put Agreement	39
Repurchase of shares	(2)
Balance at end of period	669
Additional Paid-in capital	
Balance at beginning of period	592,169
Proceeds from DRP	16,070
Stock compensation	605
Reclassification of redeemable common stock relating to Put Agreement	34,960
Repurchase of shares	(2,121)
Balance at end of period	641,683
Deferred stock compensation	
Balance at beginning of period	(48)
Stock compensation	(604)
Amortization of stock compensation	42
Balance at end of period	(610)
Accumulated distributions in excess of net income	
Balance at beginning of period	(178,745)
Net income available to common stockholders	37,035
Distributions declared ($0.71, in the aggregate for the nine months ended September 30, 2004 per basic and diluted weighted average common share outstanding	(46,735)
Balance at end of period	(188,445)
Accumulated other comprehensive income	
Balance at beginning of period	1,502
Other comprehensive loss	(1,273)
Balance at end of period	229
Total stockholders' equity	$ 453,526

The accompanying notes are an integral part of these financial statements

INLAND REAL ESTATE CORPORATION
Consolidated Statements of Cash Flows
For the nine months ended September 30, 2004 and 2003
(Dollars in thousands)
(unaudited)

Cash flows from operating activities:		Nine months ended September 30, 2004	Nine months ended September 30, 2003
Net income	$	37,035	31,017
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation		26,946	25,069
Amortization		1,801	889
Non-cash charges associated with discontinued operations		406	403
Amortization of deferred stock compensation		42	12
Amortization on acquired above market lease intangibles		622	551
Amortization on acquired below market lease intangibles		(1,098)	(866)
Gain on sale of investment properties		(4,541)	(3)
Minority interest		641	392
Loss from operations of unconsolidated ventures		328	677
Rental income under master lease agreements		486	235
Straight line rental income		(1,690)	(1,030)
Provision for doubtful accounts		(316)	393
Interest on unamortized loan fees		1,816	1,146
Changes in assets and liabilities:			
Restricted cash		1,305	539
Accounts and rents receivable		(2,822)	(1,065)
Deposits and other assets		(852)	(1,140)
Accounts payable and accrued expenses		806	110
Accrued interest payable		268	381
Accrued real estate taxes		1,449	(2,542)
Security and other deposits		76	(420)
Other liabilities		(2)	2
Prepaid rents and unearned income		(557)	810
Net cash provided by operating activities		62,149	55,560

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

INLAND REAL ESTATE CORPORATION
Consolidated Statements of Cash Flows
For the nine months ended September 30, 2004 and 2003
(Dollars in thousands)
(unaudited)

Cash flows from investing activities:		Nine months ended September 30, 2004	Nine months ended September 30, 2003
Restricted cash	$	6,356	784

Escrows held for others	(1,215)	(678)
Purchase of investment securities	(5,045)	-
Sale of investment securities	8,985	850
Purchase of marketable securities	-	(1)
Additions to investment properties, net of amounts payable	(7,253)	(11,035)
Purchase of investment properties	(64,747)	(62,321)
Acquired above market lease intangibles	(901)	-
Acquired in-place lease intangibles	(9,491)	-
Acquired below market lease intangibles	1,164	-
Proceeds from sale of investment property	27,671	494
Investment in and advances to joint venture	(2,113)	-
Mortgage receivable	-	(2,132)
Construction in progress	(3)	-
Leasing fees	(972)	(735)
Net cash used in investing activities	(47,564)	(74,774)
Cash flows from financing activities:		
Proceeds from DRP	16,085	16,715
Repurchase of shares	(2,123)	(7,482)
Loan fees	(1,381)	(1,255)
Proceeds from (pay downs on) the unsecured line of credit	(25,000)	45,000
Distributions paid	(48,271)	(47,201)
Payoff of debt	(61,963)	-
Loan proceeds	89,030	19,880
Principal payments of debt	(283)	(271)
Net cash provided by (used in) financing activities	(33,906)	25,386
Net increase (decrease) in cash and cash equivalents	(19,321)	6,172
Cash and cash equivalents at beginning of period	58,388	21,434
Cash and cash equivalents at end of period	39,067	27,606

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

INLAND REAL ESTATE CORPORATION
Consolidated Statements of Cash Flows (continued)
For the nine months ended September 30, 2004 and 2003
(Dollars in thousands)
(unaudited)

		Nine months ended September 30, 2004	Nine months ended September 30, 2003
Supplemental schedule of noncash investing and financing activities:			
Proceeds from sale of investment properties	$	36,241	-
Transfer of mortgage debt		(8,570)	-
	$	27,671	-
Reclassification of common stock related to Put Agreement	$	(35,000)	35,000
Distributions payable	$	5,311	5,197
Cash paid for interest	$	30,537	28,666
Impact of adoption of FIN 46 (consolidation of joint venture)			
Assets:			
Land, building and improvements and construction in progress (net of accumulated depreciation of $343,237)	$	9,538	-
Other assets		282	-
Total assets	$	9,820	-

Total liabilities	$	1,428	-
Investment in and advances to joint venture at January 1, 2004	$	8,392	-

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

INLAND REAL ESTATE CORPORATION
Notes to Consolidated Financial Statements
September 30, 2004
(In thousands, except per share data and square footage amounts)
(unaudited)

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Readers of this Quarterly Report should refer to the audited financial statements of Inland Real Estate Corporation (the "Company") for the fiscal year ended December 31, 2003, as certain footnote disclosures contained in such audited financial statements have been omitted from this Quarterly Report. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included in this Quarterly Report.

(1) Organization and Basis of Accounting

Inland Real Estate Corporation was formed on May 12, 1994. The Company is an owner/operator of Neighborhood Retail Centers and Community Centers located primarily within an approximate 400-mile radius of its headquarters in Oak Brook, Illinois. The Company owns, and acquires, single-user retail properties located throughout the United States. The Company is also permitted to construct or develop properties, or render services in connection with such development or construction, subject to the Company's compliance with the rules governing real estate investment trusts under the Internal Revenue Code of 1986, as amended (the "Code"). As of September 30, 2004, the Company had ownership interests in 139 investment properties, comprised of:

Eighty-six Neighborhood Retail Centers totaling approximately 5,700,000 gross leasable square feet;

Twenty-four Community Centers totaling approximately 5,200,000 gross leasable square feet; and

Twenty-nine single-user retail properties totaling approximately 1,400,000 gross leasable square feet.

The Company qualified as a real estate investment trust ("REIT") under the Code for federal income tax purposes commencing with the tax year ending December 31, 1995. So long as the Company qualifies for treatment as a REIT, the Company generally will not be subject to federal income tax to the extent it distributes at least 90% its REIT taxable income to its stockholders. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax on its taxable income at regular corporate tax rates. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and property and federal income and excise taxes on its undistributed income.

The Company has elected to be taxed, for federal income tax purposes, as a REIT. This election has important consequences because it requires the Company to satisfy certain tests regarding the nature of the revenues it can generate and the distributions that it pays to stockholders. To ensure that the Company qualifies to be taxed as a REIT, the Company determines, on a quarterly basis, that the gross income, asset and distribution tests imposed by the Code are met. On an ongoing basis, as due diligence is performed by the Company on potential real estate purchases or temporary investment of uninvested capital, the Company determines that the income from the new assets qualifies for REIT purposes.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

In the opinion of management, the financial statements contain all the adjustments necessary, which are of a normal recurring nature, to present fairly the financial position and results of operations for the periods presented herein. Results of interim periods are not necessarily indicative of results to be expected for the year.

Certain reclassifications were made to the 2003 financial statements to conform to the 2004 presentation.

The accompanying consolidated financial statements of the Company include, in addition to the accounts of its wholly-owned subsidiaries, the accounts of Inland Ryan, LLC, Inland Ryan Cliff Lake, LLC and the joint venture with Tri-Land Properties, Inc ("consolidated entities"). These entities are consolidated because the Company is either the primary beneficiary of a variable interest entity or has substantial influence and controls the entity. The primary beneficiary is the party that absorbs a majority of the entity's expected residual returns and losses. The third parties' interests in these consolidated entities are reflected as minority interest in the accompanying consolidated financial statements.

Depreciation expense is computed using the straight-line method. Buildings and improvements are depreciated based upon estimated useful lives of 30 years for buildings and improvements, 15 years for site improvements and the remaining life of the related lease for tenant improvements.

Acquired above and below market leases are amortized on a straight-line basis over the life of the related leases as an adjustment to rental income. Acquired in-place leases are amortized over the average lease term as a component of amortization expense.

The Company allocates the purchase price of each acquired investment property between land, building and improvements, other intangibles (including acquired above market leases, acquired below market leases, customer relationships and acquired in-place leases) and any assumed financing that is determined to be above or below market terms. The Company uses the information contained in the third party appraisals as the primary basis for allocating the purchase price between land, building and site improvements. The aggregate value of other intangibles is measured based on the difference between the purchase price and the property valued as if vacant.

On a quarterly basis, in accordance with Statement of Financial Accounting Standards No. 144, the Company reviews impairment indicators and if necessary conducts an impairment analysis to ensure that the carrying value of the property does not exceed its estimated fair value. The Company evaluates its investment properties to assess whether any impairment indicators are present, including recurring operating losses and significant adverse changes in legal factors or business climate. If an investment property is considered impaired, a loss is recorded to reduce the carrying value of the property to its estimated fair value. No such losses have been required or recorded in the accompanying financial statements as of and for the three and nine months ended September 30, 2004 and 2003.

Leasing fees are amortized on a straight-line basis over the life of the related lease.

Loan fees are amortized on a straight-line basis over the life of the related loan.

The fair value of mortgages payable is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair value of the Company's mortgages is estimated to be $96,945 for mortgages which bear interest at variable rates and $545,729 for mortgages which bear interest at fixed rates. The Company estimates the fair value of its mortgages payable by discounting the future cash flows of each instrument at rates currently offered to the Company for similar debt instruments of comparable maturities by the Company's lenders.

Offering costs are offset against the Stockholder's equity accounts. Offering costs consist principally of printing, selling and registration costs.

Tenants required to pay a security deposit under their lease with the Company have paid either in cash or by posting letters of credit. The letters of credit are not recorded in the accompanying consolidated financial statements. As of September 30, 2004 and December 31, 2003, the Company held letters of credit for tenant security deposits totaling approximately $449 and $414, respectively.

Rental income is recognized on a straight-line basis over the term of each lease. The difference between rental income earned on a straight-line basis and the cash rent due under provisions of the lease agreements is recorded as deferred rent receivable and is included as a component of accounts and rents receivable in the accompanying consolidated balance sheets.

The Company accrues lease termination income if there is a signed termination agreement, all of the conditions of the agreement have been met and the tenant is no longer occupying the property.

On December 2, 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin 101 "Revenue Recognition in Financial Statements." The staff determined that a lessor should defer recognition of contingent rental income, such as percentage/excess rent, until the specified target that triggers the contingent rental income is achieved. The Company has recorded percentage rental revenue in accordance with SAB 101 for all periods presented.

(In thousands, except per share data and square footage amounts)

As of September 30, 2004 and 2003, the Company had no material derivative instruments. The Company may enter into derivative financial instrument transactions in order to mitigate its interest rate risk on a related financial instrument. The Company may designate these derivative financial instruments as hedges and apply hedge accounting, as the instrument to be hedged will expose the Company to interest rate risk, and the derivative financial instrument will reduce that exposure. Gains and losses related to the derivative financial instrument would be deferred and amortized over the terms of the hedged instrument. If a derivative terminates or is sold, the gain or loss is recognized. The Company will generally enter into derivative transactions that satisfy the aforementioned criteria only.

(2) Investment Securities

The Company classifies its investment in securities in one of three categories: trading; available-for-sale; or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities in which the Company has the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Investment in securities at September 30, 2004 and 2003 are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings and reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific identification basis. Dividend income is recognized when received.

A decline in the market value of any available-for-sale security below cost that is deemed to be other than temporary results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other than temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to the end of the period and forecasted performance of the investee.

Sales of investment securities available-for-sale during the nine months ended September 30, 2004 and 2003 resulted in gains on sale of $1,069 and $38, respectively. These gains are included in other income in the accompanying Consolidated Statements of Operations.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2004 were as follows:

	Less than 12 months		12 months or longer		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

REIT Common Stock	$	2,080	36	-	-	2,080	36
Non REIT Common Stock	$	318	7	-	-	318	7

(3) Joint Ventures

On February 1, 2001, a wholly-owned subsidiary of the Company entered into an LLC agreement with a wholly-owned subsidiary of Tri-Land Properties, Inc. for the acquisition and redevelopment of the Century Consumer Mall in Merrillville, Indiana. The first phase of new construction commenced in January 2003 for an 18,000 square foot retail building fronting U.S. Route 30. This building is anchored by a 4,800 square foot Panera Bread store pursuant to an executed ten-year lease. Construction was completed during 2003 and an additional 2,400 square feet was leased. It is anticipated that lease up of this building will occur during 2004. Each partner's initial equity contribution was $500.

Through December 31, 2003, the Company had accounted for its investment in this joint venture under the equity method of accounting because the Company was not the managing member and did not have the ability to control the joint venture. The Company adopted FASB Interpretation No. 46 ("FIN 46") on January 1, 2004. In accordance with FIN 46, the Company has evaluated this joint venture and determined that it is the principal beneficiary in this variable interest entity. As a result, the accounts of the joint venture have been consolidated with the Company's financial statements for financial reporting purposes. In conjunction with this consolidation, the Company consolidated approximately $10,000 in assets held by the joint venture.

In addition, the Company has committed to lend the LLC up to $17,800. Draws on the loan bear interest at a rate of 9% per annum, with interest only paid monthly on average outstanding balances. The loan is secured by the property and matures on January 31, 2006. As of September 30, 2004, the principal balance of this mortgage receivable was $9,704. Tri-Land Properties, Inc. has guaranteed $2,500 of this mortgage receivable. During the consolidation process, this amount and the mortgage payable in the joint venture partner's accounts were eliminated.

Effective September 23, 2004, the Company formed a strategic joint venture with an affiliate of Crow Holdings Managers, LLC to each acquire a 50% ownership interest in the 97,535 square-foot Hastings Marketplace, which is located in Hastings, Minnesota. The venture acquired Hastings Marketplace from the Company for $13,200. The Company is the managing member of the venture and earns fees for providing property management and leasing services to the venture.

In connection with the sale of Hastings Marketplace to the venture, the Company recognized a gain of approximately $76. The gain and operations are not recorded as discontinued operations because of the Company's continuing involvement in this shopping center. The Company accounts for its interest in the venture using the equity method of accounting.

Summarized financial information for the unconsolidated investments is as follows:

Balance Sheet:	September 30, 2004	December 31, 2003
Investment in real estate, net	$ 11,557	-
Acquired lease intangibles, net	1,578	-
Accounts and rents receivable	113	-
Restricted cash	175	-
Loan fees, net	101	-
Other assets	20	-
Total assets	$ 13,544	-
Accounts payable and accrued expenses	11	-
Security Deposits	7	-
Mortgage payable	9,780	-
Other liabilities	175	-
Equity and partner's capital	3,571	-
Total liabilities and equity	$ 13,544	-

Statement of Operations	Nine months ended September 30, 2004	Nine months ended September 30, 2003
Rental income	$ 72	-
Tenant recoveries	4	-
Total revenues	76	-
Property operating expenses	4	-
Real estate tax expense	56	-
Interest expense	22	-
Start up expenses	650	-
Total expenses	732	-
Net loss	$ (656)	-

INLAND REAL ESTATE CORPORATION
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(4) Transactions with Related Parties

During the nine months ended September 30, 2004 and 2003, the Company purchased various administrative services, such as payroll preparation and management, data processing, insurance consultation and placement, investor relations, property tax reduction services and mail processing from affiliates of The Inland Group, Inc. The Company pays for these services on an hourly basis. The hourly rate is based on the salary of the individual rendering the services, plus a pro rata allocation of overhead including, but not limited to, employee benefits, rent, materials, fees, taxes and operating expenses incurred by each entity in operating their respective businesses. Computer services were purchased at a contract rate of $50 per hour. The Company continues to purchase these services from The Inland Group, Inc. affiliates and these expenses, totaling $193 and $645, for the three and nine months ended September 30, 2004, respectively, and $84 and $532, for the three and nine months ended September 30, 2003, respectively, are included in general and administrative expenses and property operating expenses. Additionally, the Company leases its corporate office space from an affiliate of The Inland Group, Inc. Payments under this lease were $62 and $187 for the three and nine months ended September 30, 2004, respectively and $61 and $177 for the three and nine months ended September 30, 2003, respectively, and are also included in general and administrative expenses. The Inland Group, Inc., itself and through affiliates, owns approximately 9.6% of the Company's outstanding common stock. For accounting purposes however, the Company is not directly affiliated with The Inland Group, Inc., or its affiliates.

During the nine months ended September 30, 2004 and 2003, the Company purchased legal services from attorneys employed by The Inland Real Estate Group, Inc., a wholly-owned subsidiary of The Inland Group, Inc. The fees for these services were based on costs incurred by The Inland Real Estate Group, Inc. equal to $220 per hour. For the three and nine months ended September 30, 2004 the Company paid $1 and $2, respectively, and for the three and nine months September 30, 2003, the Company paid $6 and $95, respectively, for these legal services.

An affiliate of The Inland Group, Inc. was the mortgagee on the Walgreens property, located in Decatur, Illinois. The loan secured by this mortgage matured on May 31, 2004 and the principal of approximately $624 was repaid. For the nine months ended September 30, 2004 the Company paid principal and interest payments totaling $28 and during the three and nine months ended September 30, 2003, the Company paid $17 and $51, respectively.

On February 1, 2001, a wholly-owned subsidiary of the Company entered into an LLC agreement with a wholly-owned subsidiary of Tri-Land Properties, Inc. to acquire and develop the Century Consumer Mall in Merrillville, Indiana. Richard Dube, the brother-in-law of Mr. Daniel Goodwin, the Company's chairman of the board, is the president and a principal owner of Tri-Land. Reference is made to Note 3 for more information on the Company's joint venture.

On August 12, 2003, the Company entered into an agreement with Inland Investment Advisors, Inc., an affiliate of The Inland Group, Inc. to manage its investment in securities. The Company pays a fee equal to three quarters of one percent (0.75%) per annum on the net asset value under management. The Company paid approximately $18 and $63 for these services during the three and nine months ended September 30, 2004, respectively. The Company paid no such fees during the three and nine months ended September 30, 2003.

During the year ended December 31, 2003, the Company entered into an agreement with Inland Real Estate Investment Corporation, Partnership Ownership Corporation (a wholly owned subsidiary of Inland Real Estate Investment Corporation) and Fleet National Bank. Inland Real Estate Investment Corporation and Partnership Ownership Corporation are both owned or controlled by The Inland Group, Inc. Three of the Company's directors, Messrs. Goodwin, Cosenza and Parks are directors and shareholders of The Inland Group, Inc. Mr. Goodwin owns a controlling interest in The Inland Group, Inc. Inland Real Estate Investment Corporation and Partnership Ownership Corporation have collectively pledged 6,166 shares of the Company's common stock, which they own, to secure draws under a $35,000 line of credit obtained by them from Fleet National Bank. Under the agreement, Inland Real Estate Investment Corporation paid the Company $100 in return for its agreement to repurchase a portion of these pledged shares, at a price of $8.90 per share, from Fleet National Bank if Inland Real Estate Investment Corporation defaults on the line of credit agreement and Fleet National Bank exercises its right under the pledge agreement to obtain ownership of the shares. Although Inland Real Estate Investment Corporation and Partnership Ownership Corporation have pledged shares, the Company is only required to repurchase that number of shares multiplied by $8.90 needed to satisfy any of Inland Real Estate Investment Corporation's or Partnership Ownership Corporation's obligations, including principal, accrued interest and other costs and expenses under the line of credit agreement. Further, the Company is not required to repurchase more than $15,000 worth of shares during any six month period. The maximum amount the Company is required to repurchase is approximately 4,000 shares or $35,000 of stock based on a price of $8.90 per share. In accordance with FIN 45, the Company has recorded this premium of $100 paid by Inland Real Estate Investment Corporation as a liability related to its obligation to stand ready to perform on its guarantee. The Company will recognize the premium received as income upon the termination date of this agreement. In addition, the Company has classified the potential amount to be redeemed under this agreement as temporary equity in the accompanying Consolidated Balance Sheets. This agreement was approved by the Company's independent directors who, among other things, determined the fairness of the fee received by the Company from Inland Real Estate Investment Corporation. In determining that the fee was fair, the independent directors obtained a fairness opinion, the cost of which was paid for by Inland Real Estate Investment Corporation.

On August 2, 2004, as a result of an amendment and restatement of the line of credit agreement between the lender and Inland Real Estate Investment Corporation as borrower, the lender delivered to the Company a termination and release of the Put Agreement. The Company reclassified the liability recorded for its obligation under the Put Agreement and recognized the $100 premium received as earned income on the termination date of August 2, 2004. Additionally, the Company reclassified the amount of temporary equity previously recorded on the Consolidated Balance Sheets at September 30, 2004.

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(5) Investment Properties

The Company, from time to time, receives payments under master lease agreements covering spaces vacant at the time of acquisition. The payments range from one to two years from the date of acquisition of the property or until the space is leased and tenants begin paying rent. GAAP requires the Company to treat these payments as a reduction to the purchase price of the investment properties upon receipt of the payment, rather than as rental income. As of September 30, 2004, the Company had the following six investment properties subject to master lease agreements:

- Forest Lake Marketplace, located in Forest Lake, Minnesota;
- Shops at Orchard Place, located in Skokie, Illinois;
- Rochester Marketplace, located in Rochester, Minnesota;
- University Crossing, located in Mishawaka, Indiana;
- Hastings Marketplace, located in Hastings, Minnesota (this property is held through a joint venture);and
- Deer Trace II, located in Kohler, Wisconsin.

The cumulative amounts of such payments were $7,839 and $7,353 as of September 30, 2004 and December 31, 2003, respectively.

(6) Discontinued Operations

During the nine months ended September 30, 2004, the Company sold four investment properties. During the year ended December 31, 2003, the Company sold three investment properties. Additionally, during the year ended December 31, 2003, the Company sold a 2,280 square foot free-standing restaurant building, leased to Popeye's, which was part of one of our existing investment properties. For federal and state income tax purposes, certain of the Company's sales qualified as part of tax deferred exchanges and, as a result, the tax gains are deferred until the replacement properties are disposed of in subsequent taxable transactions. The proceeds from these sales were deposited with a qualified tax deferred exchange agent with the intent of using these proceeds for future acquisitions. The following table summarizes the properties sold, date of sale, indebtedness repaid, approximate sales proceeds, net of closing costs and after repayment of debt, gain on sale and whether the sale qualified as part of a tax deferred exchange:

Property Name	Date of Sale	Indebtedness repaid	Approximate Net Sales Proceeds (after repayment of debt)	Gain on Sale	Tax Deferred Exchange
Popeye's	April 8, 2003	$ -	$ 340	$ 3	No
Summit of Park Ridge	December 24, 2003	1,600	1,600	721	Yes
Eagle Country Market	December 24, 2003	1,450	1,700	587	Yes
Eagle Ridge Center	December 30, 2003	3,000	2,000	4	Yes
Zany Brainy	January 20, 2004	1,245	1,600	873	Yes
Prospect Heights	April 23, 2004	1,095	1,200	166	Yes
Fairview Heights	August 5, 2004	8,570	5,600	2,639	Yes
Prairie Square	September 23, 2004	1,550	1,800	787	Yes

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From time to time, the Company decides to dispose of certain assets or receives unsolicited offers to purchase its investment properties, at prices in excess of book value. Upon receipt of a valid offer or the signing of a listing agreement, the Company classifies the asset as held for sale and suspends depreciation. As of September 30, 2004, the following investment properties were held for sale and depreciation was suspended as of the date noted:

June 1, 2003 – Dominick's, located in Highland Park, Illinois;

November 1, 2003 – Walgreens, located in Woodstock, Illinois;

April 19, 2004 – Wauconda Shopping Center, located in Wauconda, Illinois;

April 19, 2004 – Sequoia Shopping Center, located in Milwaukee, Wisconsin;

May 17, 2004 – Calumet Square, located in Calumet City, Illinois; and

- May 17, 2004 – Crestwood Plaza, located in Crestwood, Illinois.

If the current unsolicited offers do not result in the sale of these properties, the Company will continue to actively market them for sale. Listing agreements were signed for Wauconda Shopping Center, Sequoia Shopping Center, Calumet Square and Crestwood Plaza. These properties will continue to be marketed until they are sold.

Results of operations for the investment properties sold, or held for sale, during the three and nine months ended September 30, 2004 and 2003 (unaudited), are presented in the table below:

		Three months ended September 30, 2004	Three months ended September 30, 2003	Nine months ended September 30, 2004	Nine months ended September 30, 2003
Income:					
Rental income	$	868	1,557	3,109	4,602
Tenant recoveries		91	441	721	1,321
		959	1,998	3,830	5,923
Expenses:					
Property operating expense		102	290	455	1,319
Bad debt expense		26	(57)	35	23
Real estate expense		71	227	408	387
Interest expense		284	362	803	1,075
Depreciation and amortization		161	339	406	1,211
		644	1,161	2,107	4,015
Income from operations		315	837	1,723	1,908
Gain on sale of investment property		3,426	-	4,465	3
Income from discontinued operations	$	3,741	837	6,188	1,911

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The following assets and liabilities relating to the investment properties sold, or held for sale, as of September 30, 2004 and December 31, 2003, are presented in the table below:

		September 30, 2004 (unaudited)	December 31, 2003 (audited)
Assets:			
Accounts and rents receivable, net of provision for doubtful accounts	$	1,292	831
Land		6,020	4,433
Building		17,776	12,002
Accumulated depreciation		(4,252)	(2,835)
Loan fees, net of accumulated amortization		8	13
Leasing fees, net of accumulated amortization		54	-
Total assets held for sale	$	20,898	14,444
Liabilities:			
Accounts payable and accrued expenses	$	11	1

Accrued interest		51	47
Accrued real estate taxes		440	40
Prepaid rents and unearned income		66	9
Security and other deposits		9	-
Mortgage payable		9,842	7,645
Total liabilities associated with assets held for sale	$	10,419	7,742

(7) Operating Leases

Certain tenant leases contain provisions providing for "stepped" rent increases. GAAP requires the Company to record rental income for the period of occupancy using the effective monthly rent, which is the average monthly rent for the entire period of occupancy during the term of the lease. The accompanying consolidated financial statements include increases of $1,690 and $1,031 for the nine months ended September 30, 2004 and 2003, respectively, of rental income for the period of occupancy for which stepped rent increases apply and $18,224 and $16,534 in related accounts and rents receivable as of September 30, 2004 and December 31, 2003, respectively. The Company anticipates collecting these amounts over the terms of the leases as scheduled rent payments are made.

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(8) Mortgages Payable

The Company's mortgages payable are secured by certain of its investment properties and consist of the following at September 30, 2004 and December 31, 2003:

Mortgagee	Interest Rate at September 30, 2004	Interest Rate at December 31, 2003	Maturity Date	Current Monthly Payment	Balance at September 30, 2004	Balance at December 31, 2003
Allstate (a) (b)	7.21%	7.21%	12/2004	$ 38	$ 6,400	$ 6,400
Allstate	7.00%	7.00%	01/2005	24	4,100	4,100
Allstate	7.15%	7.15%	01/2005	18	3,050	3,050
Allstate	7.00%	7.00%	02/2005	32	5,477	5,477
Allstate	6.65%	6.65%	05/2005	53	9,600	9,600
Allstate	6.82%	6.82%	08/2005	60	10,600	10,600
Allstate	7.40%	7.40%	09/2005	221	35,787	35,787
Allstate	7.38%	7.38%	02/2006	133	2	