
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2021
or

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

For the transition period from _____ to _____

Commission File Number 001-09240

AMERICAN REALTY INVESTORS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Nevada

(State or Other Jurisdiction of
Incorporation or Organization)

94-6565852

(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)

Securities registered pursuant to Section 12(b) of the Exchange Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---------------------|-------------------|---|
| Common Stock | ARL | NYSE |

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth Company

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

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

As of November 10, 2021, there were 16,152,043 shares of common stock outstanding.

AMERICAN REALTY INVESTORS, INC.
FORM 10-Q

TABLE OF CONTENTS

| PART I. FINANCIAL INFORMATION | | PAGE |
|---|---|----------------------|
| Item 1. | Financial Statements | |
| | Consolidated Balance Sheets at September 30, 2021 and December 31, 2020 | 3 |
| | Consolidated Statements of Operations for the three and nine months ended September 30, 2021 and 2020 | 4 |
| | Consolidated Statement of Equity for the three and nine months ended September 30, 2021 and 2020 | 5 |
| | Consolidated Statements of Cash Flows for the nine months ended September 30, 2021 and 2020 | 6 |
| | Notes to Consolidated Financial Statements | 7 |
| Item 2. | Management’s Discussion and Analysis of Financial Condition and Results of Operations | 20 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risks | 26 |
| Item 4. | Controls and Procedures | 26 |
| PART II. OTHER INFORMATION | | |
| Item 1. | Legal Proceedings | 27 |
| Item 1A. | Risk Factors | 27 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 28 |
| Item 3. | Defaults Upon Senior Securities | 28 |
| Item 4. | Mine Safety Disclosures | 28 |
| Item 5. | Other Information | 28 |
| Item 6. | Exhibits | 29 |
| | Signatures | 31 |

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except share and par value amounts)
(Unaudited)

| | <u>September 30,</u> <u>2021</u> | <u>December 31,</u> <u>2020</u> |
|---|-------------------------------------|------------------------------------|
| Assets | | |
| Real estate, net | \$ 300,015 | \$ 377,383 |
| Notes receivable (including \$75,871 and \$70,375 at September 30, 2021 and December 31, 2020, respectively, from related parties) | 140,774 | 130,626 |
| Cash and cash equivalents | 63,873 | 36,814 |
| Restricted cash | 20,090 | 50,206 |
| Investment in unconsolidated joint ventures | 58,438 | 60,425 |
| Receivable from related parties | 103,384 | 129,335 |
| Other assets | 86,089 | 80,975 |
| Total assets | <u>\$ 772,663</u> | <u>\$ 865,764</u> |
| Liabilities and Equity | | |
| Liabilities: | | |
| Mortgages and notes payable | \$ 185,004 | \$ 242,711 |
| Bonds payable | 184,198 | 237,888 |
| Accounts payable and other liabilities (including \$892 and \$928 at September 30, 2021 and December 31, 2020, respectively, to related parties) | 45,169 | 27,299 |
| Accrued interest payable | 3,478 | 7,639 |
| Deferred revenue | 9,791 | 19,821 |
| Total liabilities | <u>427,640</u> | <u>535,358</u> |
| Equity | | |
| Shareholders' Equity: | | |
| Preferred stock, Series A, \$2.00 par value, 15,000,000 shares authorized, 1,800,614 shares issued and outstanding | 1,801 | 1,801 |
| Common stock, \$0.01 par value, 100,000,000 shares authorized; 16,152,043 and 16,209,228 shares issued at September 30, 2021 and December 31, 2020, respectively; and 16,152,043 shares outstanding | 162 | 162 |
| Treasury stock, 57,185 at December 31, 2020 | — | (2) |
| Paid-in capital | 62,090 | 62,092 |
| Retained earnings | 182,889 | 172,738 |
| Total shareholders' equity | <u>246,942</u> | <u>236,791</u> |
| Noncontrolling interests | 98,081 | 93,615 |
| Total equity | <u>345,023</u> | <u>330,406</u> |
| Total liabilities and equity | <u>\$ 772,663</u> | <u>\$ 865,764</u> |

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars in thousands, except per share amounts)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------------|--|-------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Revenues: | | | | |
| Rental revenues (including \$312 and \$262 for the three months ended September 30, 2021 and 2020, respectively, and \$867 and \$808 for nine months ended September 30, 2021 and 2020, respectively, from related parties) | \$ 9,628 | \$ 11,454 | \$ 30,183 | \$ 34,461 |
| Other income | 866 | 483 | 3,242 | 5,347 |
| Total revenue | <u>10,494</u> | <u>11,937</u> | <u>33,425</u> | <u>39,808</u> |
| Expenses: | | | | |
| Property operating expenses (including \$178 and \$254 for the three months ended September 30, 2021 and 2020, respectively, and \$755 and \$750 for nine months ended September 30, 2021 and 2020, respectively, from related parties) | 5,610 | 6,388 | 16,500 | 18,507 |
| Depreciation and amortization | 2,935 | 3,526 | 9,473 | 10,338 |
| General and administrative (including \$1,017 and \$1,094 for the three months ended September 30, 2021 and 2020, respectively, and \$3,434 and \$2,991 for nine months ended September 30, 2021 and 2020, respectively, from related parties) | 3,698 | 1,997 | 12,799 | 7,958 |
| Advisory fee to related party | 3,419 | 2,329 | 11,594 | 7,055 |
| Total operating expenses | <u>15,662</u> | <u>14,240</u> | <u>50,366</u> | <u>43,858</u> |
| Net operating loss | (5,168) | (2,303) | (16,941) | (4,050) |
| Interest income (including \$5,053 and \$4,812 for the three months ended September 30, 2021 and 2020, respectively, and \$15,139 and \$14,613 for the nine months ended September 30, 2021 and 2020, respectively, from related parties) | 6,128 | 5,421 | 17,388 | 16,459 |
| Interest expense (including \$1,431 and \$1,583 for the three months ended September 30, 2021 and 2020, respectively, and \$4,199 and \$5,040 for the nine months ended September 30, 2021 and 2020, respectively, from related parties) | (7,057) | (7,622) | (22,476) | (26,295) |
| (Loss) gain on foreign currency transactions | (1,639) | (1,470) | 1,185 | 774 |
| Loss on extinguishment of debt | (1,451) | — | (1,451) | — |
| Equity in income (loss) from unconsolidated joint ventures | 3,543 | 337 | 11,451 | (642) |
| Gain on sale or write-down of assets, net | 31,312 | 15,325 | 24,265 | 24,802 |
| Income tax provision | (605) | (50) | 1,196 | (346) |
| Net income | <u>25,063</u> | <u>9,638</u> | <u>14,617</u> | <u>10,702</u> |
| Net income attributable to noncontrolling interests | (5,652) | (1,651) | (4,466) | (2,075) |
| Net income attributable to the Company | <u>\$ 19,411</u> | <u>\$ 7,987</u> | <u>\$ 10,151</u> | <u>\$ 8,627</u> |
| Earnings per share - basic | | | | |
| Basic and diluted | <u>\$ 1.20</u> | <u>\$ 0.50</u> | <u>\$ 0.63</u> | <u>\$ 0.54</u> |
| Weighted average common shares used in computing earnings per share | | | | |
| Basic and diluted | <u>16,152,043</u> | <u>15,997,076</u> | <u>16,152,043</u> | <u>15,997,076</u> |

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENT OF EQUITY
(dollars in thousands, except share amounts)
(Unaudited)

| | Preferred Stock | Common Stock | Treasury Stock | Paid-in Capital | Retained Earnings | Total Shareholders' Equity | Noncontrolling Interest | Total Equity |
|--|--------------------|-----------------|-------------------|--------------------|----------------------|----------------------------------|----------------------------|-------------------|
| Three Months Ended September 30, 2021 | | | | | | | | |
| Balance, July 1, 2021 | \$ 1,801 | \$ 162 | \$ — | \$ 62,090 | \$ 163,478 | \$ 227,531 | \$ 92,429 | \$ 319,960 |
| Net income | — | — | — | — | 19,411 | 19,411 | 5,652 | 25,063 |
| Balance, September 30, 2021 | <u>\$ 1,801</u> | <u>\$ 162</u> | <u>\$ —</u> | <u>\$ 62,090</u> | <u>\$ 182,889</u> | <u>\$ 246,942</u> | <u>\$ 98,081</u> | <u>\$ 345,023</u> |
| Three Months Ended September 30, 2020 | | | | | | | | |
| Balance, July 1, 2020 | \$ 3,601 | \$ 164 | \$ (6,395) | \$ 78,421 | \$ 164,348 | \$ 240,139 | \$ 57,441 | \$ 297,580 |
| Net income | — | — | — | — | 7,987 | 7,987 | 1,651 | 9,638 |
| Balance, September 30, 2020 | <u>\$ 3,601</u> | <u>\$ 164</u> | <u>\$ (6,395)</u> | <u>\$ 78,421</u> | <u>\$ 172,335</u> | <u>\$ 248,126</u> | <u>\$ 59,092</u> | <u>\$ 307,218</u> |
| Nine Months Ended September 30, 2021 | | | | | | | | |
| Balance, January 1, 2021 | \$ 1,801 | \$ 162 | (2) | 62,092 | 172,738 | \$ 236,791 | \$ 93,615 | \$ 330,406 |
| Cancellation of treasury shares | — | — | 2 | (2) | — | — | — | — |
| Net income | — | — | — | — | 10,151 | 10,151 | 4,466 | 14,617 |
| Balance, September 30, 2021 | <u>\$ 1,801</u> | <u>\$ 162</u> | <u>\$ —</u> | <u>\$ 62,090</u> | <u>\$ 182,889</u> | <u>\$ 246,942</u> | <u>\$ 98,081</u> | <u>\$ 345,023</u> |
| Nine Months Ended September 30, 2020 | | | | | | | | |
| Balance, January 1, 2020 | \$ 3,601 | \$ 164 | \$ (6,395) | \$ 78,421 | \$ 163,708 | \$ 239,499 | \$ 57,017 | \$ 296,516 |
| Net income | — | — | — | — | 8,627 | 8,627 | 2,075 | 10,702 |
| Balance, September 30, 2020 | <u>\$ 3,601</u> | <u>\$ 164</u> | <u>\$ (6,395)</u> | <u>\$ 78,421</u> | <u>\$ 172,335</u> | <u>\$ 248,126</u> | <u>\$ 59,092</u> | <u>\$ 307,218</u> |

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)
(Unaudited)

| | Nine Months Ended September 30, | |
|---|--|------------------|
| | 2021 | 2020 |
| Cash Flow From Operating Activities: | | |
| Net income | \$ 14,617 | \$ 10,702 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Gain on sale or write down of assets | (24,265) | (24,802) |
| Gain on foreign currency transactions | (1,185) | (774) |
| Loss on extinguishment of debt | 1,451 | — |
| Depreciation and amortization | 11,699 | 13,023 |
| Recovery of bad debts | (1,326) | (542) |
| Equity in (income) loss from unconsolidated joint ventures | (11,451) | 642 |
| Distribution of income from unconsolidated joint ventures | 3,157 | 1,729 |
| Changes in assets and liabilities, net of dispositions: | | |
| Other assets | (9,167) | (13,322) |
| Related party receivables | 15,461 | (93) |
| Accrued interest payable | (4,801) | (3,895) |
| Accounts payable and other liabilities | (1,913) | (52) |
| Net cash used in operating activities | <u>(7,723)</u> | <u>(17,384)</u> |
| Cash Flow From Investing Activities: | | |
| Collection of notes receivable | 9,319 | 7,283 |
| Originations and advances on notes receivable | (3,882) | (15,718) |
| Acquisition of real estate | — | (2,664) |
| Development and renovation of real estate | (8,770) | (12,488) |
| Deferred leasing costs | (877) | (96) |
| Proceeds from sale of assets | 103,727 | 31,768 |
| Contribution to unconsolidated joint venture | (411) | — |
| Distribution from unconsolidated joint venture | 7,430 | 8,140 |
| Net cash provided by investing activities | <u>106,536</u> | <u>16,225</u> |
| Cash Flow From Financing Activities: | | |
| Proceeds from mortgages, other notes and bonds payable | 20,015 | 10,234 |
| Payments on mortgages, other notes and bonds payable | (117,193) | (31,316) |
| Debt extinguishment costs | (4,086) | — |
| Deferred financing costs | (606) | (54) |
| Net cash used in financing activities | <u>(101,870)</u> | <u>(21,136)</u> |
| Net decrease in cash, cash equivalents and restricted cash | <u>(3,057)</u> | <u>(22,295)</u> |
| Cash, cash equivalents and restricted cash, beginning of period | 87,020 | 83,311 |
| Cash, cash equivalents and restricted cash, end of period | <u>\$ 83,963</u> | <u>\$ 61,016</u> |

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

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

1. Organization

As used herein, the terms “the Company”, “we”, “our” or “us” refer to American Realty Investors, Inc., a Nevada corporation, which was formed in 1999. Our common stock is listed on the New York Stock Exchange (“NYSE”) under the symbol (“ARL”) and over 90% of our stock is owned by related party entities.

Our primary business is the acquisition, development and ownership of income-producing multifamily and commercial properties. In addition, we opportunistically acquire land for future development in in-fill or high-growth suburban markets. From time to time and when we believe it appropriate to do so, we will also sell land and income-producing properties. We generate revenues by leasing apartment units to residents, and leasing office, industrial and retail space to various for-profit businesses as well as certain local, state and federal agencies. We also generate income from the sale of land.

We own approximately 78.4% of Transcontinental Realty Investors, Inc. (“TCI”) and substantially all of our operations are conducted through TCI, whose common stock is traded on the NYSE under the symbol “TCI”. Accordingly, we include TCI’s financial results in our consolidated financial statements. Substantially all of TCI’s assets are held by its wholly-owned subsidiary, Southern Properties Capital Ltd. (“SPC”), which was formed for the purpose of raising funds by issuing non-convertible bonds that are listed on the Tel-Aviv Stock Exchange (“TASE”).

At September 30, 2021, our portfolio of properties consisted of:

- Five commercial properties, consisting of four office buildings and one retail property, comprising in aggregate of approximately 1,063,512 square feet;
- Nine multifamily properties, owned directly by us, comprising of 1,492 units;
- Approximately 1,827 acres of developed and undeveloped land; and
- Fifty-two multifamily properties, totaling 10,032 units, owned through our 50% investment in VAA.

Our day-to-day operations are managed by Pillar Income Asset Management, Inc. (“Pillar”). Their duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities, arranging debt and equity financing with third party lenders and investors, and providing various administrative services. Our commercial properties are managed by Regis Realty Prime, LLC (“Regis”). Regis provides leasing, construction management and brokerage services. Our multifamily properties are managed by outside management companies. Pillar and Regis are considered to be related parties (See Note 12 – Related Party Transactions).

2. Summary of Significant Accounting Policies

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 (“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 consolidated balance sheet at December 31, 2020 was derived from the audited consolidated financial statements at that date, but does not include all of the information and disclosures required by GAAP for complete financial statements. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2020. Certain 2020 consolidated financial statement amounts have been reclassified to conform to the current presentation.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

We consolidate entities in which we are considered to be the primary beneficiary of a variable interest entity (“VIE”) or have a majority of the voting interest of the entity. We have determined that we are a primary beneficiary of the VIE when we have (i) the power to direct the activities of a VIE that most significantly impacts its economic performance, and (ii) the obligations to absorb losses or the right to receive benefits that could potentially be significant to the VIE. In determining whether we are the primary beneficiary, we consider qualitative and quantitative factors, including ownership interest, management representation, ability to control decision and other contractual rights.

We account for entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary under the equity method of accounting. Accordingly, we include our share of the net earnings or losses of these entities in our results of operations.

Newly Issued Accounting Standards

In March 2020, the FASB issued ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting. The standard provides guidance, optional expedients and exceptions that reference London Interbank Offered Rate (“LIBOR”) or another reference rate expected to be discontinued due to reference rate reform. The standard was effective upon issuance and can be applied through December 31, 2022. We have mortgage notes payable with interest rates that reference LIBOR, and therefore, we will adopt this standard when LIBOR is discontinued.

On April 10, 2020, the FASB issued a Staff Q&A (“Q&A”) related to the application of the lease guidance in ASC 842 for the accounting impact of lease concessions related to the COVID-19 pandemic. The Q&A allows an entity to make an election to account for lease concessions related to the effects of the COVID-19 as though enforceable rights and obligations for those concessions existed. As a result of this election, an entity will not have to analyze each lease to determine whether enforceable rights and obligations for concessions exist in the lease and can elect to apply or not apply the lease modification guidance in ASC 842, as long as the concessions do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. Our adoption of the guidance of the Q&A did not have a significant impact on our consolidated financial statements during the three and nine months ended September 30, 2021 and 2020.

3. Earnings Per Share

Earnings Per Share (“EPS”) is computed by dividing net income available to common shares, adjusted for preferred dividends, by the weighted-average number of common shares outstanding during the period. Shares issued during the period are weighted for the portion of the period that they were outstanding.

The following table details our basic and diluted earnings per common share calculation:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------------|--|-------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Net income | \$ 25,063 | \$ 9,638 | \$ 14,617 | \$ 10,702 |
| Net income attributable to noncontrolling interests | (5,652) | (1,651) | (4,466) | (2,075) |
| Net income attributable to common shares | <u>\$ 19,411</u> | <u>\$ 7,987</u> | <u>\$ 10,151</u> | <u>\$ 8,627</u> |
| Weighted-average common shares outstanding — basic and diluted | <u>16,152,043</u> | <u>15,997,076</u> | <u>16,152,043</u> | <u>15,997,076</u> |
| EPS - attributable to common shares — basic and diluted | <u>\$ 1.20</u> | <u>\$ 0.50</u> | <u>\$ 0.63</u> | <u>\$ 0.54</u> |

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

4. Supplemental Cash Flow Information

The following presents the schedule of interest paid and other supplemental cash flow information:

| | Nine Months Ended September 30, | |
|--|--|------------------|
| | 2021 | 2020 |
| Cash paid for interest | \$ 26,307 | \$ 25,351 |
| Cash - beginning of period | | |
| Cash and cash equivalents | \$ 36,814 | \$ 51,228 |
| Restricted cash | 50,206 | 32,083 |
| | <u>\$ 87,020</u> | <u>\$ 83,311</u> |
| Cash - end of period | | |
| Cash and cash equivalents | \$ 63,873 | \$ 32,986 |
| Restricted cash | 20,090 | 28,030 |
| | <u>\$ 83,963</u> | <u>\$ 61,016</u> |
| Proceeds from mortgages, notes and bonds payable | | |
| Proceeds from mortgages and notes payable | \$ 20,015 | \$ 10,234 |
| Proceeds from bonds | — | — |
| | <u>\$ 20,015</u> | <u>\$ 10,234</u> |
| Payments on mortgages, notes and bonds payable | | |
| Payments on mortgages and notes payable | \$ 63,535 | \$ 9,592 |
| Payments on bonds payable | 53,658 | 21,724 |
| | <u>\$ 117,193</u> | <u>\$ 31,316</u> |

The following is a schedule of noncash investing and financing activities:

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2021 | 2020 |
| Assets contributed to joint venture | \$ 18,608 | \$ — |
| Liabilities assumed by joint venture | \$ 15,606 | \$ — |
| Notes receivable received in exchange for related party receivable | \$ 9,259 | \$ — |
| Distribution from joint venture applied to Earn Out Obligation | \$ 5,441 | \$ — |
| Property acquired in exchange for note payable | \$ — | \$ 3,350 |
| Note receivable issued in exchange for property | \$ — | \$ 1,761 |
| Debt assumed in sale of property | \$ — | \$ 8,238 |

5. Operating Segments

Our segments are based on the internal reporting that we review for operational decision-making purposes. We operate in two reportable segments: (i) the acquisition, development, ownership and management of multifamily properties and (ii) the acquisition, ownership and management of commercial properties. The services for our multifamily segment include rental of apartments and other tenant services, including parking and storage space rental. Asset information by segment is not reported because we do not use this measure to assess performance or make decisions to allocate resources. Therefore, depreciation and amortization expense is not allocated among segments. General and administrative expenses, advisory fees, interest income and interest expense are not included in segment profit as our internal reporting addresses these items on a corporate level.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

The following table presents our reportable segments for the three and nine months ended September 30, 2021 and 2020:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------|---|-----------------|--|------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Multifamily Segment | | | | |
| Revenues | \$ 3,703 | \$ 3,685 | \$ 11,068 | \$ 10,943 |
| Operating expenses | (2,072) | (2,413) | (6,306) | (6,466) |
| Profit from segment | 1,631 | 1,272 | 4,762 | 4,477 |
| Commercial Segment | | | | |
| Revenues | 5,925 | 7,769 | 19,115 | 23,518 |
| Operating expenses | (3,538) | (3,975) | (10,194) | (12,041) |
| Profit from segment | 2,387 | 3,794 | 8,921 | 11,477 |
| Total profit from segments | \$ 4,018 | \$ 5,066 | \$ 13,683 | \$ 15,954 |

The table below reflects the reconciliation of total profit from segments to net income for the three and nine months ended September 30, 2021 and 2020:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-----------------|--|------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Total profit from segments | \$ 4,018 | \$ 5,066 | \$ 13,683 | \$ 15,954 |
| Other non-segment items of income (expense) | | | | |
| Depreciation | (2,935) | (3,526) | (9,473) | (10,338) |
| General and administrative | (3,698) | (1,997) | (12,799) | (7,958) |
| Advisory fee to related party | (3,419) | (2,329) | (11,594) | (7,055) |
| Other income | 6,128 | 5,421 | 3,242 | 5,347 |
| Interest income | 866 | 483 | 17,388 | 16,459 |
| Interest expense | (7,057) | (7,622) | (22,476) | (26,295) |
| (Loss) gain on foreign currency transaction | (1,639) | (1,470) | 1,185 | 774 |
| Loss on extinguishment of debt | (1,451) | — | (1,451) | — |
| Income (losses) from unconsolidated joint ventures | 3,543 | 337 | 11,451 | (642) |
| Gain on sales or write-down of assets | 31,312 | 15,325 | 24,265 | 24,802 |
| Income tax provision | (605) | (50) | 1,196 | (346) |
| Net income | \$ 25,063 | \$ 9,638 | \$ 14,617 | \$ 10,702 |

6. Lease Revenue

We lease our multifamily properties and commercial properties under agreements that are classified as operating leases. Our multifamily property leases generally includes minimum rents and charges for ancillary services. Our commercial property leases generally included minimum rents and recoveries for property taxes and common area maintenance. Minimum rental revenues are recognized on a straight-line basis over the terms of the related leases.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

The following table summarizes the components of our rental revenue for the three and nine months ended September 30, 2021 and 2020:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------|---|------------------|--|------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Fixed component | \$ 9,124 | \$ 11,107 | \$ 28,287 | \$ 33,111 |
| Variable component | 504 | 347 | 1,896 | 1,350 |
| | <u>\$ 9,628</u> | <u>\$ 11,454</u> | <u>\$ 30,183</u> | <u>\$ 34,461</u> |

The following table summarizes the future rental payments that are payable to us from non-cancelable leases. The table excludes multifamily leases, which typically have a term of one-year or less:

| | |
|------------|------------------|
| 2021 | \$ 3,794 |
| 2022 | 13,431 |
| 2023 | 9,188 |
| 2024 | 5,674 |
| 2025 | 5,261 |
| Thereafter | 26,499 |
| | <u>\$ 63,847</u> |

7. Real Estate Activity

Below is a summary of our real estate as of September 30, 2021 and December 31, 2020:

| | September 30, 2021 | December 31, 2020 |
|-------------------------------|-------------------------------|------------------------------|
| Land | \$ 42,625 | \$ 50,759 |
| Building and improvements | 225,375 | 297,644 |
| Tenant improvements | 21,364 | 30,935 |
| Construction in progress | 71,044 | 77,891 |
| Total cost | 360,408 | 457,229 |
| Less accumulated depreciation | (60,725) | (82,418) |
| Total real estate, net | 299,683 | 374,811 |
| Property held for sale | 332 | 2,572 |
| Total real estate | <u>\$ 300,015</u> | <u>\$ 377,383</u> |

The gain on sale or write-down of assets, net for the three and nine months ended September 30, 2021 and 2020 consist of the following:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------|---|------------------|--|------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Land(1) | \$ 4,042 | \$ 5,774 | \$ 15,153 | \$ 15,248 |
| Multifamily Properties(2) | — | 3,704 | 11,441 | 3,704 |
| Commercial Properties(3) | 27,270 | 4,609 | 27,270 | 4,609 |
| Other(4) | — | 1,238 | (29,599) | 1,241 |
| | <u>\$ 31,312</u> | <u>\$ 15,325</u> | <u>\$ 24,265</u> | <u>\$ 24,802</u> |

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

- (1) Includes the gain on sale of lots related to our investment in Windmill Farms, Mercer Crossing and other land holdings.
- (2) Includes the gain from the sale of a 50% ownership interest in Overlook at Allensville Phase II (See Note 9 – Investment in Unconsolidated Joint Ventures) and the gain on the sale of various multifamily properties that had previously been deferred (See Note 14 – Deferred Income).
- (3) On August 26, 2021, we sold 600 Las Colinas, a 512,173 square foot office building in Irving, Texas for \$74,750, resulting in gain on sale of \$27,270. We used the proceeds to pay down the mortgage note payable on the property (See 10 - Mortgages and Other Notes Payable) and for general corporate purposes. On May 1, 2020, we sold Villager Apartments, a 33 unit multifamily property in Pensacola, Florida for \$2,426, resulting in a gain on sale of \$898. The sales price was funded by the issuance of a \$1,761 note receivable and the assumption of a \$665 mortgage note payable on the property. On July 16, 2020, we sold Farnham Park Apartments, 144 unit multifamily property in Port Arthur, Texas for \$13,300, resulting in a gain on the sale of \$2,684. The sales price was funded by cash payment of \$4,215 and the assumption of the \$9,085 mortgage note payable on the property.
- (4) Includes a \$29,600 loss on the remeasurement of the Earn Out Obligation in connection with our investment in VAA (See Note 9 - Investment in Unconsolidated Joint Ventures).

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

8. Notes Receivable

The following table summarizes our notes receivable as of September 30, 2021 and December 31, 2020:

| Property/Borrower | Carrying value | | Interest Rate | Maturity Date |
|--|---------------------------|--------------------------|----------------------|----------------------|
| | September 30, 2021 | December 31, 2020 | | |
| ABC Land and Development, Inc. | \$ 4,408 | \$ 4,408 | 9.50 % | 6/30/26 |
| ABC Paradise, LLC | 1,210 | 1,210 | 9.50 % | 6/30/26 |
| Autumn Breeze(1) | 2,344 | 1,867 | 5.00 % | 7/1/22 |
| Bellwether Ridge(1) | 3,950 | 3,858 | 5.00 % | 11/1/26 |
| Forest Pines(1) | 2,872 | 2,869 | 5.00 % | 11/1/22 |
| Lake Wales | 3,000 | 3,000 | 9.50 % | 6/30/26 |
| Legacy Pleasant Grove | 496 | 496 | 12.00 % | 10/23/22 |
| McKinney Ranch | 4,554 | 4,554 | 6.00 % | 9/15/22 |
| One Realco Land Holding, Inc. | 1,728 | 1,728 | 9.50 % | 6/30/26 |
| Parc at Ingleside(1) | 3,122 | 2,523 | 5.00 % | 11/1/26 |
| Parc at Opelika(1) | 2,098 | — | 10.00 % | 1/13/23 |
| Parc at Windmill Farms(1) | 7,830 | 7,803 | 5.00 % | 11/1/22 |
| Phillips Foundation for Better Living, Inc.(2) | — | 61 | 12.00 % | 3/31/23 |
| Phillips Foundation for Better Living, Inc.(2) | 813 | — | 12.00 % | 3/31/24 |
| Plum Tree(1) | 1,353 | 857 | 5.00 % | 4/26/26 |
| Riverview on the Park Land, LLC | 1,045 | 1,045 | 9.50 % | 6/30/26 |
| RNC Portfolio, Inc. | 8,853 | 8,853 | 5.00 % | 9/1/24 |
| Spartan Land | 5,907 | 5,907 | 12.00 % | 1/16/23 |
| Spyglass of Ennis(1) | 5,363 | 5,360 | 5.00 % | 11/1/22 |
| Steeple Crest(1) | 6,498 | 6,498 | 5.00 % | 8/1/26 |
| Unified Housing Foundation, Inc. (2)(3) | 2,881 | 2,880 | 12.00 % | 6/30/23 |
| Unified Housing Foundation, Inc. (2)(3) | 212 | 212 | 12.00 % | 6/30/23 |
| Unified Housing Foundation, Inc. (2)(3) | 6,831 | 6,831 | 12.00 % | 6/30/23 |
| Unified Housing Foundation, Inc. (2)(3) | 10,401 | 10,896 | 12.00 % | 6/30/23 |
| Unified Housing Foundation, Inc. (2)(3) | 10,096 | 10,096 | 12.00 % | 3/31/22 |
| Unified Housing Foundation, Inc. (2)(3) | 6,990 | 6,990 | 12.00 % | 3/31/23 |
| Unified Housing Foundation, Inc. (2)(3) | 3,615 | 3,615 | 12.00 % | 5/31/23 |
| Unified Housing Foundation, Inc. (2)(3) | 24,054 | 26,209 | 12.00 % | 12/31/32 |
| Unified Housing Foundation, Inc. (2)(3) | 6,521 | — | 12.00 % | 3/31/24 |
| Unified Housing Foundation, Inc.(2)(3) | 1,549 | — | 12.00 % | 4/30/24 |
| Unified Housing Foundation, Inc.(2)(3) | 180 | — | 12.00 % | 6/30/24 |
| | <u>\$ 140,774</u> | <u>\$ 130,626</u> | | |

- (1) The note is convertible, at our option, into a 100% ownership interest in the underlying development property, and is collateralized by the underlying development property.
- (2) The borrower is determined to be a related party due to our significant investment in the performance of the collateral secured by the notes receivable.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

- (3) Principal and interest payments on the notes from Unified Housing Foundation, Inc. ("UHF") are funded from surplus cash flow from operations, sale or refinancing of the underlying properties and are cross collateralized to the extent that any surplus cash available from any of the properties underlying the notes.

9. Investment in Unconsolidated Joint Ventures

On November 19, 2018, we formed the VAA joint venture with the Macquarie Group ("Macquarie"). In connection with the formation of VAA, we sold a 50% ownership interest in certain multifamily properties to Macquarie for a \$236,800 cash payment, resulting in a gain on sale of assets of \$154,100. In connection with the formation of VAA, ten out of the 51 properties were subject to an earn-out provision ("Earn Out") that provides for a remeasurement of value after a two-year period following the completion of construction. Upon the formation of VAA, we recorded a liability ("Earn Out Obligation") for the \$10,000 advance on the Earn Out that we received from Macquarie.

Upon receipt of funds, both parties transferred their respective ownership interests in the multifamily properties to VAA in exchange for a 50% voting interest and a 49% profit participation interest ("Class A interest") in VAA and note payable ("Mezzanine Loan") in accordance with the terms of a contribution agreement (the "Contribution"). Upon completion of the Contribution, VAA owned and controlled 51 multifamily properties. VAA assumed all liabilities of those properties, including mortgage debt insured by the Department of Housing and Urban Development ("HUD").

Concurrent with the formation of the joint venture, VAA issued a Class B interest with a 2% profits participation interest and no voting rights to Daniel J. Moos, our former President and Chief Executive Officer ("Class B Member"). The Class B Member serves as the manager of VAA.

Interest on the Mezzanine loan is limited to cash generated from the properties and matures concurrently with the termination of VAA. Accordingly, we account for our interest in the Mezzanine Loan as an addition to our equity interest in VAA and include interest income on the Mezzanine loan in income from unconsolidated joint ventures.

On March 30, 2021, we sold a 50% ownership interest in Overlook at Allensville Phase II, a 144 unit multifamily property in Sevierville, Tennessee to Macquarie for \$2,551, resulting in gain on sale of \$1,417. Concurrent with the sale, we each contributed our 50% ownership interests in Overlook at Allensville Phase II into VAA.

On July 13, 2021, we received the arbitration result of a dispute regarding the measurement of the Earn Out Obligation. Our position and claims were declined, and the position of Macquarie was fully accepted. As a result, we are required to pay approximately \$39,600 to Macquarie to satisfy the Earn Out Obligation, and therefore, recorded a charge of \$29,600 during the nine months ended September 30, 2021 (See Note 7 – Real Estate Activity).

In accordance with the the joint venture operating agreement, the Earn Out Obligation will be paid from our share of future distributions from VAA, which generally occur each six months. During the three months ended September 30, 2021, our \$5,441 distribution from VAA was paid directly to Macquarie as a reduction of the Earn Out Obligation.

We also own a 20% ownership interest in a 20% interest in Grappa Fiorentina, LLC ("Milano"), which operates several pizza parlors in Central and Northern California. Milano also has 23 franchised locations, including two operating, under the trade name Angelo & Vito's Pizzerias.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

The following is a summary of our investment in unconsolidated joint ventures:

| | September 30, 2021 | December 31, 2020 |
|--|-------------------------------|------------------------------|
| Assets (1) | | |
| Real estate | \$ 1,227,945 | \$ 1,230,197 |
| Other assets | 114,626 | 113,537 |
| Total assets | <u>\$ 1,342,571</u> | <u>\$ 1,343,734</u> |
| Liabilities and Partners' Capital (1) | | |
| Mortgage notes payable | \$ 870,000 | \$ 843,522 |
| Mezzanine notes payable | 242,942 | 239,878 |
| Other liabilities | 37,992 | 45,619 |
| Our share of partners' capital | 81,676 | 93,334 |
| Outside partner's capital | 109,961 | 121,381 |
| Total liabilities and partners' capital | <u>\$ 1,342,571</u> | <u>\$ 1,343,734</u> |
| <i>Investment in unconsolidated joint ventures</i> | | |
| Our share of partners' capital | \$ 81,676 | \$ 93,334 |
| Our share of Mezzanine note payable | 121,471 | 119,939 |
| Basis adjustment (2) | (144,709) | (152,848) |
| Total investment in unconsolidated joint ventures | <u>\$ 58,438</u> | <u>\$ 60,425</u> |

- (1) These amounts include the assets of VAA of \$1,277,069 and \$1,279,197 at September 30, 2021 and December 31, 2020, respectively, and liabilities of VAA of \$1,128,268 and \$1,106,231 at September 30, 2021 and December 31, 2020, respectively.
- (2) We amortize the difference between the cost of our investments in unconsolidated joint ventures and the book value of our underlying equity into income on a straight-line basis consistent with the lives of the underlying assets.

The following is a summary of income (loss) from our investments in unconsolidated joint ventures:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------------|--|--------------------|
| | 2021 | 2020 | 2021 | 2020 |
| Revenue (1) | | | | |
| Rental revenue | \$ 33,563 | \$ 29,999 | \$ 96,670 | \$ 86,841 |
| Other revenue | 17,080 | 15,182 | 50,131 | 44,018 |
| Total revenue | <u>50,643</u> | <u>45,181</u> | <u>146,801</u> | <u>130,859</u> |
| Expenses (2) | | | | |
| Operating expenses | 32,052 | 29,629 | 91,305 | 84,310 |
| Depreciation and amortization | 8,194 | 8,190 | 24,393 | 24,312 |
| Other income | — | — | (2,356) | — |
| Interest | 13,906 | 12,574 | 41,971 | 42,093 |
| Total expenses | <u>54,152</u> | <u>50,393</u> | <u>155,313</u> | <u>150,715</u> |
| Net loss | <u>\$ (3,509)</u> | <u>\$ (5,212)</u> | <u>\$ (8,512)</u> | <u>\$ (19,856)</u> |
| Our equity in the income (loss) in unconsolidated joint ventures | <u>\$ 3,543</u> | <u>\$ 337</u> | <u>\$ 11,451</u> | <u>\$ (642)</u> |

- (1) These amounts include revenue of VAA of \$35,572 and \$31,591 during the three months ended September 30, 2021 and 2020, respectively, and \$102,403 and \$90,875 during the nine months ended September 30, 2021 and 2020, respectively.
- (2) These amounts include expenses of VAA of \$39,880 and \$37,287 during the three months ended September 30, 2021 and 2020, respectively, and \$113,885 and \$112,333 during the nine months ended September 30, 2021 and 2020, respectively.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

10. Mortgages and Other Notes Payable

The following table summarizes our mortgages and other notes payable as of September 30, 2021 and December 31, 2020:

| Property / Entity | Carrying value | | Effective Interest Rate | Maturity Date |
|-------------------------------------|--------------------|-------------------|-------------------------|---------------|
| | September 30, 2021 | December 31, 2020 | | |
| 600 Las Colinas(1) | \$ — | \$ 35,589 | 5.30 % | 11/1/2023 |
| 770 South Post Oak | 11,709 | 11,871 | 4.40 % | 6/1/2025 |
| Parc at Athens(2) | 1,155 | 1,155 | 5.90 % | 8/28/2022 |
| Chelsea | 8,077 | 8,194 | 3.40 % | 12/1/2050 |
| EQK Portage - Land | 3,350 | 3,350 | 10.00 % | 11/13/2024 |
| HSW Partners | — | 17,790 | 9.50 % | 6/17/2021 |
| Forest Grove(3) | 7,295 | 7,333 | 3.75 % | 5/5/2024 |
| Landing Bayou | 14,467 | 14,643 | 3.50 % | 9/1/2053 |
| Legacy at Pleasant Grove | 13,428 | 13,653 | 3.60 % | 4/1/2048 |
| McKinney 36 Land | 705 | 820 | 8.00 % | 6/30/2022 |
| New Concept Energy | 3,542 | 3,542 | 6.00 % | 9/30/2022 |
| Overlook at Allensville Phase II(4) | — | 15,621 | 3.80 % | 5/1/2059 |
| Parc at Denham Springs Phase II | 16,004 | 16,128 | 4.10 % | 2/1/2060 |
| RCM HC Enterprises(5) | 5,086 | — | 9.50 % | 12/17/2026 |
| Stanford Center | 39,044 | 39,093 | 6.00 % | 2/26/2022 |
| Sugar Mill Phase III | 9,237 | 9,298 | 4.50 % | 2/1/2060 |
| Toulon | 13,786 | 13,975 | 3.20 % | 12/1/2051 |
| Villas at Bon Secour(6) | 19,495 | 10,280 | 4.00 % | 8/25/2028 |
| Vista Ridge | 9,868 | 9,979 | 4.00 % | 8/1/2053 |
| Windmill Farms(7) | 8,756 | 10,397 | 6.00 % | 2/28/2023 |
| | <u>\$ 185,004</u> | <u>\$ 242,711</u> | | |

- (1) On August 26, 2021, we paid off the loan in connection with the sale of the underlying property (See 7 - Real Estate Activity).
- (2) On March 2, 2021, the loan was extended to August 28, 2022.
- (3) The loan bears interest at prime rate plus 0.5%.
- (4) On March 30, 2021, the loan was assumed by VAA in connection with our contribution of the underlying property to the joint venture (See Note 9 – Investment in Unconsolidated Joint Ventures).
- (5) On June 4, 2021, the lender assumed the remaining \$1,986 balance from our loan from HSW Partners and extended the maturity to December 17, 2026.
- (6) On August 25, 2021, we replaced the existing loan on the property with a new \$20,015 loan that bears interest at 3.08% and matures on August 25, 2028.
- (7) On March 4, 2021, the loan was extended to February 28, 2023 at an interest rate of 5%.

Interest payable at September 30, 2021 and December 31, 2020, was \$1,328 and \$1,212, respectively. We capitalized interest of \$3,112 and \$267 during the three months ended September 30, 2021 and 2020, respectively, and \$7,263 and \$852 during the nine months ended September 30, 2021 and 2020, respectively.

As of September 30, 2021, we were in compliance with all of our loan covenants except for the minimum debt service coverage ratio (“DSCR”) for the loan on 770 South Post Oak. As a result, the lender may require us to lock the surplus cash

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

flow of the property (“Cash Trap”) into a designated deposit account controlled by them, until we are in compliance with the DSCR for a period of two consecutive quarters.

11. Bonds Payable

We have issued three series of nonconvertible bonds ("Bonds") through SPC, which are traded on the TASE. The Bonds are denominated in New Israeli Shekels ("NIS") and provide for semiannual principal and interest payments through maturity.

In connection with the Bonds, we incurred a (loss) gain on foreign currency transactions of \$(1,639) and \$(1,470) during the three months ended September 30, 2021 and 2020, respectively, and \$1,185 and \$774 for the nine months ended September 30, 2021 and 2020, respectively.

The outstanding balance of our Bonds at September 30, 2021 and December 31, 2020 is as follows:

| Bond Issuance | September 30, 2021 | December 31, 2020 | Interest Rate | Maturity |
|--|-------------------------------|------------------------------|--------------------------|-----------------|
| Series A Bonds(1) | \$ 63,147 | \$ 95,133 | 7.30 % | 7/31/23 |
| Series B Bonds(1) | 52,029 | 65,318 | 6.80 % | 7/31/25 |
| Series C Bonds(2) | 75,281 | 85,537 | 4.65 % | 1/31/23 |
| | <u>190,457</u> | <u>245,988</u> | | |
| Less unamortized deferred issuance costs | <u>(6,259)</u> | <u>(8,100)</u> | | |
| | <u><u>\$ 184,198</u></u> | <u><u>\$ 237,888</u></u> | | |

(1) The bonds are collateralized by the assets of SPC.

(2) The bonds are collateralized by a trust deed in Browning Place, a 625,297 square foot office building in Farmers Branch, Texas.

12. Related Party Transactions

We engage in certain services and business transactions with related parties, including but not limited to, the rent of office space, leasing services, asset management, administrative services, and the acquisition and dispositions of real estate. 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 and Regis are wholly owned by an affiliates of Realty Advisors, Inc. ("RAI"), which owns approximately 90.8% of the Company. Pillar is compensated for advisory services in accordance with an agreement. Regis receives property management fees and leasing commissions in accordance with the terms of its property-level management agreement. In addition, Regis is entitled to receive real estate brokerage commissions in accordance with the terms of a non-exclusive brokerage agreement.

Rental income includes \$312 and \$262 for the three months ended September 30, 2021 and 2020, respectively, and \$867 and \$808 for the nine months ended September 30, 2021 and 2020, respectively, for office space leased to Pillar and Regis.

Property operating expense includes \$178 and \$254 for the three months ended September 30, 2021 and 2020, respectively, and \$755 and \$750 for the nine months ended September 30, 2021 and 2020, respectively, for management fees on commercial properties payable to Regis.

General and administrative expense includes \$1,017 and \$1,094 for the three months ended September 30, 2021 and 2020, respectively, and \$3,434 and \$2,991 for the nine months ended September 30, 2021 and 2020, respectively, for employee compensation and other reimbursable costs payable to Pillar.

Advisor fees paid to Pillar were \$3,419 and \$2,329 for the three months ended September 30, 2021 and 2020, respectively, and \$11,594 and \$7,055 for the nine months ended September 30, 2021 and 2020, respectively.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

Notes receivable include amounts held by UHF and Pillar (See Note 8 – Notes Receivable). UHF is deemed to be a related party due to our significant investment in the performance of the collateral secured by the notes receivable. Interest income on these notes was \$5,053 and \$4,812 for the three months ended September 30, 2021 and 2020, respectively, and \$15,139 and \$14,613 for the nine months ended September 30, 2021 and 2020, respectively.

Interest expense on notes payable to Pillar was \$1,431 and \$1,583 for the three months ended September 30, 2021 and 2020, respectively, and \$4,199 and \$5,040 for the nine months ended September 30, 2021 and 2020, respectively.

Receivable from related party represents the amount outstanding from Pillar for loans and unreimbursed fees, expenses and costs as provided above.

13. Noncontrolling Interests

The noncontrolling interest represents the third party ownership interest in TCI and Income Opportunity Realty Investors, Inc. ("IOR"). We owned 78.4% of TCI and 81.1% in IOR during the three and nine months ended September 30, 2021 and 2020.

14. Deferred Income

In previous years, we sold properties to related parties at a gain and therefore the sales criteria for the full accrual method was not met, and as such we deferred the gain recognition and accounted for the sales by applying the finance, deposit, installment or cost recovery methods, as appropriate. The gain on these transactions is deferred until the properties are sold to a non-related third party.

On January 29, 2021, UHF sold El Dorado, a 208 unit multifamily property in McKinney, Texas; Limestone Ranch, a 252 unit multifamily property in Lewisville, Texas; and Marquis, a 276 unit multifamily property in Lewisville, Texas to a non-related third party. As a result of this sale, we recognized a gain of \$10,026 during the nine months ended September 30, 2021 that had previously been deferred.

As of September 30, 2021 and December 31, 2020, we had deferred gain of \$9,791 and \$19,821, respectively.

15. Income Taxes

We are part of a tax sharing and compensating agreement with respect to federal income taxes with TCI and IOR. In accordance with the agreement, our expense (benefit) in each year is calculated based on the amount of losses absorbed by taxable income multiplied by the maximum statutory tax rate of 21%.

The following table summarizes our income tax provision:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------|-------------------------------------|--------------|------------------------------------|---------------|
| | 2021 | 2020 | 2021 | 2020 |
| Current | \$ 605 | \$ 50 | \$ (1,196) | \$ 346 |
| Deferred | — | — | — | — |
| | <u>\$ 605</u> | <u>\$ 50</u> | <u>\$ (1,196)</u> | <u>\$ 346</u> |

16. Commitments and Contingencies

We believe that we will generate excess cash from property operations in the next twelve months; such excess, however, might not be sufficient to discharge all of our obligations as they become due. We intend to sell income-producing assets, refinance real estate and obtain additional borrowings primarily secured by real estate to meet our liquidity requirements.

We were the primary guarantor, on a \$24,300 mezzanine loan between UHF and a lender. The guarantee was removed on January 29, 2021, concurrent with the repayment of the loan by UHF.

AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands, except per share and square foot amounts)
(Unaudited)

We were a defendant in litigation with David Clapper and related entities (collectively, "Clapper") regarding a multifamily property transaction that occurred in 1988. In March 2016, the court ruled in favor of Clapper and awarded them approximately \$59,000. We appealed the ruling, and the appellate court remanded the case to trial, which occurred in May 2021. As a result, the Court vacated the prior award and determined that Clapper would take nothing.

In February 2019, a lawsuit was brought by Paul Berger ("Berger") against us and others that alleges that TCI completed improper sales and/or transfers of property with IOR. Berger requests that TCI pay off various related party loans to IOR and that IOR then distribute the funds to its shareholders. We intend to vigorously defend against the allegations. The trial for this matter is set for November 2022.

On July 13, 2021, we received the arbitration verdict in connection with our dispute on the measurement of the Earn Out Obligation (See Note 9 – Investment in Unconsolidated Joint Ventures), which determined that our position and claims were declined, and the position of Macquarie was fully accepted. As a result, we are required to pay approximately \$39,600 to Macquarie to satisfy the Earn Out Obligation.

17 Subsequent Events

The date to which events occurring after September 30, 2021, the date of the most recent balance sheet, have been evaluated for possible adjustment to the consolidated financial statements or disclosure is November 10, 2021, 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 our Form 10-K for the year ended December 31, 2020 (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 our markets and the effect on occupancy and rental rates;
- Our 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" Annual Report on Form 10-K, which investors should review.

We continue to closely monitor the impact of the COVID-19 pandemic on all aspects of our business and our property portfolio. While we did not incur significant disruptions during the nine months ended September 30, 2021 from the COVID-19 pandemic, our commercial properties have experienced a decline in occupancy. We believe this decline to be temporary and do not expect a significant decrease in rental revenue.

We are unable to predict the impact that the COVID-19 pandemic will have on our financial condition, results of operations and cash flows due to numerous uncertainties. These uncertainties include the scope, severity and duration of the pandemic, the actions taken to contain the pandemic or mitigate its impact and the direct and indirect economic effects of the pandemic and containment measures, among others. The pandemic continues to have an impact on the U.S. economy and on the local markets in which our properties are located. Nearly every industry has been impacted directly or indirectly, and the commercial real estate market has come under pressure due to numerous factors, including preventative measures taken by local, state and federal authorities to alleviate the public health crisis such as mandatory business closures, quarantines, and restrictions on travel and “shelter-in-place” or “stay-at-home” orders.

Management's 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 throughout the Southern United States. Our portfolio of income-producing properties includes residential apartment communities ("multifamily properties"), office buildings and retail properties ("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.

Our operations are managed by Pillar Income Asset Management, Inc. (“Pillar”) in accordance with an Advisory Agreement. Pillar’s duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities. Pillar also arranges our debt and equity financing with third party lenders and investors. We have no employees. Employees of Pillar render services to us in accordance with the terms of the Advisory Agreement. Pillar is considered to be a related party due to its common ownership with Realty Advisors, Inc. (“RAI”), who is our controlling shareholder.

The following is a summary of our recent acquisition, disposition, financing and development activities:

Acquisitions and Dispositions

- On March 5, 2020, we acquired a 49.2 acres land parcel in Kent, Ohio for \$5.4 million that was funded by a \$2.0 million cash payment and a \$3.4 million note payable that bears interest at 10% and matures on November 13, 2024.
- On May 1, 2020, we sold Villager, a 33 unit multifamily property in Fort Walton, Florida for \$2.4 million, resulting in a gain on sale of \$1.0 million.
- On July 16, 2020, we sold Farnham Park, a 144 unit multifamily property in Port Arthur, Texas for \$13.3 million, resulting in a gain on sale of \$2.7 million.
- On September 14, 2020, we sold Bridge View Plaza, a retail property in La Crosse, Wisconsin for \$5.3 million, resulting in a gain on sale of \$4.6 million.
- On March 30, 2021, we sold a 50% ownership interest in Overlook at Allensville Phase II, a 144 unit multifamily property in Sevierville, Tennessee to Macquarie for \$2.6 million resulting in gain on sale of \$1.4 million. Concurrent with the sale, we each contributed our 50% ownership interests in Overlook at Allensville Phase II into VAA.
- On August 26, 2021, we sold 600 Las Colinas, a 512,173 square foot office building in Irving, Texas for \$74.8 million, resulting in gain on sale of \$27.3 million. We used the proceeds to pay down the mortgage note payable on the property (See "Financing Activities") and for general corporate purposes.
- During the nine months ended September 30, 2021, we sold a total of 134.7 acres of land from our holdings in Windmill Farms for \$19.0 million, in aggregate, resulting in gains on sale of \$9.2 million. In addition, we sold 13.2 acres of land from our holdings in Mercer Crossing for \$8.4 million, resulting in a gain on sale of \$6.0 million.
- During the nine months ended September 30, 2021, we recorded a loss of \$29.6 million on the remeasurements of certain assets ("Earn Out Obligation") that were sold in connection with our investment in VAA (See Note 16 – Commitments and Contingencies of our consolidated financial statements).

Financing Activities

- On November 30, 2020, we issued \$19.7 million in additional Series A bonds (See Note 11 of our consolidated financial statements) for \$18.8 million in net proceeds. We used the proceeds to fund our bond payments that were due on January 30, 2021.
- On December 3, 2020, we extended our \$14.7 million loan from HSW Partners to June 17, 2021.
- On March 2, 2021, we extended our \$1.2 million loan on Parc at Athens to August 28, 2022.
- On March 4, 2021, we extended the maturity of our \$8.8 million loan on Windmill Farms until February 28, 2023 at a reduced interest rate of 5%.
- On August 25, 2021, we replaced the existing loan on Villas at Bon Secour with a new \$20.0 million loan that bears interest at 3.08% and matures on August 25, 2028.
- On August 26, 2021, we paid off the \$35.9 million loan on 600 Las Colinas in connection with the sale of the underlying property (See "Acquisitions and Dispositions").

Development Activities

During the year ended December 31, 2020, we completed the construction of Parc at Denham Springs Phase II and Sugar Mill Phase III for a total cost of \$17.2 million and \$14.2 million, respectively.

Our current developments projects at September 30, 2021, are as follow: (dollars in thousands)

| Property | Location | No. of Units | Costs to Date (1) | Total Projected Costs (1) |
|-------------------|-----------------|---------------------|--------------------------|----------------------------------|
| Parc at Athens | Athens, AL | 232 | \$ 2,465 | \$ 34,800 |
| Heritage McKinney | McKinney, TX | 170 | 3,251 | 24,650 |
| | | 402 | \$ 5,716 | \$ 59,450 |

(1) Costs include land and construction hard costs, construction soft costs and loan borrowing costs.

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with United States generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Some of these estimates and assumptions include judgments on revenue recognition, estimates for common area maintenance and real estate tax accruals, provisions for uncollectible accounts, impairment of long-lived assets, the allocation of purchase price between tangible and intangible assets, capitalization of costs and fair value measurements. Our significant accounting policies are described in more detail in Note 2—Summary of Significant Accounting Policies in our notes to the consolidated financial statements in the Annual Report. However, the following policies are deemed to be critical.

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 our own separate interests, or affiliates of the entity.

Results of Operations

Many of the variations in the results of operations, discussed below, occurred because of the transactions affecting our properties described above, including those related to the Lease-Up Properties and the Disposition Properties (each as defined below).

For purposes of the discussion below, we define "Same Properties" as those properties that are substantially leased-up and in operation for the entirety of both periods of the comparison. Non-Same Properties for comparison purposes include those properties that have been recently constructed or leased-up ("Lease-up Properties") and properties that have been disposed of ("Disposition Properties"). A developed property is considered leased-up, when it achieves occupancy of 80% or more. We move a property in and out of Same Properties based on whether the property is substantially leased-up and in operation for the entirety of both periods of the comparison. Accordingly, the Same Properties consist of all properties, excluding the Lease-up Properties and the Disposition Properties for the periods of comparison.

For the comparison of the three and nine months ended September 30, 2021 to the three and nine months ended September 30, 2020, the Lease-up Properties are Forest Grove, Parc at Denham Springs Phase II and Sugar Mill Phase III; and the Disposition Properties are Bridge View Plaza, Farnham Park, Villager, Overlook at Allensville Phase II and 600 Las Colinas.

The following table summarizes our results of operations for the three and nine months ended September 30, 2021 and 2020:

| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|--|-------------------------------------|-----------------|------------------|------------------------------------|------------------|-----------------|
| | 2021 | 2020 | Variance | 2021 | 2020 | Variance |
| Multifamily Segment | | | | | | |
| Revenue | \$ 3,703 | \$ 3,685 | \$ 18 | \$ 11,068 | \$ 10,943 | \$ 125 |
| Operating expenses | (2,072) | (2,413) | 341 | (6,306) | (6,466) | 160 |
| | 1,631 | 1,272 | 359 | 4,762 | 4,477 | 285 |
| Commercial Segment | | | | | | |
| Revenue | 5,925 | 7,769 | (1,844) | 19,115 | 23,518 | (4,403) |
| Operating expenses | (3,538) | (3,975) | 437 | (10,194) | (12,041) | 1,847 |
| | 2,387 | 3,794 | (1,407) | 8,921 | 11,477 | (2,556) |
| Segment profit | 4,018 | 5,066 | (1,048) | 13,683 | 15,954 | (2,271) |
| Other non-segment items of income (expense) | | | | | | |
| Depreciation and amortization | (2,935) | (3,526) | 591 | (9,473) | (10,338) | 865 |
| General, administrative and advisory | (7,117) | (4,326) | (2,791) | (24,393) | (15,013) | (9,380) |
| Interest, net | (929) | (2,201) | 1,272 | (5,088) | (9,836) | 4,748 |
| Loss on extinguishment of debt | (1,451) | — | (1,451) | (1,451) | — | (1,451) |
| (Loss) gain on foreign currency transactions | (1,639) | (1,470) | (169) | 1,185 | 774 | 411 |
| Gain sale or write down of assets | 31,312 | 15,325 | 15,987 | 24,265 | 24,802 | (537) |
| Income (loss) from joint ventures | 3,543 | 337 | 3,206 | 11,451 | (642) | 12,093 |
| Other income | 261 | 433 | (172) | 4,438 | 5,001 | (563) |
| Net income | <u>\$ 25,063</u> | <u>\$ 9,638</u> | <u>\$ 15,425</u> | <u>\$ 14,617</u> | <u>\$ 10,702</u> | <u>\$ 3,915</u> |

Comparison of the three months ended September 30, 2021 to the three months ended September 30, 2020:

Our \$15.4 million increase in net income during the three months ended September 30, 2021 is primarily attributed to the following:

- The \$1.4 million decrease in profit from the commercial segment is due to the Disposition Properties.
- The \$2.8 million increase in general, administrative and advisory expenses is primarily due to a an increase in advisory fees related to the sale of 600 Las Colinas (See "Acquisitions and Dispositions" in Management's Overview), the refinance of Villas at Bon Secour (See "Financing Activities" in Management's Overview), and legal costs associated with the Clapper litigation and the VAA Earn Out arbitration.
- The \$16.0 million increase in gain is primarily due to the gain on sale of 600 Las Colinas in 2021, offset in part by the gain on sale of various commercial and multifamily properties in 2020 (See "Acquisitions and Dispositions" in Management's Overview).
- The \$3.2 million increase in income from joint ventures is due to the increase in occupancy of the various lease-up properties at VAA.

Comparison of the nine months ended September 30, 2021 to the nine months ended September 30, 2020:

Our \$3.9 million increase in net income during the nine months ended September 30, 2021 is primarily attributed to the following:

- The \$2.6 million decrease in profit from the commercial segment is due to the Disposition Properties.

- The \$9.4 million increase in general, administrative and advisory expenses is primarily due to an increase in advisory fees related to the sale of 600 Las Colinas (See "Acquisitions and Dispositions" in Management's Overview), the refinance of Villas at Bon Secour (See "Financing Activities" in Management's Overview), and legal costs associated with the Clapper litigation and the VAA Earn Out arbitration.
- The \$12.3 million increase in income from joint ventures is due to the increase in occupancy of various lease-up properties at VAA.

Liquidity and Capital Resources

Our principal sources of cash have been, and will continue to be, property operations; proceeds from land and income-producing property sales; collection of notes receivable; refinancing of existing mortgage notes payable; and additional borrowings, including mortgage notes and bonds payable, and lines of credit.

Our principal liquidity needs are to 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.

We anticipate that our cash and cash equivalents as of September 30, 2021, along with cash that will be generated in the remainder of 2021 from notes and interest receivables, will be sufficient to meet all of our cash requirements. We intend to selectively sell land and income-producing assets, refinance or extend real estate debt and seek additional borrowings secured by real estate to meet our liquidity requirements. Although history cannot predict the future, historically, we have been successful at refinancing and extending a portion of our current maturity obligations.

The following summary discussion of our cash flows is based on the consolidated statements of cash flows in our consolidated financial statements, and is not meant to be an all-inclusive discussion of the changes in our cash flows for the periods presented below (dollars in thousands):

| | Nine Months Ended September 30, | | Incr / (Decr) |
|---|--|-------------|----------------------|
| | 2021 | 2020 | |
| Net cash used in operating activities | \$ (7,723) | \$ (17,384) | \$ 9,661 |
| Net cash provided by investing activities | \$ 106,536 | \$ 16,225 | \$ 90,311 |
| Net cash used in financing activities | \$ (101,870) | \$ (21,136) | \$ (80,734) |

The decrease in cash used in operating activities is primarily due to the \$15.6 million decrease in related party receivables, offset in part by a decrease in accrued interest.

The increase in cash provided by investing activities is primarily due to a \$72.0 million increase in proceeds from sale of assets and a \$11.8 million decrease in originations and advances on notes receivable. The increase in cash proceeds on sale of assets is primarily due the sale of 600 Las Colinas in 2021 (See "Acquisitions and Dispositions" in Management's Overview).

The increase in cash used in financing activities is primarily due a \$85.9 million increase in payments of mortgages, notes and bonds payable. The increase in payments of mortgages, notes and bonds payable is due to the pay off of 600 Las Colinas in 2021, the refinancing of Villas at Bon Secour in 2021 (See "Financing Activities" in Management's Overview), and an increase in payments on the bonds payable.

Funds From Operations ("FFO")

We use FFO in addition to net income to report our operating and financial results and considers FFO and FFO-diluted as supplemental measures for the real estate industry and a supplement to GAAP measures. The National Association of Real Estate Investment Trusts ("Nareit") defines FFO as net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from sales of properties, plus real estate related depreciation and amortization, impairment write-downs of real estate and write-downs of investments in an affiliate where the write-downs have been driven by a decrease in the value of real estate held by the affiliate and after adjustments for unconsolidated joint ventures. Adjustments for unconsolidated joint ventures are calculated to reflect FFO on the same basis. We also present FFO excluding the impact of the effects of foreign currency transactions.

FFO and FFO on a diluted basis are useful to investors in comparing operating and financial results between periods. This is especially true since FFO excludes real estate depreciation and amortization, as we believe real estate values fluctuate based on market conditions rather than depreciating in value ratably on a straight-line basis over time. We believe that such a presentation also provides investors with a meaningful measure of our operating results in comparison to the operating results of other real estate companies. In addition, we believe that FFO excluding gain (loss) from foreign currency transactions provide useful supplemental information regarding our performance as they show a more meaningful and consistent comparison of our operating performance and allows investors to more easily compare our results.

We believe that FFO does not represent cash flow from operations as defined by GAAP, should not be considered as an alternative to net income as defined by GAAP, and is not indicative of cash available to fund all cash flow needs. We also caution that FFO, as presented, may not be comparable to similarly titled measures reported by other real estate companies.

We compensate for the limitations of FFO by providing investors with financial statements prepared according to GAAP, along with this detailed discussion of FFO and a reconciliation of net income to FFO and FFO-diluted. We believe that to further understand our performance, FFO should be compared with our reported net income and considered in addition to cash flows in accordance with GAAP, as presented in our consolidated financial statements.

The following table reconciles our net (loss) income attributable to the Company to FFO and FFO-basic and diluted, excluding gain from foreign currency transactions for the three and nine months ended September 30, 2021 and 2020 (dollars and shares in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|----------|------------------------------------|-----------|
| | 2021 | 2020 | 2021 | 2020 |
| Net income attributable to the Company | \$ 19,411 | \$ 7,987 | \$ 10,151 | \$ 8,627 |
| Depreciation and amortization | 2,935 | 3,526 | 9,473 | 10,338 |
| Gain on sale or write down of assets | (31,312) | (15,325) | (24,265) | (24,802) |
| Gain on sale of land | 4,042 | 5,774 | 15,153 | 15,248 |
| Depreciation and amortization on unconsolidated joint ventures at pro rata share | 2,984 | 3,417 | 7,016 | 6,913 |
| FFO-Basic and Diluted | (1,940) | 5,379 | 17,528 | 16,324 |
| Loss on extinguishment of debt | 1,451 | — | 1,451 | — |
| Loss (gain) on foreign currency transactions | 1,639 | 1,470 | (1,185) | (774) |
| FFO-adjusted | \$ 1,150 | \$ 6,849 | \$ 17,794 | \$ 15,550 |

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Optional and not included.

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 1. LEGAL PROCEEDINGS

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

We were a defendant in litigation with David Clapper and related entities (collectively, “Clapper”) regarding a multifamily property transaction that occurred in 1988. In March 2016, the court ruled in favor of Clapper and awarded them approximately \$59.0 million. We appealed the ruling, and the appellate court remanded the case to trial, which occurred in May 2021. As a result, the Court vacated the prior award and determined that Clapper would take nothing.

In February 2019, a lawsuit was brought by Paul Berger (“Berger”) against us and others that alleges that TCI completed improper sales and/or transfers of property with Income Opportunity Realty Investors, Inc. (“IOR”). Berger requests that we pay off various related party loans to IOR and that IOR then distribute the funds to its shareholders. TCI intend to vigorously defend against the allegations. The trial for this matter is set for November 2022.

On July 13, 2021, we received the arbitration verdict in connection with a dispute on the measurement of the Earn Out Obligation (See Note 9 – Investment in Unconsolidated Joint Ventures of our consolidated financial statements), which determined that our position and claims were declined, and the position of Macquarie was fully accepted. As a result, we are required to pay approximately \$39.6 million to Macquarie to satisfy the Earn Out Obligation.

ITEM 1A RISK FACTORS

Except as set forth below, there have been no material changes from the risk factors previously disclosed in the 2020 10-K. For a discussion on these risk factors, please see “Item 1A. Risk Factors” contained in the 2020 10-K.

Risks Related to COVID-19 Pandemic

We continue to closely monitor the impact of the COVID-19 pandemic on all aspects of our business and our property portfolio. While we did not incur significant disruptions during the nine months ended September 30, 2021 from the COVID-19 pandemic, our commercial properties have experienced a decline in occupancy. We are unable to predict the impact that the COVID-19 pandemic will have on our financial condition, results of operations and cash flows due to numerous uncertainties. These uncertainties include the scope, severity and duration of the pandemic, the actions taken to contain the pandemic or mitigate its impact and the direct and indirect economic effects of the pandemic and containment measures, among others. Nearly every industry has been impacted directly or indirectly, and the commercial real estate market has come under pressure due to numerous factors, including preventative measures taken by local, state and federal authorities to alleviate the public health crisis such as mandatory business closures, quarantines, and restrictions on travel and “shelter-in-place” or “stay-at-home” orders. The future impact of COVID-19 on our business and financial activities will depend on future developments, which at this stage are unpredictable considering the fluctuations of COVID-19 outbreaks and the resulting changes in the markets.

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

We have a program that allows for the repurchase of up to 1,250,000 shares. There were no shares purchased under this program during the nine months ended September 30, 2021. As of September 30, 2021, 986,750 shares have been purchased and 263,250 shares may be purchased under the program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

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

| Exhibit Number | Description of Exhibit |
|-----------------------|---|
| 3.0 | Certificate of Restatement of Articles of Incorporation of American Realty Investors, Inc. dated August 3, 2000 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000). |
| 3.1 | Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc. dated August 29, 2000 (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q dated September 30, 2000). |
| 3.2 | Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc. decreasing the number of authorized shares of and eliminating Series B Cumulative Convertible Preferred Stock dated August 23, 2003 (incorporated by reference to Exhibit 3.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003). |
| 3.3 | Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc., decreasing the number of authorized shares of and eliminating Series I Cumulative Preferred Stock dated October 1, 2003 (incorporated by reference to Exhibit 3.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003). |
| 3.4 | Bylaws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement on Form S-4 filed December 30, 1999). |
| 4.1 | Certificate of Designations, Preferences and Relative Participating or Optional or Other Special Rights, and Qualifications, Limitations or Restrictions Thereof of Series F Redeemable Preferred Stock of American Realty Investors, Inc., dated June 11, 2001 (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001). |
| 4.2 | Certificate of Withdrawal of Preferred Stock, Decreasing the Number of Authorized Shares of and Eliminating Series F Redeemable Preferred Stock, dated June 18, 2002 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002). |
| 4.3 | Certificate of Designation, Preferences and Rights of the Series I Cumulative Preferred Stock of American Realty Investors, Inc., dated February 3, 2003 (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002). |
| 4.4 | Certificate of Designation for Nevada Profit Corporations designating the Series J 8% Cumulative Convertible Preferred Stock as filed with the Secretary of State of Nevada on March 16, 2006 (incorporated by reference to Registrant's current report on Form 8-K for event of March 16, 2006). |
| 4.5 | 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). |
| 10.1 | Advisory Agreement between American Realty Investors, Inc. and Pillar Income Asset Management, Inc., dated April 30, 2011 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, dated May 2, 2011). |
| 10.2 | Second Amendment to Modification of Stipulation of Settlement dated October 17, 2001 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4, dated February 24, 2002). |
| 31.1* | Certification by the Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended. |
| 32.1* | Certification pursuant to 18 U.S.C. 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |

[Table of Contents](#)

- 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: November 10, 2021

By: /s/ Erik L. Johnson

Erik L. Johnson
Executive Vice President and Chief Financial Officer
(Principal Executive and Financial Officer)

CERTIFICATION

I, Erik L. Johnson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Realty Investors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;
4. The registrant's other certifying officers(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal controls over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
 - (d) Disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2021

By: /s/ Erik L. Johnson

Erik L. Johnson
Executive Vice President and Chief Financial Officer
(Principal Executive and Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned officer of American Realty Investors, Inc., a Nevada corporation (the “Company”) hereby certifies that:

- (i) The Company’s Quarterly Report on Form 10-Q for the three months ended September 30, 2021 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (ii) The information contained in the Company’s Quarterly Report on Form 10-Q for the three months ended September 30, 2021 fairly presents in all material respects, the financial condition and results of operations of the Company, at and for the period indicated.

AMERICAN REALTY INVESTORS, INC.

Date: November 10, 2021

By: /s/ Erik L. Johnson
Erik L. Johnson
Executive Vice President and Chief Financial Officer
(Principal Executive and Financial Officer)