AMERICAN REALTY INVESTORS INC
Form 10-Q
August 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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	75-2847135
(State or Other Jurisdiction of Incorporation or Organization)	(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

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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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	15,514,360
(Class)	(Outstanding at August 14, 2017)

AMERICAN REALTY INVESTORS, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2017	December 31, 2016
	(unaudited)	
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	$1,059,981	$1,017,684
Real estate subject to sales contracts at cost, net of depreciation	48,366	48,919
Less accumulated depreciation	(177,700)	(165,597)
Total real estate	930,647	901,006
Notes and interest receivable		
Performing (including $99,793 in 2017 and $128,548 in 2016 from related parties)	123,911	143,601
Less allowance for doubtful accounts (including $15,537 in 2017 and 2016 from related parties)	(17,037)	(17,037)
Total notes and interest receivable	106,874	126,564
Cash and cash equivalents	58,260	17,522
Restricted cash	37,585	38,399
Investments in unconsolidated subsidiaries and investees	6,294	6,087
Receivable from related party	30,913	24,672
Other assets	62,163	60,659
Total assets	$1,232,736	$1,174,909
Liabilities and Shareholders’ Equity		
Liabilities:		
Notes and interest payable	$826,309	$845,107
Notes related to subject to sales contracts	376	376
Notes related to assets subject to sales contract	4,012	5,612
Bond and bond interest payable	104,505	—
Deferred revenue (including $70,915 in 2017 and $70,935 in 2016 from sales to related parties)	91,087	91,380
Accounts payable and other liabilities (including $10,769 in 2017 and $10,854 in 2016 to related parties)	48,303	56,303

	1,074,592	998,778
Shareholders' equity:		
Preferred stock, Series A: $2.00 par value, authorized 15,000,000 shares, issued and outstanding 2,000,614 shares in 2017 and 2016 (liquidation preference $10 per share), including 900,000 shares in 2017 and 2016 held by ARL or subsidiaries.	2,205	2,205
Common stock, $0.01 par value, authorized 100,000,000 shares; issued 15,930,145 and 14,443,404 shares; outstanding 15,514,360 and 14,027,619 shares in 2017 and 2016, respectively; including 140,000 shares held by TCI (consolidated) in 2017 and 2016.	159	159
Treasury stock at cost; 415,785 shares in 2016 and 2015, and 140,000 shares held by TCI (consolidated) as of 2017 and 2016	(6,395)	(6,395)
Paid-in capital	110,751	111,510
Retained earnings	(2,202)	14,398
Total American Realty Investors, Inc. shareholders' equity	104,518	121,877
Non-controlling interest	53,626	54,254
Total shareholders' equity	158,144	176,131
Total liabilities and shareholders' equity	$1,232,736	$1,174,909

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

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
	(dollars in thousands, except per share amounts)			
Revenues:				
Rental and other property revenues (including $199 and $174 for the three months and $389 and $347 for the six months ended 2017 and 2016, respectively, from related parties)	$31,587	$30,834	$63,409	$60,039
Expenses:				
Property operating expenses (including $239 and $231 for the three months and $476 and $441 for the six months ended 2017 and 2016, respectively, from related parties)	15,429	15,191	31,693	30,407
Depreciation and amortization	6,409	5,868	12,739	11,698
General and administrative (including $552 and $942 for the three months and $1,295 and $1,860 for the six months ended 2017 and 2016, respectively, from related parties)	1,995	2,412	4,026	4,437
Net income fee to related party	77	54	137	126
Advisory fee to related party	2,849	2,687	5,508	5,425
Total operating expenses	26,759	26,212	54,103	52,093
Net operating income	4,828	4,622	9,306	7,946
Other income (expenses):				
Interest income (including $4,972 and $4,504 for the three months and $9,092 and $10,029 for the six months ended 2017 and 2016, respectively, from related parties)	5,059	4,788	9,852	10,079
Other income	(116)	902	1,327	1,200
Mortgage and loan interest (including $1,683 and $1,355 for the three months and $3,195 and $2,447 for the six months ended 2017 and 2016, respectively, from related parties)	(17,347)	(13,975)	(34,143)	(28,189)
Earnings from unconsolidated subsidiaries and investees	153	129	208	284
Foreign currency transaction loss	(3,425)	—	(3,747)	—
Total other expenses	(15,676)	(8,156)	(26,503)	(16,626)
Loss before gains on sale of income producing properties and land, non-controlling interest, and taxes	(10,848)	(3,534)	(17,197)	(8,680)
Gain on sale of income-producing properties	—	5,168	—	4,925
Gain (loss) on land sales	(476)	1,719	(31)	3,370

Net income (loss) from continuing operations before taxes	(11,324)	3,353	(17,228)	(385)
Income tax benefit	—	—	—	1
Net income (loss) from continuing operations	(11,324)	3,353	(17,228)	(384)
Discontinued operations:				
Net income from discontinued operations	—	—	—	3
Income tax expense from discontinued operations	—	—	—	(1)
Net income from discontinued operations	—	—	—	2
Net income (loss)	(11,324)	3,353	(17,228)	(382)
Net (income) loss attributable to non-controlling interest	435	(864)	628	(334)
Net income (loss) attributable to American Realty Investors, Inc.	(10,889)	2,489	(16,600)	(716)
Preferred dividend requirement	(275)	(53)	(550)	(550)
Net income (loss) applicable to common shares	$(11,164)	$2,436	$(17,150)	$(1,266)
Earnings per share - basic				
Net income (loss) from continuing operations	$(0.72)	$0.16	$(1.11)	$(0.08)
Earnings per share - diluted				
Net income (loss) from continuing operations	$(0.72)	$0.16	$(1.11)	$(0.08)
Weighted average common shares used in computing earnings per share	15,514,360	15,514,360	15,514,360	15,514,360
Weighted average common shares used in computing diluted earnings per share	15,514,360	15,514,360	15,514,360	15,514,360
Amounts attributable to American Realty Investors, Inc.				
Net income (loss) from continuing operations	$(10,889)	$2,489	$(16,600)	$(718)
Net income from discontinued operations	—	—	—	2
Net income (loss) applicable to American Realty Investors, Inc.	$(10,889)	$2,489	$(16,600)	$(716)

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

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AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS’ EQUITY

For the Six Months Ended June 30, 2017

(unaudited, dollars in thousands, except share amounts)

	Total	**Comprehensive**	**Preferred**	**Common Stock**		**Treasury**	**Paid-i**
	Equity	**Loss**	**Stock**	**Shares**	**Amount**	**Stock**	**Capita**
Balance, December 31, 2016	$ 176,131	$ (58,737)	$ 2,205	15,930,145	$ 159	$ (6,395)	$ 111,51
Net loss	(17,228)	(17,228)	—	—	—	—	—
Assumption of non-controlling interests	(209)	—	—	—	—	—	(209
Series A preferred stock dividend ($1.00 per share)	(550)	—	—	—	—	—	(550
Balance, June 30, 2017	$ 158,144	$ (75,965)	$ 2,205	15,930,145	$ 159	$ (6,395)	$ 110,75

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

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AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

	Six Months Ended June 30,	
	2017	2016
	(dollars in thousands)	
Net loss	$(17,228)	$(382)
Other comprehensive income (loss)	—	—
Total comprehensive loss	(17,228)	(382)
Comprehensive (income) loss attributable to non-controlling interest	628	(334)
Comprehensive loss attributable to American Realty Investors, Inc.	$(16,600)	$(716)

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

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Six Months Ended June 30, 2017	2016
	(dollars in thousands)	
Cash Flow From Operating Activities:		
Net loss	$(17,228)	$(382)
Adjustments to reconcile net loss applicable to common shares to net cash flow from operating activities:		
Loss (gain) on sale of land	31	(3,370)
Gain on sale of income-producing properties	—	(4,925)
Depreciation and amortization	12,739	10,635
Amortization of deferred borrowing costs	2,131	2,303
Amortization of bond issuance costs	462	—
Earnings from unconsolidated subsidiaries and investees	(207)	(284)
Decrease (increase) in assets:		
Accrued interest receivable	4,053	(549)
Other assets	(477)	2,016
Prepaid expense	(4,195)	(716)
Escrow	2,857	16,105
Earnest money	(1,164)	(259)
Rent receivables	(1,669)	—
Related party receivables	(4,930)	21,762
Increase (decrease) in liabilities:		
Accrued interest payable	141	(554)
Other liabilities	7,985	(7,370)
Net cash provided by operating activities	529	34,412
Cash Flow From Investing Activities:		
Proceeds from notes receivable	19,753	3,788
Origination or advances of notes receivable	(4,116)	(6,850)
Acquisition of income producing properties	—	(33,857)
Acquisition of land held for development	(11,440)	—
Proceeds from sale of income-producing properties	—	9,377
Proceeds from sale of land	1,596	6,347
Investment in unconsolidated real estate entities	207	2,497
Improvement of land held for development	(585)	(1,722)
Improvement of income-producing properties	(1,895)	(2,416)
Construction and development of new properties	(26,708)	(27,966)
Net cash used in investing activities	(23,188)	(50,802)

Cash Flow From Financing Activities:		
Proceeds from Series A bonds payable	102,364	—
Proceeds from notes payable	82,865	78,487
Recurring amortization of principal on notes payable	(12,083)	(7,250)
Payments on maturing notes payable	(113,838)	(49,094)
Deferred financing costs	676	(1,283)
Bond issuance costs	6,253	—
Preferred stock dividends - Series A	(550)	(550)
Net cash provided by financing activities	65,687	20,310
Net increase in cash and cash equivalents	43,028	3,920
Cash and cash equivalents, beginning of period	15,232	15,232
Cash and cash equivalents, end of period	$58,260	$19,152
Supplemental disclosures of cash flow information:		
Cash paid for interest	$28,065	$21,124

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 1999. The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange (“NYSE”) under the symbol (“ARL”). Over 80% of ARL’s stock is owned by related party entities.

ARL and a subsidiary own approximately 78% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc. (“TCI”), a Nevada corporation, whose common stock is traded on the NYSE under the symbol (“TCI”). TCI, a subsidiary of ARL, owns approximately 81.1% of the common stock of Income Opportunity Realty Investors, Inc. (“IOR”). Effective July 17, 2009, IOR’s financial results were consolidated with those of ARL and TCI and their subsidiaries. IOR’s common stock is traded on the New York Stock Exchange (“NYSE MKT”) under the symbol (“IOR”).

ARL’s Board of Directors is responsible for directing the overall affairs of ARL and for setting the strategic policies that guide the Company. As of April 30, 2011, the Board of Directors delegated the day-to-day management of the Company to Pillar Income Asset Management, Inc. (“Pillar”), a Nevada corporation, under a written Advisory Agreement that is reviewed annually by ARL’s Board of Directors. The directors of ARL are also directors of TCI and IOR. The Chairman of the Board of Directors of ARL also serves as the Chairman of the Board of Directors of TCI and IOR. The officers of ARL also serve as officers of TCI, IOR and Pillar.

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

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.

Properties

We own or had interests in a total property portfolio of 59 income-producing properties as of June 30, 2017. The properties consisted of:

Eight commercial properties consisting of five office buildings and three retail centers comprising in aggregate approximately 2.0 million rentable square feet;

A golf course comprising approximately 96 acres;

50 apartment communities totaling 8,226 units, excluding apartments being developed; and

3,674 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We are in the predevelopment process on several residential apartment communities that have not yet begun construction. At June 30, 2017, we had seven apartment projects in development. The third-party developer typically holds a general partner as well as a majority limited partner interest in a limited partnership formed for the purpose of building a single property, while we generally take a minority limited partner interest in the limited partnership. We may contribute land to the partnership as part of our equity contribution or we may contribute the necessary funds to the partnership to acquire the land. We are required to fund all necessary equity contributions while the third-party developer is responsible for obtaining construction financing, hiring a general contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our Consolidated Financial Statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer’s partnership interests in exchange for any remaining unpaid developer fees.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted in accordance with such rules and regulations, although management believes the disclosures are adequate to prevent the information presented from being misleading. In the opinion of management, all adjustments (consisting of normal recurring matters) considered necessary for a fair presentation have been included. The results of operations for the six months ended June 30, 2017, 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, 2016 was derived from the audited Consolidated Financial Statements at that date, but does not include all of the information and disclosures required by U.S. GAAP for complete financial statements. For further information, refer to the Consolidated Financial Statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. Certain 2016 Consolidated Financial Statement amounts have been reclassified to conform to the 2017 presentation.

Principles of Consolidation

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

In determining whether we are the primary beneficiary of a VIE, we consider qualitative and quantitative factors, including, but not limited to: the amount and characteristics of our investment; the obligation or likelihood for us or other investors to provide financial support; our and the other investors’ ability to control or significantly influence key decisions for the VIE; and the similarity with and significance to the business activities of us and the other investors.

Significant judgments related to these determinations include estimates about the current future fair values and performance of real estate held by these VIEs and general market conditions.

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

Real Estate, Depreciation and Impairment

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

Real Estate Held For Sale

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

Prior to January 1, 2015, the operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying Consolidated Statements of Operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. Effective January 1, 2015, Accounting Standards Update 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” (“ASU 2014-08”) substantially changed the criteria for determining whether a disposition qualifies for discontinued operations presentation. Since the Company adopted ASU 2014-08, effective January 1, 2015, we have had no dispositions that met the discontinued operations criteria.

Cost Capitalization

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

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

Fair Value Measurement

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

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

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

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

Deferred Costs

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

Related Parties

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

Newly Issued Accounting Standards

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

In February 2016, Accounting Standards Update No. 2016-02 (“ASU 2016-02”), Leases was issued. This guidance establishes a new model for accounting for leases and provides for enhanced disclosures. ASU 2016-02 is effective for reporting periods beginning after December 15, 2018. The Company is currently evaluating the impact the adoption of this guidance, if any, on its financial position and results of operations.

NOTE 2. REAL ESTATE ACTIVITY

Below is a summary of the real estate owned as of June 30, 2017 (dollars in thousands):

Apartments	$695,192
Apartments under construction	64,546
Commercial properties	220,801
Land held for development	79,442
Real estate subject to sales contract	48,366
Total real estate	$1,108,347
Less accumulated depreciation	(177,700)
Total real estate, net of depreciation	$930,647

The highlights of our significant real estate transactions for the six months ended June 30, 2017 are listed below:

Purchases

During the six months ended June 30, 2017, we acquired four land parcels for development for a total purchase price of $12.9 million, adding 34.56 acres to the development portfolio.

Sales

During the six months ended June 30, 2017, TCI recorded three land sales; selling a total of 10.82 acres of land located in Texas to independent third parties for a total sales price of $1.6 million. We recorded an aggregate loss of less than $0.1 million from the land sales.

As of June 30, 2017, the Company has approximately 91 acres of land, at various locations that were sold to related parties in multiple transactions. These transactions are treated as “subject to sales contract” on the Consolidated Balance Sheets. Due to the related party nature of the transactions TCI has deferred the recording of the sales in accordance with ASC 360-20.

We continue to invest in the development of multifamily properties. During the six months ended June 30, 2017, we have disbursed $24.4 million related to the construction or predevelopment of various apartment complexes and capitalized $0.9 million of interest costs.

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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 guarantees, unless noted otherwise, are so secured. Management intends to service and hold for investment the mortgage notes in our portfolio. A majority of the notes receivable provide for principal to be paid at maturity. Below is a summary of our notes receivable as of June 30, 2017 (dollars in thousands):

Borrower	Maturity Date	Interest Rate		Amount	Security
Performing loans:					
H198, LLC (Las Vegas Land)	01/20	12.00	%	$5,907	Secured
Leman Development, Ltd [2]	N/A	0.00	%	1,500	Unsecured
One Realco Corporation [1,2]	01 /17	3.00	%	7,000	Unsecured
Oulan-Chikh Family Trust	03 /21	8.00	%	174	Secured
Realty Advisors Management, Inc. [1]	12 /19	2.28	%	20,387	Unsecured
Unified Housing Foundation, Inc. (Echo Station) [1]	12 /32	12.00	%	1,480	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) [1]	12 /32	12.00	%	2,000	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) [1]	12 /32	12.00	%	9,100	Secured
Unified Housing Foundation, Inc. (Limestone Canyon) [1]	12 /32	12.00	%	4,640	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) [1]	12 /32	12.00	%	1,952	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) [1]	12 /32	12.00	%	6,000	Secured
Unified Housing Foundation, Inc. (Parkside Crossing) [1]	12 /32	12.00	%	1,935	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase I) [1]	12 /32	12.00	%	2,485	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase II) [1]	12 /32	12.00	%	2,555	Secured
Unified Housing Foundation, Inc. (Sendero Ridge) [1]	12 /32	12.00	%	4,812	Secured
Unified Housing Foundation, Inc. (Timbers of Terrell) [1]	12 /32	12.00	%	1,323	Secured
Unified Housing Foundation, Inc. (Tivoli) [1]	12 /32	12.00	%	7,966	Secured
Unified Housing Foundation, Inc. [1]	12 /17	12.00	%	1,207	Unsecured
Unified Housing Foundation, Inc. [1]	12 /18	12.00	%	3,994	Unsecured
Unified Housing Foundation, Inc. [1]	12 /18	12.00	%	6,407	Unsecured
Unified Housing Foundation, Inc. [1]	06 /19	12.00	%	5,400	Unsecured
Unified Housing Foundation, Inc. [1]	06 /20	12.00	%	5,760	Unsecured
Other related party notes	Various	Various		1,349	Various secured
Other related party notes	Various	Various		782	Various unsecur
Other non-related party notes	Various	Various		3,247	Various secured
Other non-related party notes	Various	Various		9,039	Various unsecur
Accrued interest				5,510	
Total Performing				$123,911	
Allowance for estimated losses				(17,037)	

Total	**$106,874**

(1) Related party notes.

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

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

At June 30, 2017, we had mortgage loans and accrued interest receivable from related parties, net of allowances, totaling $105.5 million. We recognized interest income of $9.9 million related to these notes receivables.

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

NOTE 4. INVESTMENT IN UNCONSOLIDATED INVESTEES

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

Investments in unconsolidated investees consist of the following:

	Percentage ownership as of June 30, 2017	June 30, 2016
Gruppa Florentina, LLC	20.00%	20.00%

Gruppa Florentina, LLC is the sole shareholder of Milano Restaurants International Corporation, ("Milano") which operates 33 pizza parlors under the trade name "Me-N-Ed's Pizza Parlors" and four pizza parlors operating under the trade name "Blast 825 Pizza", located primarily in Central and Northern California. Milano has a 100% ownership interest in Siena Corp, which operates two grills under the trade names "Me-N-Ed's Victory Grill" and "Me-N-Ed's Coney Island Grill". Milano has a 100% ownership interest in Piazza del Pane, Inc., which operates two restaurants located in Central California. Milano also has 23 franchised locations, including two operating, under the trade name Angelo & Vito's Pizzerias.

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

As of June 30,	2017	2016
Real estate, net of accumulated depreciation	$13,578	$13,692
Notes receivable	9,969	8,858
Other assets	30,188	30,655
Notes payable	(9,514)	(10,648)
Other liabilities	(7,821)	(7,304)
Shareholders' equity	(36,400)	(35,253)

For the Six Months Ended June 30,	2017	2016
Revenue	$27,458	$27,321

Depreciation	(575)	(575)
Operating expenses	(25,533)	(24,841)
Interest expense	(353)	(405)
Income from continuing operations	997	1,500
Income from discontinued operations	—	—
Net income	$997	$1,500
Company’s proportionate share of earnings	$199	$300

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NOTE 5. NOTES PAYABLE

Below is a summary of our notes and interest payable as of June 30, 2017 (dollars in thousands):

	Notes Payable	Accrued Interest	Total Debt
Apartments	$539,556	$ 1,459	$541,015
Apartments under Construction	32,564	—	32,564
Commercial	127,542	599	128,141
Land	29,200	229	29,429
Real estate subject to sales contract	3,542	470	4,012
Mezzanine financing	101,173	—	101,173
Other	12,909	(2)	12,907
Total	$846,486	$ 2,755	$849,241
Unamortized deferred borrowing costs	(18,544)	—	(18,544)
Total	$827,942	$ 2,755	$830,697

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

There are various land mortgages, secured by the property, that are in the process of a modification or extension to the original note due to expiration of the loan. We are in constant contact with these lenders, working together in order to modify the terms of these loans and we anticipate a timely resolution that is similar to the existing agreement or subsequent modification During the six months ended June 30, 2017, we refinanced three loans with a total principal balance of $80.1 million. The transactions provided for lower monthly payments over the term of the loans due to lower interest rates and the extension of maturity dates of the loans.

In conjunction with the development of various apartment projects and other developments, we drew down $13.7 million in construction loans during the six months ended June 30, 2017.

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. SERIES A BONDS PAYABLE

On February 13, 2017, Southern Properties Capital LTD, a British Virgin Islands corporation ("Southern"), filed a final prospectus with the Tel Aviv Stock Exchange LTD (the "TASE") for an offering and sale of nonconvertible Series A Bonds (the "Debentures"), to be issued by Southern, which is an indirect subsidiary of TCI. Southern, in turn, wholly owns interest in other entities, which, in turn, are the principal owners of various residential and commercial properties located in the south and southwestern portions of the United States. The Debentures are unsecured obligations of Southern. On February 14, 2017, Southern commenced the institutional tender of the Debentures and accepted application for 276 million Israeli, new Shekels (approximately $73,651,065 USD, based on the exchange rate of 3.7474 Shekels to the U.S. Dollar effective February 14, 2017) in both institutional and public tenders, at an annual interest rate averaging approximately 7.38%. The Series A Bonds have a stated interest rate of 7.3% and an effective yield of 9.25%.

On May 16, 2017, Southern issued nonconvertible Series A Bonds for 100.2 million Israeli, new Shekels (approximately $27,769,615 USD, based on the exchange rate of 3.607 Shekels to the U.S. Dollar) at an annual interest rate of 7.3%.

On July 12, 2017, Southern sold nonconvertible Series A Bonds for 23.8 million Israeli, new Shekels (approximately $6,668,998 USD, based on the exchange rate of 3.574 Shekels to the U.S. Dollar) in both institutional and public tenders, at an annual interest rate averaging approximately 7.3%.

Foreign Currency Gain or Loss

Principal and interest will be paid in Israeli Shekels as the bonds mature. Interest payments are due semiannually beginning in July 2017 through July 2023 with ten semiannual principal payments due beginning July 2019 through July 2023. Until such actual payments are made, there will not be any significant need to convert US dollars to Israeli shekels.

The Company records unrealized gains or losses each quarter based upon the relative exchange values of the US dollar and the Israeli shekel; however, no gain or loss will be realized until a conversion from US dollars to Israeli shekels actually occurs in the future. The recorded unrealized gain or loss is reflected as a separate line item to highlight the fact that it is a non-cash transaction until such time as actual payment of principal and interest on the bonds is made. During the six months ended June 30, 2017, the Company recorded a net loss on foreign currency transaction of $3.7 million.

NOTE 7. RELATED PARTY TRANSACTIONS

The following table reflects the reconciliation of the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of June 30, 2017 (dollars in thousands):

	Pillar
Related party receivable, December 31, 2016	$24,672
Cash transfers	37,397
Advisory fees	(5,507)
Net income fee	(137)
Cost reimbursements	(1,205)
Interest income	431
Notes receivable purchased	(447)
Fees and commissions	(1,147)
Expenses paid by Advisor	(2,860)
Financing (mortgage payments)	(17,161)
Sales/purchases transactions	(3,123)
Tax sharing	—
Purchase of obligations	—
Related party receivable, June 30, 2017	$30,913

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

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

Presented below is our reportable segments' operating income for the three months ended June 30, 2017 and 2016, including segment assets and expenditures (dollars in thousands):

For the Three Months Ended June 30, 2017	Commercial Properties	Apartments	Land	Other	Total
Rental and other property revenues	$ 8,553	$ 23,030	$—	$4	$31,587
Property operating expenses	(4,900)	(10,211)	(168)	(150)	(15,429)
Depreciation	(2,397)	(4,030)	—	18	(6,409)
Mortgage and loan interest	(2,121)	(5,028)	(389)	(9,809)	(17,347)
Interest income	—	—	—	5,059	5,059
Loss on land sales	—	—	(476)	—	(476)
Segment operating income (loss)	$ (865)	$ 3,761	$(1,033)	$(4,878)	$(3,015)
<u>Balance Sheet Data</u>					
Capital expenditures	$ 557	$ —	$186	$—	$743
Real estate assets	$ 148,718	$ 654,119	$127,810	$—	$930,647
<u>Property Sales</u>					
Sales price	$ —	$ —	$507	$—	$507
Cost of sale	—	—	(983)	—	(983)

Loss on sale	$ —	$ —	$ (476)	$—	$ (476)

For the Three Months Ended June 30, 2016	Properties	Apartments	Land	Other	Total
Rental and other property revenues	$ 8,947	$ 21,856	$ 30	$ 1	$ 30,834
Property operating expenses	(4,836)	(10,168)	(169)	(18)	(15,191)
Depreciation	(2,270)	(3,616)	—	18	(5,868)
Mortgage and loan interest	(1,696)	(6,109)	(841)	(5,329)	(13,975)
Loan charges and prepayment penalties	—	—	—	—	—
Interest income	—	—	—	4,788	4,788
Gain on sale of income producing properties	6	5,162	—	—	5,168
Gain on land sales	—	—	1,719	—	1,719
Segment operating income (loss)	$ 151	$ 7,125	$ 739	$ (540)	$ 7,475
<u>Balance Sheet Data</u>					
Capital expenditures	$ 680	$ (146)	$ 727	$—	$ 1,261
Real estate assets	$ 151,759	$ 603,829	$ 145,816	$—	$ 901,404
<u>Property Sales</u>					
Sales price	$—	$ 8,100	$ 3,154	$—	$ 11,254
Cost of sale	—	(2,932)	(1,435)	—	(4,367)
Gain on sale	$—	$ 5,168	$ 1,719	$—	$ 6,887

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The table below reflects the reconciliation of segment information to the corresponding amounts in the Consolidated Statements of Operations for the three months ended June 30, 2017 and 2016 (dollars in thousands):

	2017	2016
Segment operating income	$ (3,015)	$ 7,475
Other non-segment items of income (expense)		
General and administrative	(1,995)	(2,412)
Net income fee to related party	(77)	(54)
Advisory fee to related party	(2,849)	(2,687)
Other income	(3,541)	902
Earnings from unconsolidated investees	153	129
Net income (loss) from continuing operations	$ (11,324)	$ 3,353

Presented below is our reportable segments' operating income for the six months ended June 30, 2017 and 2016, including segment assets and expenditures (dollars in thousands):

For the Six Months Ended June 30, 2017	Commercial Properties	Apartments	Land	Other	Total
Rental and other property revenues	$ 17,711	$ 45,691	$ —	$ 7	$ 63,409
Property operating expenses	(9,839)	(20,956)	(447)	(451)	(31,693)
Depreciation	(4,699)	(8,076)	—	36	(12,739)
Mortgage and loan interest	(3,727)	(11,787)	(1,083)	(17,546)	(34,143)
Interest income	—	—	—	9,852	9,852
Loss on land sales	—	—	(31)	—	(31)
Segment operating income (loss)	$ (554)	$ 4,872	$ (1,561)	$ (8,102)	$ (5,345)
Balance Sheet Data					
Capital expenditures	$ 1,932	$ 585	$ —	$ —	$ 2,517
Real estate assets	$ 148,718	$ 654,119	$ 127,810	$ —	$ 930,647
Property Sales					
Sales price	$ —	$ —	$ 1,596	$ —	$ 1,596
Cost of sale	—	—	(1,627)	—	(1,627)
Loss on sale	$ —	$ —	$ (31)	$ —	$ (31)

For the Six Months Ended June 30, 2016	Commercial Properties	Apartments	Land	Other	Total
Rental and other property revenues	$ 16,838	$ 43,170	$ 30	$ 1	$ 60,039
Property operating expenses	(9,931)	(19,562)	(916)	2	(30,407)
Depreciation	(4,584)	(7,151)	—	37	(11,698)
Mortgage and loan interest	(3,671)	(12,265)	(1,153)	(11,100)	(28,189)
Interest income	—	—	—	10,079	10,079

Gain on sale of income producing properties	6	4,919	—	—	4,925
Gain on land sales	—	—	3,370	—	3,370
Segment operating income (loss)	$ (1,342)	$ 9,111	$ 1,331	$ (981)	$ 8,119
Balance Sheet Data					
Capital expenditures	$ 2,080	$ (146)	$ 1,498	$ —	$