

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 March 31, 2019

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-15663

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

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

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

(469) 522-4200

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)  Yes  No.

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  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.

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

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

15,997,076  
(Outstanding at May 13, 2019)

**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**

	<b>March 31, 2019</b>	<b>December 31, 2018</b>
	(unaudited)	(audited)
	(dollars in thousands, except share and par value)	
<b>Assets</b>		
Real estate, at cost	\$ 449,007	\$ 455,993
Real estate subject to sales contracts at cost	3,488	3,149
Real estate held for sale at cost, net of depreciation	14,737	-
Less accumulated depreciation	(80,755)	(78,099)
Total real estate	386,477	381,043
Notes and interest receivable (including \$102,031 in 2019 and \$105,803 in 2018 from related parties)	138,731	140,327
Less allowance for estimated losses (including \$14,269 in 2019 and 2018 from related parties)	(14,269)	(14,269)
Total notes and interest receivable	124,462	126,058
Cash and cash equivalents	28,163	36,428
Restricted cash	52,964	70,187
Investment in VAA	67,229	68,399
Investment in other unconsolidated investees	7,660	7,602
Receivable from related party	78,348	70,377
Other assets	69,510	66,055
Total assets	\$ 814,813	\$ 826,149
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
Notes and interest payable	\$ 293,473	\$ 286,968
Bond and interest payable	151,465	158,574
Deferred revenue (including \$30,359 in 2019 and \$33,904 in 2018 to related parties)	30,359	33,904
Accounts payable and other liabilities (including \$10,212 in 2019 and \$9,984 in 2018 to related parties)	24,938	25,576
Total liabilities	500,235	505,022
<b>Shareholders' equity:</b>		
Preferred stock, Series A: \$2.00 par value, authorized 15,000,000 shares, issued 1,800,614 and outstanding 614 in 2019 and 2018 (liquidation preference \$10 per share), including 1,800,000 shares held by ARL and its subsidiaries in 2019 and 2018.	5	5
Common stock, \$0.01 par value, 100,000,000 shares authorized; 16,412,861 shares issued and 15,997,076 outstanding as of 2019 and 2018, including 140,000 shares held by TCI (consolidated) in 2019 and 2018.	164	164
Treasury stock at cost; 415,785 shares in 2019 and 2018, and 140,000 shares held by TCI (consolidated) as of 2019 and 2018.	(6,395)	(6,395)
Paid-in capital	84,818	84,885
Retained earnings	173,519	179,666
Total American Realty Investors, Inc. shareholders' equity	252,111	258,325
Non-controlling interest	62,467	62,802
Total shareholders' equity	314,578	321,127
Total liabilities and shareholders' equity	\$ 814,813	\$ 826,149

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

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

	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Revenues:</b>		
Rental and other property revenues (including \$113 and \$208 for the three months ended 2019 and 2018, respectively, from related parties)	\$ 11,929	\$ 31,083
<b>Expenses:</b>		
Property operating expenses (including \$257 and \$227 for the three months ended 2019 and 2018, respectively, from related parties)	5,997	14,424
Depreciation and amortization	3,109	6,391
General and administrative (including \$1,597 and \$1,140 for the three months ended 2019 and 2018, respectively, from related parties)	2,605	2,341
Net income fee to related party	100	53
Advisory fee to related party	1,853	2,956
Total operating expenses	<u>13,664</u>	<u>26,165</u>
Net operating (loss) income	(1,735)	4,918
<b>Other income (expenses):</b>		
Interest income (including \$5,881 and \$4,426 for the three months ended 2019 and 2018, respectively, from related parties)	6,153	5,109
Other income	3,667	1,901
Mortgage and loan interest (including \$2,307 and \$1,799 for the three months ended 2019 and 2018, respectively, from related parties)	(9,968)	(15,724)
Foreign currency transaction (loss) gain	(5,818)	1,756
Equity loss from VAA	(1,055)	-
Earnings from unconsolidated subsidiaries and investees	58	320
Total other expenses	<u>(6,963)</u>	<u>(6,638)</u>
Loss before gain on land sales, non-controlling interest, and taxes	(8,698)	(1,720)
Gain on land sales	2,216	1,335
Net loss from continuing operations before taxes	<u>(6,482)</u>	<u>(385)</u>
Net loss from continuing operations	(6,482)	(385)
Net loss	(6,482)	(385)
Net loss (income) attributable to non-controlling interest	335	(275)
Net loss attributable to American Realty Investors, Inc.	(6,147)	(660)
Preferred dividend requirement	-	(225)
Net loss applicable to common shares	<u>\$ (6,147)</u>	<u>\$ (885)</u>
<b>Earnings per share - basic</b>		
Net loss from continuing operations	\$ (0.38)	\$ (0.06)
<b>Earnings per share - diluted</b>		
Net loss from continuing operations	\$ (0.38)	\$ (0.06)
Weighted average common shares used in computing earnings per share	15,997,076	15,938,077
Weighted average common shares used in computing diluted earnings per share	15,997,076	15,938,077
<b>Amounts attributable to American Realty Investors, Inc.</b>		
Net loss from continuing operations	\$ (6,147)	\$ (660)
Net loss applicable to American Realty Investors, Inc.	<u>\$ (6,147)</u>	<u>\$ (660)</u>

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

**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**For the Three Months Ended March 31, 2019 and 2018**  
**(unaudited, dollars in thousands, except share amounts)**

	Total Equity	Comprehensive Income (Loss)	Preferred Stock	Common Stock		Treasury Stock	Paid-in Capital	Retained Earnings	Non- Interest
				Shares	Amount				
<b>Balance, December 31, 2018</b>	\$ 321,127	\$ 106,086	\$ 5	16,412,861	\$ 164	\$ (6,395)	\$ 84,885	\$ 179,666	\$ 62,802
Net loss	(6,482)	(6,147)	-	-	-	-	-	(6,147)	(335)
Distribution to equity partner	(67)	-	-	-	-	-	(67)	-	-
<b>Balance, March 31, 2019</b>	<b>\$ 314,578</b>	<b>\$ 99,939</b>	<b>\$ 5</b>	<b>16,412,861</b>	<b>\$ 164</b>	<b>\$ (6,395)</b>	<b>\$ 84,818</b>	<b>\$ 173,519</b>	<b>\$ 62,467</b>

	Total Equity	Comprehensive Income (Loss)	Preferred Stock	Common Stock		Treasury Stock	Paid-in Capital	Retained Earnings	Non- controlling Interest
				Shares	Amount				
<b>Balance, December 31, 2017</b>	\$ 165,883	\$ (67,613)	\$ 2,205	15,930,145	\$ 159	\$ (6,395)	\$ 110,138	\$ 5,967	\$ 53,809
Net loss	(385)	(660)	-	-	-	-	-	(660)	275
Series A preferred stock dividend (\$1.00 per share)	(225)	-	-	-	-	-	(225)	-	-
<b>Balance, March 31, 2018</b>	<b>\$ 165,273</b>	<b>\$ (68,273)</b>	<b>\$ 2,205</b>	<b>15,930,145</b>	<b>\$ 159</b>	<b>\$ (6,395)</b>	<b>\$ 109,913</b>	<b>\$ 5,307</b>	<b>\$ 54,084</b>

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

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

	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(dollars in thousands)</b>	
Net loss	\$ (6,482)	\$ (385)
Total comprehensive loss	(6,482)	(385)
Comprehensive loss (income) attributable to non-controlling interest	335	(275)
Comprehensive loss attributable to American Realty Investors, Inc.	\$ (6,147)	\$ (660)

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

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

	<b>For the Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(dollars in thousands)</b>	
<b>Cash Flow From Operating Activities:</b>		
Net loss	\$ (6,482)	\$ (385)
Adjustments to reconcile net income (loss) applicable to common shares to net cash provided by (used in) operating activities:		
Foreign currency transaction loss (gain)	5,818	(1,756)
Gain on sale of land	(2,216)	(1,335)
Depreciation and amortization	3,109	6,391
Amortization of deferred borrowing costs	339	983
Amortization of bond issuance costs	592	299
Loss from joint venture	1,055	-
(Earnings) from unconsolidated subsidiaries and investees	(58)	(320)
(Increase) decrease in assets:		
Accrued interest receivable	1,726	842
Other assets	4,822	(1,468)
Prepaid expense	(5,340)	7,365
Rent receivables	(3,275)	259
Related party receivables	(7,971)	(7,621)
Increase (decrease) in liabilities:		
Accrued interest payable	(5,466)	(2,796)
Other liabilities	<u>(3,102)</u>	<u>3,047</u>
Net cash (used in) provided by operating activities	<u>(16,449)</u>	<u>3,505</u>
<b>Cash Flow From Investing Activities:</b>		
Proceeds from notes receivables	255	-
Origination of notes receivables	(385)	(11,118)
Acquisition of land held for development	(2,479)	-
Proceeds from sale of income producing properties	-	2,128
Proceeds from sale of land	8,715	3,649
Improvement of income producing properties	(3,699)	(633)
Construction and development of new properties	<u>(7,838)</u>	<u>(20,117)</u>
Net cash (used in) investing activities	<u>(5,431)</u>	<u>(26,091)</u>
<b>Cash Flow From Financing Activities:</b>		
Proceeds from bonds	-	39,399
Bond payments	(10,378)	-
Bond issuance costs	-	(2,022)
Proceeds from notes payable	8,019	17,343
Recurring payment of principal on notes payable	(1,182)	(7,415)
Payments on maturing notes payable	-	(16,750)
Distributions to equity partner	(67)	-
Preferred stock dividends - Series A	-	(225)
Net cash (used in) provided by financing activities	<u>(3,608)</u>	<u>30,330</u>
Net increase in cash and cash equivalents	(25,488)	7,744
Cash and cash equivalents, beginning of period	<u>106,615</u>	<u>88,538</u>
Cash and cash equivalents, end of period	<u>\$ 81,127</u>	<u>\$ 96,282</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	<u>\$ 10,887</u>	<u>\$ 13,375</u>
<b>Schedule of noncash investing and financing activities:</b>		
Notes receivable received from sale of income-producing properties	\$ -	\$ 6,384

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 81.25% 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 NYSE American 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.

Southern Properties Capital Ltd. a British Virgin Island corporation (“Southern” or “SPC”), is a wholly owned subsidiary of TCI that was incorporated on August 16, 2016 for the purpose of raising funds by issuing debentures that cannot be converted into shares on the Tel-Aviv Stock Exchange (“TASE”). Southern operates in the United States and is primarily involved in investing in, developing, constructing and operating income-producing properties of multi-family residential real estate assets. Southern is included in the consolidated financial statements of TCI.

On January 1, 2012, the Company’s subsidiary, TCI, entered into a development agreement with Unified Housing Foundation, Inc. (“UHF”) a non-profit corporation that provides management services for the development of residential apartment projects in the future. This development agreement was terminated December 31, 2013. The Company has also invested in surplus cash notes receivables from UHF and has sold several residential apartment properties to UHF in prior years. Due to this ongoing relationship and the significant investment in the performance of the collateral secured under the notes receivable, UHF has been determined to be a related party.

On November 19, 2018, TCI executed an agreement between the Macquarie Group (“Macquarie”) and SPC and TCI to create a joint venture, Victory Abode Apartments, LLC (“VAA”) to address existing and future demand for quality multifamily residential housing through acquisition and development of sustainable Class A multifamily housing in focused secondary and tertiary markets. In connection with the formation of the joint venture, SPC and TCI contributed a portfolio of 49 income producing apartment complexes, and 3 development projects in various stages of construction and received cash consideration of \$236.8 million. At the time of the transfer of the properties, the joint venture

assumed all liabilities of those properties, including mortgage debt to the Department of Housing and Urban Development (“HUD”).

VAA is equally owned and controlled by Abode JVP, LLC, a wholly-owned subsidiary of SPC and Summerset Intermediate Holdings 2 LLC (“Summerset”), a wholly-owned indirect subsidiary of Macquarie. Pursuant to the Agreement, Abode JVP, LLC and Summerset each own voting and profit participation rights of 50% and 49%, respectively (“Class A Members”). The remaining 2% of the profit participation interest is held by Daniel J. Moos ARL’s President and Chief Executive Officer (“Class B Member”) who also serves as the Manager of the joint venture.

## **Properties**

At March 31, 2019, our income-producing properties consisted of:

- Seven commercial properties consisting of five office buildings and two retail properties comprising in aggregate of approximately 1.7 million square feet;
- Nine residential apartment communities owned directly by us comprising 1,489 units, excluding apartments being developed;
- Approximately 2,324 acres of developed and undeveloped land; and
- Fifty-one residential apartment communities totaling 9,786 units owned by our 50% owned investee VAA.

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. 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 three months ended March 31, 2019, 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, 2018 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, 2018. Certain 2018 Consolidated Financial Statement amounts have been reclassified to conform to the 2019 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 investments in Gruppa Fiorentina, LLC and VAA are 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.

## **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 February 2016, FASB issued ASU 2016-02 (“ASU 2016-02”), Leases. 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 adoption of ASU 2016-02 did not have a material impact on the Company’s financial position and results of operations.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* that eliminates, adds and modifies certain disclosure requirements for fair value measurements. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2019. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively. All other amendments should be applied retrospectively. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of ASU 2018-13 may have on its consolidated financial statements.

## NOTE 2. INVESTMENT IN VAA

On November 19, 2018, TCI executed an agreement with Macquarie Group (“Macquarie”) to create a joint venture, Victory Abode Apartments, LLC (“VAA”) to address existing and future demand for quality multifamily residential housing through acquisition and development of sustainable Class A multifamily housing in focused secondary and tertiary markets.

The Company accounts for its investment in VAA under the equity method of accounting. Under the equity method of accounting, our net equity in the investment is reflected within the Consolidated Balance Sheets in the caption ‘Investment in VAA’, and our share of the net income or loss from the joint venture is included within the Consolidated Statements of Operations in the caption ‘Equity earnings from VAA’. The joint venture agreements may designate different percentage allocations among investors for profits and losses; however, our recognition of joint venture income or loss generally follows the joint venture’s distribution priorities, which may change upon the achievement of certain investment return thresholds and other agreed upon adjustments.

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

	<b>March 31, 2019</b>
<b>Balance Sheet</b>	
Net real estate assets	\$ 1,257,557
Other assets	67,020
Debt, net	(796,065)
Other liabilities	(275,448)
Total equity	<u>(253,064)</u>
	<b>For the Three Months Ended March 31, 2019</b>
<b>Results of Operations</b>	
Total revenue	\$ 27,401
Total property, operating, and maintenance expenses	(14,169)
Interest expense	(15,070)
Depreciation and Amortization	(15,233)
Total other expense	<u>(675)</u>
Net loss	<u>\$ (17,746)</u>

Below is a reconciliation of our allocation of income or loss from VAA.

	<b>For the Three Months Ended March 31, 2019</b>
VAA net loss	\$ (17,746)
<i>Adjustments to reconcile to income (loss) from VAA</i>	
Interest expense on mezzanine loan	6,089
In-place lease intangibles - amortization expense	8,336
Depreciation basis differences	1,211
<b>Net loss</b>	<b>\$ (2,110)</b>
Percentage ownership in VAA	50%
Loss from VAA	\$ (1,055)

### NOTE 3. REAL ESTATE ACTIVITY

Below is a summary of the real estate owned as of March 31, 2019 (dollars in thousands):

Apartments	\$ 111,537
Apartments under construction	35,608
Commercial properties	227,861
Land held for development	74,001
Real estate subject to sales contract	3,488
Real estate subject to sales contract	14,737
Total real estate, at cost, less impairment	\$ 467,232
Less accumulated depreciation	(80,755)
<b>Total real estate, net of depreciation</b>	<b>\$ 386,477</b>

The following is a description of our significant real estate and financing transactions for the three months ended March 31, 2019:

We sold 76 land parcels (or 11.96 acres of land) from our Mercer Crossing land holdings in Farmers Branch, Texas and 10.33 acres of land, located in Dallas, Texas to third parties for an aggregate sales price of \$8.7 million and recognized a gain on the sale of approximately \$2.2 million.

We purchased from a third party 8.94 acres of land located in Collin County, Texas for a total purchase price of \$2.5 million. In addition, purchased an option to buy 37.8 acres of land (6.3 acres located in Collin County, Texas and 31.5 acres located in Clark County, Nevada) for \$2.0 million from a third party land developer.

We entered into a purchase and sale agreement with a third party for the sale of Vista Ridge Apartments, located in Lee County, Mississippi. This asset is classified as 'held for sale' for the period ended March 31, 2019.

We continue to invest in the development of apartment projects. During the three months ended March 31, 2019, we have invested \$7.6 million related to the construction or predevelopment of various apartment complexes and capitalized \$0.2 million of interest costs.

#### NOTE 4. SUPPLEMENTAL CASH FLOW INFORMATION

For the three months ended March 31, 2019 and 2018, the Company paid interest expense of \$10.9 million and \$13.4 million, respectively.

Cash and cash equivalents, and restricted cash for the three months ended March 31, 2019 and 2018 was \$81.1 million and \$96.3 million, respectively. The following is a reconciliation of the Company's cash and cash equivalents, and restricted cash to the total presented in the consolidated statement of cash flows.

	<b>March 31,</b>	
	<b>2019</b>	<b>2018</b>
Cash and cash equivalents	\$ 28,163	\$ 40,899
Restricted cash (cash held in escrow)	34,690	38,784
Restricted cash (certificate of deposits)	11,876	10,652
Restricted cash (held with Trustee)	6,398	5,947
	<u>\$ 81,127</u>	<u>\$ 96,282</u>

Amounts included in restricted cash represent funds set aside to meet contractual obligations with certain financial institutions for the payment of reserve replacement deposits and tax and insurance escrow. In addition, restricted cash includes funds to the Bond's Trustee for payment of principal and interests.

## NOTE 5. 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 March 31, 2019 (dollars in thousands):

Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
H198, LLC (Las Vegas Land)	01/20	12.00%	5,907	Secured
H198, LLC (Legacy at Pleasant Grove Land)	10/19	12.00%	496	Secured
Oulan-Chikh Family Trust	03/21	8.00%	174	Secured
H198, LLC (McKinney Ranch Land)	09/20	6.00%	4,554	Secured
Forest Pines	09/19	5.00%	2,230	Secured
Spyglass Apartments of Ennis, LP	11/19	5.00%	5,141	Secured
Bellwether Ridge	05/20	5.00%	3,540	Secured
Parc at Windmill Farms	05/20	5.00%	6,202	Secured
Unified Housing Foundation, Inc. (Echo Station) <sup>(1)</sup>	12/32	12.00%	1,481	Secured
Unified Housing Foundation, Inc. (Inwood on the Park) <sup>(1)</sup>	12/32	12.00%	3,639	Secured
Unified Housing Foundation, Inc. (Kensington Park) <sup>(1)</sup>	12/32	12.00%	3,933	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) <sup>(1)</sup>	12/32	12.00%	2,000	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) <sup>(1)</sup>	12/32	12.00%	6,369	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) <sup>(1)</sup>	12/32	12.00%	2,732	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) <sup>(1)</sup>	12/32	12.00%	1,953	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) <sup>(1)</sup>	12/32	12.00%	2,000	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) <sup>(1)</sup>	12/32	12.00%	4,000	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase I) <sup>(1)</sup>	12/32	12.00%	2,485	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase II) <sup>(1)</sup>	12/32	12.00%	2,555	Secured
Unified Housing Foundation, Inc. (Timbers of Terrell) <sup>(1)</sup>	12/32	12.00%	1,323	Secured
Unified Housing Foundation, Inc. (Tivoli) <sup>(1)</sup>	12/32	12.00%	6,140	Secured
Unified Housing Foundation, Inc. (Trails at White Rock) <sup>(1)</sup>	12/32	12.00%	3,815	Secured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12/19	12.00%	10,401	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	06/20	12.00%	11,075	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12/32	12.00%	1,349	Unsecured
Realty Advisors Management, Inc. <sup>(1)</sup>	12/24	2.28%	20,387	Unsecured
One Realco Corporation	01/20	3.00%	7,000	Unsecured
Other related party notes <sup>(1) (2)</sup>	Various	Various	2,363	Various secured interests
Other non-related party notes	Various	Various	1,377	Various secured interests
Other non-related party notes	Various	Various	2,671	Various unsecured interests
Accrued interest			9,439	
<b>Total Performing</b>			\$ 138,731	
Allowance for estimated losses			(14,269)	
<b>Total</b>			<b>\$ 124,462</b>	

<sup>(1)</sup> Related party notes.

<sup>(2)</sup> 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 March 31, 2019, we had mortgage loans and accrued interest receivable from related parties, net of allowances, totaling \$114.3 million. We recognized interest income of \$2.5 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 6. INVESTMENT IN UNCONSOLIDATED INVESTEES

The summary data presented below includes our investments accounted for under the equity method, except for our investment in VAA which is discussed in detail in Note 2 'Investment in VAA'.

The Company owns a 20% interest in Grappa Fiorentina, LLC which 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 as of March 31, 2019 and March 31, 2018 from our investees (dollars in thousands):

	<u>March 31,</u> <u>2019</u>	<u>March 31,</u> <u>2018</u>
<b>SUMMARY OF FINANCIAL POSITION:</b>		
Real estate, net of accumulated depreciation	\$ 13,530	\$ 13,810
Notes receivable	11,508	11,238
Other assets	31,381	32,566
Notes payable	(9,853)	(11,287)
Other liabilities	(6,584)	(7,320)
Shareholders' equity/partners capital	<u>(39,982)</u>	<u>(39,007)</u>
	<u>For the three months ended March 31,</u>	<u>For the three months ended March 31,</u>
<b>SUMMARY OF OPERATIONS:</b>	<u>2019</u>	<u>2018</u>
Revenue	\$ 13,626	\$ 13,144
Depreciation	(364)	(364)
Operating expenses	(12,815)	(11,991)
Interest expense	(156)	(161)
Income from continuing operations	<u>291</u>	<u>628</u>
Net income	<u>\$ 291</u>	<u>\$ 628</u>
Company's 20% proportionate share of earnings	<u>\$ 58</u>	<u>\$ 126</u>

## NOTE 7. NOTES AND INTEREST PAYABLE

Below is a summary of our notes and interest payable as of March 31, 2019 (dollars in thousands):

	<b>Notes Payable</b>	<b>Accrued Interest</b>	<b>Total</b>
Apartments	\$ 94,368	\$ 269	\$ 94,637
Apartments under Construction	21,919	-	21,919
Commercial	136,126	670	136,796
Land	26,930	180	27,110
Corporate and other notes	22,027	73	22,100
<b>Total</b>	<b>\$ 301,370</b>	<b>\$ 1,192</b>	<b>\$ 302,562</b>
Unamortized deferred borrowing costs	(9,089)	-	(9,089)
	<b>\$ 292,281</b>	<b>\$ 1,192</b>	<b>\$ 293,473</b>

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

In conjunction with the development of various apartment projects and other developments, we drew down \$7.5 million in construction loans during the three months ended March 31, 2019.

## NOTE 8. BONDS AND BONDS INTEREST PAYABLE

Following is the outstanding balance of SPC's Bonds and interest payable as of March 31, 2019 and December 31, 2018 (dollars in thousands):

	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Bonds (Series A)	\$ 99,376	\$ 106,686
Bonds (Series B)	37,913	36,740
Bonds (Series B expansion)	19,906	19,290
<b>Total outstanding bonds</b>	<b>157,195</b>	<b>162,716</b>
Less: deferred bond issuance costs	(7,587)	(8,179)
<b>Total outstanding bonds, net</b>	<b>149,608</b>	<b>154,537</b>
Accrued Interest	1,857	4,037
<b>Total outstanding bonds, net and accrued interest</b>	<b>\$ 151,465</b>	<b>\$ 158,574</b>

The aggregate maturity of the bonds are as follows:

Year	March 31, 2019	December 31, 2018
2019	\$ 11,024	\$ 22,049
2020	22,049	22,049
2021	33,629	33,629
2022	33,629	33,629
2023	30,070	30,070
Thereafter	26,794	21,290
	<b>\$ 157,195</b>	<b>\$ 162,716</b>

On January 31, 2019, the Company paid \$10.4 million and \$5.8 million on bond principal and interests, respectively, and recognized a loss on foreign currency exchange rate of \$5.8 million.

#### **NOTE 9. DEFERRED INCOME**

In previous years, the Company has sold properties to related parties where we have had continuing involvement in the form of management or financial assistance associated with the sale of the properties. Because of the continuing involvement associated with the sale, the sales criteria for the full accrual method is not met, and as such the Company has deferred some or all of the gain recognition and accounted for the sale by applying the finance, deposit, installment or cost recovery methods, as appropriate, until the sales criteria is met. The gain on these transactions have been deferred until the properties are sold to a non-related third party. As of March 31, 2019, we had deferred gain of \$30.4 million.

For the quarter ended March 31, 2019, the Company recognized, from the proportionate share of the remaining deferred income, \$3.6 million as gain on sale, as a result of the sale of land to third parties.

#### **NOTE 10. RELATED PARTY TRANSACTIONS**

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.

The following table reflects the reconciliation of the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of March 31, 2019 (dollars in thousands):

	<b>Pillar</b>
Related party receivable, December 31, 2018	\$ 70,377
Cash transfers	10,682
Advisory fees	(1,853)
Net income fee	(100)
Cost reimbursements	(1,551)
Interest income	1,414
Expenses (paid) received by Advisor	(289)
Financing (mortgage payments)	(74)
Income tax expense	(258)
Related party receivable, March 31, 2019	\$ 78,348

## NOTE 11. 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 March 31, 2019 and 2018, including segment assets and expenditures (dollars in thousands):

<b>For the Three Months Ended March 31, 2019</b>	<b>Properties</b>	<b>Apartments</b>	<b>Land</b>	<b>Other</b>	<b>Total</b>
Rental and other property revenues	\$ 8,227	\$ 3,700	\$ -	\$ 2	\$ 11,929
Property operating expenses	(3,936)	(2,058)	43	(46)	(5,997)
Depreciation	(2,375)	(734)	-	-	(3,109)
Mortgage and loan interest	(1,967)	(934)	(329)	(6,738)	(9,968)
Interest income	-	-	-	6,153	6,153
Gain on land sales	-	-	2,216	-	2,216
Segment operating (loss) income	<u>\$ (51)</u>	<u>\$ (26)</u>	<u>\$ 1,930</u>	<u>\$ (629)</u>	<u>\$ 1,224</u>
Capital expenditures	3,690	-	5,167	-	8,857
Real estate assets	154,791	150,841	80,845	-	386,477
<b>Property Sales</b>					
Sales price	\$ -	\$ -	\$ 8,715	\$ -	\$ 8,715
Cost of sale	-	-	(6,499)	-	(6,499)
Gain on sale	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,216</u>	<u>\$ -</u>	<u>\$ 2,216</u>
<b>For the Three Months Ended March 31, 2018</b>					
	<b>Commercial Properties</b>	<b>Apartments</b>	<b>Land</b>	<b>Other</b>	<b>Total</b>
Rental and other property revenues	\$ 7,555	\$ 23,525	\$ 1	\$ 2	\$ 31,083
Property operating expenses	(3,749)	(10,582)	-	(93)	(14,424)
Depreciation	(2,292)	(4,149)	-	50	(6,391)
Mortgage and loan interest	(1,849)	(5,456)	(195)	(8,224)	(15,724)
Interest income	-	-	-	5,109	5,109
Gain on land sales	-	-	1,335	-	1,335
Segment operating (loss) income	<u>\$ (335)</u>	<u>\$ 3,338</u>	<u>\$ 1,141</u>	<u>\$ (3,156)</u>	<u>\$ 988</u>
Capital expenditures	633	-	-	-	633
Real estate assets	135,799	726,244	116,436	651	979,130
<b>Property Sales</b>					
Sales price	\$ -	\$ 8,512	\$ 7,239	\$ -	\$ 15,751
Cost of sale	-	(8,512)	(5,904)	-	(14,416)
Gain on sale	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,335</u>	<u>\$ -</u>	<u>\$ 1,335</u>

The table below reflects the reconciliation of segment information to the corresponding amounts in the Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018 (dollars in thousands):

	<b>For the Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Segment operating income	\$ 1,224	\$ 988
Other non-segment items of income (expense)		
General and administrative	(2,605)	(2,341)
Net income fee to related party	(100)	(53)
Advisory fee to related party	(1,853)	(2,956)
Other income	(2,151)	3,657
Loss from joint venture	(1,055)	-
Earnings from unconsolidated investees	58	320
Net loss from continuing operations	<u>\$ (6,482)</u>	<u>\$ (385)</u>

The table below reflects a reconciliation of the segment information to the corresponding amounts in the Consolidated Balance Sheets (dollars in thousands):

	<b>As of March 31,</b>	
	<b>2019</b>	<b>2018</b>
Segment assets	\$ 386,477	\$ 979,130
Investments in unconsolidated investees	75,634	6,716
Notes and interest receivable	124,462	128,756
Other assets	228,240	197,721
Total assets	<u>\$ 814,813</u>	<u>\$ 1,312,323</u>

## **NOTE 12. COMMITMENTS, CONTINGENCIES, AND LIQUIDITY**

*Liquidity.* Management believes that ARL will generate excess cash flow from property operations in 2019; such excess, however, will not be sufficient to discharge all of ARL's obligations as they became due. Management intends to sell land and income-producing real estate, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

*Partnership Buyouts.* ARL is the limited partner in various partnerships related to the construction of residential properties. As permitted in the respective partnership agreements, ARL intends to purchase the interests of the general and any other limited partners in these partnerships subsequent to the completion of these projects. The amounts paid to buy out the non-affiliated partners are limited to development fees earned by the non-affiliated partners and are outlined in the respective partnership agreements.

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

*Guarantees.* The Company is the primary guarantor on a \$39.1 million mezzanine loan between UHF and a lender. In addition, ARI and an officer of the Company are limited recourse guarantors of the loan. As of March 31, 2019 UHF was in compliance with the covenants to the loan agreement.

### **ART and ART Midwest, Inc.**

While the Company and all entities in which the Company has a direct or indirect equity interest are not parties to or obligated in any way for the outcome, a formerly owned entity (American Realty Trust, Inc.) and its former subsidiary (ART Midwest, Inc.) have been engaged since 1999 in litigation with Mr. David Clapper and entities related to Mr. Clapper (collectively, the “Clapper Parties”). The matter originally involved a transaction in 1998 in which ART Midwest, Inc. was to acquire eight residential apartment complexes from the Clapper Parties. Through the years, a number of rulings, both for and against American Realty Trust, Inc. “ART” and ART Midwest, Inc., were issued. In October 2011, a ruling was issued under which the Clapper Parties received a judgment for approximately \$74 million, including \$26 million in actual damages and \$48 million interest. The ruling was against ART and ART Midwest, Inc., but no other entity. During February 2014, the Court of Appeals affirmed a portion of the judgment in favor of the Clapper Parties, but also ruled that a double counting of a significant portion of the damages had occurred and remanded the case back to the trial court to recalculate the damage award, as well as pre- and post-judgment interest thereon. Subsequently, the trial court recalculated the damage award, reducing it to approximately \$59 million, inclusive of actual damages and then current interest. ART was also a significant owner of a partnership interest in the partnership that was awarded the initial damages in this matter.

The Clapper Parties subsequently filed a new lawsuit against ARI, its subsidiary EQK Holdings, Inc. “EQK”, and ART. The Clapper Parties seek damages from ARL for payment by ART to ARL of ART’s stock in EQK in exchange for a release of the Antecedent Debt owed by ART to ARI. In February 2018 the court determined that this legal matter should not have been filed in federal court and therefore granted motions to dismiss on jurisdictional grounds. In June 2018, the court overruled its own grant of motions to dismiss and reinstated the case. We continue to vigorously defend the case and management believes it has defenses to the claims.

In 2005, ART filed suit against a major national law firm over the initial transaction. That action was initially abated while the principal case with the Clapper Parties was pending, but the abatement was recently lifted. The trial court subsequently dismissed the case on procedural grounds, but ART has filed a notice of appeal. The appeal was heard in February 2018 and we are awaiting a ruling by the appeals court. In January 2012, the Company sold all of the issued and outstanding stock of ART to an unrelated party for a promissory note in the amount of \$10 million. At December 31, 2012, the Company fully reserved and valued such note at zero.

### **Dynex Capital, Inc.**

On July 20, 2015, the 68<sup>th</sup> Judicial District Court in Dallas County, Texas issued its Final Judgment in Cause No. DC-03-00675, styled Basic Capital Management, Inc., American Realty Trust, Inc., Transcontinental Realty Investors, Inc., Continental Poydras Corp., Continental Common, Inc. and Continental Baronne, Inc. v. Dynex Commercial, Inc. The case, which was litigated for more than a decade, had its origin with Dynex Commercial making loans to Continental Poydras Corp., Continental Common, Inc. and Continental Baronne, Inc. (subsidiaries of Continental Mortgage & Equity Trust (“CMET”), an entity which merged into TCI in 1999 after the original suit was filed). Under the original loan commitment, \$160 million in loans were to be made to the entities. The loans were conditioned on the execution of a commitment between Dynex Commercial and Basic Capital Management, Inc. (“Basic”).

An original trial in 2004, which also included Dynex Capital, Inc. as a defendant, resulted in a jury awarding damages in favor of Basic for “lost opportunity,” as well as damages in favor of ART and in favor of TCI and its subsidiaries for “increased costs” and “lost opportunity.” The original Trial Court judge ignored the jury’s findings, however, and entered a “Judgment Notwithstanding the Verdict” (“JNOV”) in favor of the Dynex entities (the judge held the Plaintiffs were not entitled to any damages from the Dynex entities). After numerous appeals by all parties, Dynex Capital, Inc. was ultimately dismissed from the case and the remaining claims against Dynex Commercial were remanded to the Trial Court for a new judgment consistent with the jury’s findings. The Court entered the new Final Judgment against Dynex Commercial, Inc. on July 20, 2015.

The Final Judgment entered against Dynex Commercial, Inc. on July 20, 2015 awarded Basic was \$0.256 million in damages, plus pre-judgment interest of \$0.192 million for a total amount of \$0.448 million. The Judgment awarded ART was \$14.2 million in damages, plus pre-judgment interest of \$10.6 million for a total amount of \$24.8 million. The Judgment awarded TCI was \$11.1 million, plus pre-judgment interest of \$8.4 million for a total amount of \$19.5 million. The Judgment also awarded Basic, ART, and TCI post-judgment interest at the rate of 5% per annum from

April 25, 2014 until the date their respective damages were paid. Lastly, the Judgement awarded Basic, ART, and TCI was \$1.6 million collectively in attorneys' fees from Dynex Commercial, Inc.

TCI is working with counsel to identify assets and collect on the Final Judgment against Dynex Commercial, Inc., as well as pursue additional claims, if any, against Dynex Capital, Inc.

### **Berger Litigation**

On February 4, 2019, an individual claiming to be a stockholder holding 7,900 shares of Common Stock of Income Opportunity Realty Investors, Inc. ("IOR") filed a Complaint in the United States District Court for the Northern District of Texas, Dallas Division, individually and allegedly derivatively on behalf of IOR, against Transcontinental Realty Investors, Inc. ("TCI"), American Realty Investors, Inc. ("ARL"), (TCI is a shareholder of IOR, ARL is a shareholder of TCI) Pillar Income Asset Management, Inc. ("Pillar"), (collectively the "Companies"), certain officers and directors of the Companies ("Additional Parties") and two other individuals. The Complaint filed alleges that the sale and/or exchange of certain tangible and intangible property between the Companies and IOR during the last ten years of business operations constitutes a breach of fiduciary duty by the one or more of Companies, the Additional Defendants and/or the directors of IOR. The case alleges other related claims. The Plaintiff seeks certification as a representative of IOR and all of its shareholders, unspecified damages, a return to IOR of various funds and an award of costs, expenses, disbursements (including Plaintiff's attorneys' fees) and prejudgment and post-judgment interest. The named Defendants intend to vigorously defend the action, deny all of the allegations of the Complaint, and believe the allegations to be wholly without any merit.

### **NOTE 13. EARNINGS PER SHARE**

Earnings Per Share ("EPS") have been computed pursuant to the provisions of ASC Topic 260, "Earnings Per Share". The computation of basic EPS is calculated by dividing net income available to common shareholders from continuing operations, adjusted for preferred dividends, by the weighted-average number of common shares outstanding during the period. Shares issued during the period shall be weighted for the portion of the period that they were outstanding.

As of March 31, 2019, we have 1,800,614 shares issued and 614 shares outstanding of Series A 10.0% cumulative convertible preferred stock. These shares may be converted into common stock at 90% of the average daily closing price of the common stock for the prior 20 trading days. These are considered in the computation of diluted earnings per share if the effect of applying the if-converted method is dilutive. Of the issued 1,800,614 shares of Series A 10.0% cumulative convertible preferred stock, 1,800,000 shares are held by ARL and its subsidiaries. Dividends are not paid on the shares owned by ARL.

### **NOTE 14. SUBSEQUENT EVENTS**

The date to which events occurring after March 31, 2019, the date of the most recent balance sheet, have been evaluated for possible adjustment to the Consolidated Financial Statements or disclosure is May 15, 2019, which is the date on which the Consolidated Financial Statements were available to be issued.

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

The following discussion and analysis by management should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes included in this Quarterly Report on Form 10-Q (the "Quarterly Report") and in the Company's Form 10-K for the year ended December 31, 2018 (the "Annual Report").

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

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

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

- risks associated with our dependence on key personnel whose continued service is not guaranteed; and
- the other risk factors identified in this Form 10-Q, including those described under the caption “Risk Factors.”

The risks included here are not exhaustive. Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements, include among others, the factors listed and described at Part I, Item 1A. “Risk Factors” in the Company’s Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company’s Form 10-K for the fiscal year ended December 31, 2018.

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

## **Overview**

We are an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties and land held for development. Our portfolio of income-producing properties includes residential apartment communities, office buildings and other commercial properties. Our investment strategy includes acquiring existing income-producing properties, as well as developing new properties on land already owned or acquired for a specific development project. We acquire land primarily in urban in-fill locations or high-growth suburban markets. We are an active buyer and seller of real estate.

During the three months ended March 31, 2019, we sold 76 land parcels (or 11.96 acres of land) from our Mercer Crossing land holdings in Farmers Branch, Texas and 10.33 acres of land in Dallas, Texas to third parties for an aggregate sales price of \$8.7 million and recognized a gain on the sale of approximately \$2.2 million.

In addition, we purchased from a third party 8.94 acres of land located in Collin County, Texas for a total purchase price of \$2.5 million, and also purchased an option to buy 37.8 acres of land (6.3 acres located in Collin County, Texas and 31.5 acres located in Clark County, Nevada) for \$2.0 million from a third party land developer.

We entered into a purchase and sale agreement with a third party for the sale of Vista Ridge Apartments, located in Lee County, Mississippi. This asset is classified as ‘held for sale’ for the period ended March 31, 2019.

As of March 31, 2019, we owned 1,489 units in nine residential apartment communities, and seven commercial properties comprising approximately 1.7 million rentable square feet. In addition, we own approximately 2,324 acres of land held for development. The Company currently owns income-producing properties and land in six states.

We finance our acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. We finance our development projects principally with variable interest rate construction loans that are converted to long-term, fixed rate amortizing mortgages when the development project is completed and occupancy has been stabilized. We will, from time to time, also enter into partnerships with various investors to acquire income-producing properties or land and to sell interests in certain of our wholly owned properties. When we sell assets, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. We generate operating revenues primarily by leasing apartment units to residents and leasing office, retail and industrial space to commercial tenants. We have no employees.

We have historically engaged in and may continue to engage in certain business transactions with related parties, including, but not limited to, asset acquisition and dispositions. Transactions involving related parties cannot be

presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in our best interest.

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.

### **Critical Accounting Policies**

We present our Consolidated Financial Statements in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The FASB Accounting Standards Codification ("ASC") is the single source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP.

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

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

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

### **Real Estate**

Upon acquisitions of real estate, we assess the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, "above-market" and "below-market" leases, origination costs, acquired in-place leases, other identified intangible assets and assumed liabilities in accordance with ASC Topic 805 "Business

Combinations”, and allocate the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

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

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

### **Depreciation and Impairment**

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

Management reviews its long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates impairment in value. An impairment loss is recognized if the carrying amount of its assets is not recoverable and exceeds its fair value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods.

### **Investments in Unconsolidated Real Estate Ventures**

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

### **Recognition of Rental Income**

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. On our Consolidated Balance Sheets, we include as a receivable the excess of rental income recognized over rental payments actually received pursuant to the terms of the individual commercial lease agreements.

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

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

### **Revenue Recognition on the Sale of Real Estate**

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

### **Non-Performing Notes Receivable**

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

### **Interest Recognition on Notes Receivable**

We record interest income as earned in accordance with the terms of the related loan agreements.

### **Allowance for Estimated Losses**

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

### **Fair Value of Financial Instruments**

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

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

Level 1 – Unadjusted quoted prices for identical and unrestricted assets or liabilities in active markets.

Level 2 – Quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Unobservable inputs that are significant to the fair value measurement.

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

### **Related Parties**

We apply ASC Topic 805, "Business Combinations", to evaluate business relationships. Related parties 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.

### **Results of Operations**

The following discussion and analysis is based on our Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018, as included in Part I, Item 1. "Financial Statements" of this report. At March 31, 2019 and 2018, we owned or had interests in a portfolio of nine and fifty-three income-producing properties, respectively.

#### ***Comparison of the three months ended March 31, 2019 to the same period ended 2018:***

For the three months ended March 31, 2019, we reported a net loss applicable to common shares of 6.1 million or \$0.38 per diluted earnings per share, as compared to a net loss applicable to common shares of \$0.9 million or \$0.06 per diluted earnings per share for the same period ended 2018.

### **Revenues**

Rental and other property revenues were \$11.9 million for the three months ended March 31, 2019, compared to \$31.1 million for the same period in 2018. The \$19.2 million decrease is primarily due to a decrease in the amount of multifamily residential apartment buildings currently in our portfolio of nine as compared to fifty-three multifamily residential apartment buildings for the same period a year ago as a result of the deconsolidation of forty-nine residential apartment properties that were sold into the VAA Joint Venture during the fourth quarter of 2018. As the assets are now treated as unconsolidated investments, our share of rental revenues is part of income from unconsolidated investments in the current period and are no longer treated as rental income (Refer to Note 2).

### **Expenses**

Property operating expenses decreased by \$8.4 million to \$6.0 million for the three months ended March 31, 2019 as compared to \$14.4 million for the same period in 2018. The decrease in property operating expenses is primarily due to the deconsolidation of forty-nine residential apartment properties that were sold into the VAA Joint Venture during the fourth quarter of 2018 which resulted in a decrease in salary and related payroll expenses of \$1.7 million, real estate taxes of approximately \$3.0 million and general property operating and maintenance expenses of \$3.7 million.

Depreciation and amortization decreased by \$3.3 million to \$3.1 million during the three months ended March 31, 2019 as compared to \$6.4 million for the three months ended March 31, 2018. This decrease is primarily due to the deconsolidation of the residential apartments in connection with our previous sale and contribution of our interests to the VAA Joint Venture.

General and administrative expense was \$2.6 million for the three months ended March 31, 2019, compared to \$2.3 million for the same period in 2018. The increase of \$0.3 million in general and administrative expenses is the result

of increases in advisory and management fees of approximately \$0.4 million and professional and finance fees of \$0.3 million offset by a decrease in accounting, tax and other general administrative fees of \$0.6 million.

#### **Other income (expense)**

Interest income was \$6.2 million for the three months ended March 31, 2019, compared to \$5.1 million for the same period in 2018. The increase of \$1.1 million was due to an increase of \$1.3 million in interest on receivable owed from our Advisors, offset by a decrease of \$0.8 in interest on notes receivable from other related parties.

Other income was \$3.7 million for the three months ended March 31, 2019, compared to \$1.9 million for the same period in 2018. The increase is primarily the result of a \$3.6 million gain recognized for deferred income associated with the sale of land during the quarter just ended to third parties.

Mortgage and loan interest expense was \$9.9 million for the three months ended March 31, 2019 as compared to \$15.7 million for the same period in 2018. The decrease of \$5.8 million is due to the deconsolidation of residential apartment properties into the VAA Joint Venture which were encumbered by mortgage debt.

Foreign currency transaction was a loss of \$5.8 million for the three months ended March 31, 2019 as compared to a gain of \$1.8 million for the same period in 2018. During the first quarter just ended, we paid \$10.4 million in principal and \$5.8 million in interests payments to our bonds denominated in Israel Shekels.

Loss from unconsolidated investments was \$1.0 million for the three months ended March 31, 2019 as compared to earnings of \$320 thousand for the three months ended March 31, 2018. The loss from unconsolidated investments during the first quarter just ended was driven primarily from our share in the losses reported by the VAA Joint Venture (Refer to Note 2).

Gain on land sales was \$2.2 for the three months ended March 31, 2019, compared to \$1.3 million for the same period in 2018. In the current period we sold approximately 22.3 acres of land for a sales price of \$8.7 million which resulted in a gain of \$2.2 million. For the same period in 2018, we sold 112.2 acres of land for a sales price of \$7.2 million and recognized a gain of \$1.3 million.

#### **Liquidity and Capital Resources**

##### **Our principal liquidity needs are:**

- fund normal recurring expenses;
- meet debt service and principal repayment obligations including balloon payments on maturing debt;
- fund capital expenditures, including tenant improvements and leasing costs;
- fund development costs not covered under construction loans; and
- fund possible property acquisitions.

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

- property operations;
- proceeds from land and income-producing property sales;
- collection of mortgage notes receivable;
- collection of receivables from related party companies;

- refinancing of existing debt; and
- additional borrowing, including mortgage notes, mezzanine financing and lines of credit.

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

### Cash Flow Summary

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

	<u>For the Three Months</u>		<u>Variance</u>
	<u>2019</u>	<u>2018</u>	
Net cash (used in) provided by operating activities	\$ (16,449)	\$ 3,505	\$ (19,954)
Net cash (used in) investing activities	\$ (5,431)	\$(26,091)	\$ 20,660
Net cash (used in) provided by financing activities	\$ (3,608)	\$ 30,330	\$ (33,938)

Our primary use of cash for operations is daily operating costs, general and administrative expenses, advisory fees, and land holding costs. Our primary source of cash from operating activities is from rental income on properties. In addition, we have a related party account in which excess cash is transferred to or from.

Our primary cash outlays for investing activities are for construction and development, acquisition of land and income-producing properties, and capital improvements to existing properties. During the three months ended March 31, 2019, we advanced \$385 thousand toward various notes receivables, purchased land for development for \$2.5 million, and invested approximately \$11.5 million for the development of new properties and improvement of income producing properties. For the three months ended March 31, 2018, we advanced \$11.1 million toward various notes receivables and invested \$20.1 million for development of new properties.

Our primary sources of cash from investing activities are from the proceeds on the sale of land and income-producing properties. During the three months ended March 31, 2019, we received aggregate sales proceeds of \$8.7 million from the sale of 22.3 acres of land and recorded a gain of \$2.2 million. For the three months ended March 31, 2018, we received aggregate sales proceeds of \$3.6 million from the sale of approximately 112 acres of land and recorded a gain on the sale of approximately \$1.3 million. In addition, we received aggregate sale proceeds of \$2.1 million from the sale of six income producing properties.

Our primary sources of cash from financing activities are from proceeds on notes payables either through refinancing our existing loans or by obtaining new financing. Our primary cash outlays are for recurring debt payments and payments on maturing notes payable. During the three months ended March 31, 2019, the decrease in cash flow from financing activities is primarily due to a payment on bond principal of \$10.4 million, and payments on our outstanding notes of \$1.2 million, offset by proceeds from notes of approximately \$8.0 million. During the three months ended March 31, 2018, the increase in cash flow from financing activities was primarily due to \$39.4 million of proceeds received from the sale of nonconvertible Series B Bonds by Southern.

## **Environmental Matters**

Under various federal, state and local environmental laws, ordinances and regulations, we may be potentially liable for removal or remediation costs, as well as certain other potential costs relating to hazardous or toxic substances (including governmental fines and injuries to persons and property) where property-level managers have arranged for the removal, disposal or treatment of hazardous or toxic substances. In addition, certain environmental laws impose liability for release of asbestos-containing materials into the air, and third parties may seek recovery for personal injury associated with such materials.

Management is not aware of any environmental liability relating to the above matters that would have a material adverse effect on our business, assets or results of operations.

## **Inflation**

The effects of inflation on our operations are not quantifiable. Revenues from property operations tend to fluctuate proportionately with inflationary increases and decreases in real estate costs. Fluctuations in the rate of inflation also affect the sales values of properties and the ultimate gains to be realized from property sales. To the extent that inflation affects interest rates, earnings from short-term investments and the cost of new financings as well as the cost of variable interest rate debt will be affected.

## **Tax Matters**

ARL is a member of the May Realty Holdings, Inc., (“MRHI”) consolidated group for federal income tax reporting. There is a tax sharing and compensating agreement between ARL, Income Opportunities Realty Investors, Inc. (“IOR”), and Transcontinental Realty Investors, Inc. (“TCI”).

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. ARL had a loss for federal income tax purposes for the first three months of 2019 and 2018.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

We may be exposed to interest rate changes primarily as a result of long-term debt used to acquire properties and make loans and other permitted investments. Our management’s objectives, with regard to interest rate risks, are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve these objectives, we will borrow primarily at fixed rates or variable rates with the lowest margins available and in some cases, with the ability to convert variable rates to fixed rates. Of our \$301 million in notes payable at March 31, 2018, \$42.6 million represented debt subject to variable interest rates. If our variable interest rates increased 100 basis points, we estimate that total annual interest cost, would increase by \$0.1 million, and would result in an increase of \$0.01 in our loss per share.

Our variable rate exposure is mitigated through the ability to secure long-term fixed rate HUD financing on the residential apartment complexes with a weighted average borrowing rate of approximately 7.29% at March 31, 2019.

## **ITEM 4. CONTROLS AND PROCEDURES**

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

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

## **PART II. OTHER INFORMATION**

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

On September 1, 2000, the Board of Directors approved a share repurchase program authorizing the repurchase of up to a total of 1,000,000 shares of ARL common stock. This repurchase program has no termination date. In August 2010, the Board of Directors approved an increase in the share repurchase program for up to an additional 250,000 shares of Common Stock which results in a total authorization under the repurchase program for up to 1,250,000 shares. There were no shares purchased under this program during the first quarter of 2019. As of March 31, 2019, 986,750 shares have been purchased and 263,250 shares may be purchased under the program.

## ITEM 6. EXHIBITS

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

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
<a href="#">3.0</a>	Certificate of Restatement of Articles of Incorporation of American Realty Investors, Inc. dated August 3, 2000 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
<a href="#">3.1</a>	Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc. dated August 29, 2000 (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q dated September 30, 2000).
<a href="#">3.2</a>	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc. decreasing the number of authorized shares of and eliminating Series B Cumulative Convertible Preferred Stock dated August 23, 2003 (incorporated by reference to Exhibit 3.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
<a href="#">3.3</a>	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc., decreasing the number of authorized shares of and eliminating Series I Cumulative Preferred Stock dated October 1, 2003 (incorporated by reference to Exhibit 3.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
<a href="#">3.4</a>	Bylaws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement on Form S-4 filed December 30, 1999).
<a href="#">4.1</a>	Certificate of Designations, Preferences and Relative Participating or Optional or Other Special Rights, and Qualifications, Limitations or Restrictions Thereof of Series F Redeemable Preferred Stock of American Realty Investors, Inc., dated June 11, 2001 (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
<a href="#">4.2</a>	Certificate of Withdrawal of Preferred Stock, Decreasing the Number of Authorized Shares of and Eliminating Series F Redeemable Preferred Stock, dated June 18, 2002 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002).
<a href="#">4.3</a>	Certificate of Designation, Preferences and Rights of the Series I Cumulative Preferred Stock of American Realty Investors, Inc., dated February 3, 2003 (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002).
<a href="#">4.4</a>	Certificate of Designation for Nevada Profit Corporations designating the Series J 8% Cumulative Convertible Preferred Stock as filed with the Secretary of State of Nevada on March 16, 2006 (incorporated by reference to Registrant's current report on Form 8-K for event of March 16, 2006).
<a href="#">4.5</a>	Certificate of Designation for Nevada Profit Corporation designating the Series K Convertible Preferred Stock as filed with the Secretary of State of Nevada on May 6, 2013 (incorporated by reference to Registrant's current report on form 8-K for event of May 7, 2013).
<a href="#">10.1</a>	Advisory Agreement between American Realty Investors, Inc. and Pillar Income Asset Management, Inc., dated April 30, 2011 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, dated May 2, 2011).

10.2	Second Amendment to Modification of Stipulation of Settlement dated October 17, 2001 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4, dated February 24, 2002).
<a href="#">31.1*</a>	Certification by the Principal Executive Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
<a href="#">31.2*</a>	Certification by the Principal Financial Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
<a href="#">32.1*</a>	Certification pursuant to 18 U.S.C. 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

**SIGNATURE PAGE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN REALTY INVESTORS, INC.

Date: May 15, 2019

By: /s/ Daniel J. Moos

Daniel J. Moos  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 15, 2019

By: /s/ Gene S. Bertcher

Gene S. Bertcher  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)