

AMERICAN REALTY INVESTORS INC

Form 10-Q

August 14, 2007

Table of Contents

---

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

---

**FORM 10-Q**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

**SECURITIES EXCHANGE ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007**

**Or**

**“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

**SECURITIES EXCHANGE ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**Commission File Number 001-15663**

---

**AMERICAN REALTY INVESTORS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Nevada**  
(State or Other Jurisdiction of

Incorporation or Organization)

**1800 Valley View Lane, Suite 300**

**Dallas, Texas 75234**

(Address of principal executive offices)

(Zip Code)

**75-2847135**  
(I.R.S. Employer

Identification No.)

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

(469) 522-4200

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE**

**PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

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

**10,136,193**  
(Outstanding at August 3, 2007)

---

**Table of Contents**

**AMERICAN REALTY INVESTORS, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

<b>PART I. FINANCIAL INFORMATION</b>	<b>PAGE</b>
Item 1. Financial Statements	
<u>Consolidated Balance Sheets at June 30, 2007 (unaudited) and December 31, 2006</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006 (unaudited)</u>	4
<u>Consolidated Statement of Shareholders' Equity for the six months ended June 30, 2007 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006 (unaudited)</u>	7
<u>Notes to Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	27
Item 4. <u>Controls and Procedures</u>	27
<b>PART II. OTHER INFORMATION</b>	
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	28
Item 6. <u>Exhibits</u>	29
<u>SIGNATURE PAGES</u>	30

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****AMERICAN REALTY INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS**

	June 30,	December 31,
	2007	2006
	(dollars in thousands)	
	(unaudited)	
<b>Assets</b>		
Real estate held for investment	\$ 1,503,291	\$ 1,249,833
Less accumulated depreciation	(185,046)	(178,029)
	1,318,245	1,071,804
Real estate held for sale, net of depreciation	42,153	134,593
Real estate subject to sales contract	65,174	66,027
Notes and interest receivable		
Performing (\$29,523 in 2007 and \$28,541 in 2006 from affiliates)	58,262	50,668
Non-performing	23,253	2,963
	81,515	53,631
Less allowance for estimated losses	(1,003)	(1,000)
	80,512	52,631
Marketable securities, at market value	11,226	9,038
Cash and cash equivalents	5,470	7,035
Restricted cash	4,168	6,000
Investments in equity investees	31,260	25,056
Other assets (\$45,972 in 2007 and \$52,793 in 2006 from affiliate)	139,847	121,487
	\$ 1,698,055	\$ 1,493,671
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Notes payable (\$8,036 in 2007 and \$7,499 in 2006 to affiliates)	\$ 1,265,046	\$ 1,022,370
Liabilities related to assets held for sale	57,685	43,579
Liabilities subject to sales contract	32,224	58,816
Stock-secured notes payable	22,546	22,452
Accounts payable and other liabilities (\$1,058 in 2007 and \$5,839 in 2006 to affiliates)	117,734	107,771
	1,495,235	1,254,988
Commitments and contingencies		
Minority interest	61,548	78,194
Stockholders equity:		
Common Stock; \$.01 par value, authorized 100,000,000 shares, issued 11,592,272 shares in 2007 and 2006	114	114

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

Preferred Stock; \$2.00 par value, authorized 50,000,000 shares, issued and outstanding Series A 3,389,560 shares in 2007 and 2006 (liquidation preference \$33,909), including 900,000 shares in 2007 and 2006 held by subsidiaries	4,979	4,979
Additional paid-in capital	106,624	93,378
Treasury stock, at cost, 1,453,657 and 1,443,272 shares in 2007 and 2006, respectively	(15,588)	(15,146)
Retained earnings	43,236	75,380
Accumulated other comprehensive income	1,907	1,784
	141,272	160,489
	\$ 1,698,055	\$ 1,493,671

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	For the Three Months		For the Six Months	
	Ended June 30, 2007	2006	Ended June 30, 2007	2006
	(dollars in thousands)		(dollars in thousands)	
Property revenue:				
Rental and other property revenues (\$352 in 2007 and \$517 in 2006 from affiliates)	\$ 52,111	\$ 43,129	\$ 103,218	\$ 86,880
Expenses:				
Property operating expenses (\$4,419 in 2007 and \$3,306 in 2006 to affiliates)	33,702	30,161	66,205	58,114
Depreciation and amortization	7,585	6,219	14,383	12,304
General and administrative (\$1,761 in 2007 and \$2,550 in 2006 to affiliates)	3,773	1,901	8,513	4,831
Advisory fee to affiliate	3,834	3,230	7,133	6,310
Total operating expenses	48,894	41,511	96,234	81,559
Operating income	3,217	1,618	6,984	5,321
Other income (expense):				
Interest income from notes receivable (\$816 in 2007 and \$828 in 2006 from affiliates)	1,477	2,093	3,031	3,238
Gain (loss) on foreign currency transaction	(135)	2	(4)	4
Other income (\$2,767 in 2007 and \$2,085 in 2006 from affiliate)	1,726	405	4,270	2,013
Mortgage and loan interest (\$363 in 2007 and \$232 in 2006 to affiliates)	(25,027)	(19,434)	(50,420)	(37,219)
Net income fee to affiliate			705	
Litigation settlement		1,434	24	1,804
Total other income (expense)	(21,959)	(15,500)	(42,394)	(30,160)
Loss before gain on land sales, minority interest and equity in income of unconsolidated real estate entities	(18,742)	(13,882)	(35,410)	(24,839)
Gain on land sales		10,668	4,897	13,408
Minority interest	(281)	(798)	(505)	32
Equity in income of unconsolidated real estate entities		86		261
Loss from continuing operations	(19,023)	(3,926)	(31,018)	(11,138)
Income tax benefit (expense)	(1,196)	1,545	42	1,343
Net loss from continuing operations	(20,219)	(2,381)	(30,976)	(9,795)
Income (loss) from discontinued operations	(3,417)	4,414	120	3,837
Income tax benefit (expense)	1,196	(1,545)	(42)	(1,343)
Net income (loss) from discontinued operations	(2,221)	2,869	78	2,494
Net income (loss)	(22,440)	488	(30,898)	(7,301)
Preferred dividend requirement	(624)	(631)	(1,246)	(1,245)

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

Net loss applicable to common shares \$ (23,064) \$ (143) \$ (32,144) \$ (8,546)

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS Continued****(unaudited)**

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2007	2006	2007	2006
	(dollars in thousands)		(dollars in thousands)	
<b>Basic earnings per share:</b>				
Loss from continuing operations	\$ (2.06)	\$ (0.30)	\$ (3.18)	\$ (1.09)
Income (loss) from discontinued operations	(0.22)	0.28	0.01	0.25
Net loss applicable to common shares	\$ (2.28)	\$ (0.02)	\$ (3.17)	\$ (0.84)
<b>Diluted earnings per share:</b>				
Loss from continuing operations	\$ (2.06)	\$ (0.30)	\$ (3.18)	\$ (1.09)
Income (loss) from discontinued operations	(0.22)	0.28	0.01	0.25
Net loss applicable to common shares	\$ (2.28)	\$ (0.02)	\$ (3.17)	\$ (0.84)
<b>Weighted average common shares used in computing earnings per share:</b>				
Basic	10,141,525	10,149,000	10,141,525	10,149,000
Diluted	10,141,525	10,149,000	10,141,525	10,149,000

Series A Cumulative Convertible Preferred Stock (3,389,560 and 3,391,000 shares of Preferred Stock convertible into common stock estimated to be 2,957,000 common shares) and options to purchase 70,750 shares of ARI's common stock were excluded from the computation of diluted earnings per share for the three and six months ended June 30, 2007 and 2006, because the effect of their inclusion would be antidilutive.

The accompanying notes are an integral part of these Consolidated Financial Statements.



Table of Contents

## AMERICAN REALTY INVESTORS, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

For the Six Months Ended June 30, 2007

(dollars in thousands)

(unaudited)

	Common Stock		Preferred Stock		Additional Paid-in Capital	Treasury Stock		Accumulated Other Retained		Comprehensive Income/(Loss) Equity	Stockholders
	Shares	Amount	Shares	Amount		Shares	Amount	Earnings	Income/(Loss)		
<b>Balance, January 1, 2007</b>	11,592,272	\$ 114	3,389,560	\$ 4,979	\$ 93,378	1,443,272	\$ (15,146)	\$ 75,380	1,784	\$ 160,489	
Unrealized loss on foreign currency translation									(668)		(668)
Unrealized gain on marketable securities									791		791
Net loss								(30,898)			(30,898)
Acquisition of minority interest					13,246						13,246
Repurchase of common stock						10,385	(442)				(442)
Series A preferred stock cash dividend (\$1.00 per share)								(1,246)			(1,246)
<b>Balance, June 30, 2007</b>	11,592,272	\$ 114	3,389,560	\$ 4,979	\$ 106,624	1,453,657	\$ (15,588)	\$ 43,236	\$ 1,907	\$ 141,272	

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	<b>For the Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(dollars in thousands)</b>	
<b>Cash Flows From Operating Activities:</b>		
Loss from continuing operations	\$ (30,976)	\$ (9,795)
Adjustments to reconcile net income to net cash used in operating activities		
Gain on sale of land	(5,794)	(1,080)
Depreciation and amortization	14,225	13,617
Amortization of deferred borrowing costs	2,762	970
Income tax benefit expense	(42)	(1,343)
Equity in (income) loss of investees		261
Gain (loss) on foreign currency transaction	4	(4)
(Increase) decrease in assets:		
Accrued interest receivable		(1,932)
Other assets	(39,073)	(2,874)
Investments	(1,410)	
Notes receivable	(22,868)	
Prepaid expense	(2,575)	
Escrows	1,472	
Rents receivable	(1,577)	
Increase (decrease) in liabilities:		
Notes payable	(15,813)	
Accrued interest payable	(202)	(1,403)
Minority interest	(50)	(3,719)
Other liabilities	11,748	(5,790)
<b>Net cash used in operating activities</b>	<b>(90,169)</b>	<b>(13,092)</b>
<b>Cash Flows From Investing Activities:</b>		
Collections on notes receivable	13,489	14,831
Proceeds from sale of notes receivable		6,749
Funding of notes receivable		(2,211)
Acquisition of land held for development	(14,506)	(39,359)
Real estate improvements	(12,783)	(9,942)
Real estate construction and development	(91,682)	
Proceeds from sales of income-producing properties	41,431	
Proceeds from sale of land	4,531	16,342
Acquisition of income producing properties	(112,193)	(7,496)
Investment in joint venture	(3,659)	
Improvement of land held for sale	(2,869)	
Improvement of income producing properties	(8,094)	
Acquisition of minority interests	(1,301)	
Payments made for marketable securities	(697)	
Distributions to equity investees	(1,524)	
Earnest money/escrow deposits	5,310	(988)
<b>Net cash provided by (used in) investing activities</b>	<b>(184,547)</b>	<b>(22,074)</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.



**Table of Contents****AMERICAN REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS** Continued

(unaudited)

	<b>For the Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(dollars in thousands)</b>	
<b>Cash Flows From Financing Activities:</b>		
Proceeds from notes payable	289,962	89,623
Construction and development financing	84,243	
Recurring amortization of principal on notes payable	(6,632)	
Other payments on notes payable	(62,997)	
Increase in due from affiliates	28,186	
Payments on maturing notes payable	(1,122)	
Payments on notes payable related to asset sales and refinancings	(34,040)	(40,179)
Deferred borrowing costs	(11,848)	(2,499)
Net advances from (payments to) affiliates	(10,346)	
Restricted cash	1,832	
Dividends paid to shareholders	(455)	
Purchase of treasury stock	(485)	
Preferred dividends paid	(1,246)	(321)
<b>Net cash (used in) provided by financing activities</b>	<b>275,052</b>	<b>46,624</b>
<b>Discontinued Operations:</b>		
Cash used in operating activities	(1,060)	(12,423)
Cash used in financing activities — payment of notes payable	(29,012)	
Cash provided by investing activities	28,171	3,444
<b>Net cash provided (used) by discontinued operations</b>	<b>(1,901)</b>	<b>(8,979)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(1,565)</b>	<b>2,479</b>
Cash and cash equivalents, beginning of period	7,035	13,904
<b>Cash and cash equivalents, end of period</b>	<b>\$ 5,470</b>	<b>\$ 16,383</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Cash paid for interest	\$ 50,335	\$ 32,260
<b>Schedule of Non-Cash Investing and Financing Activities:</b>		
Increase in minority interest related to acquisition of real estate		14,835
Notes payable assumed from buyer upon sale of real estate		42,156
Note payable assumed by affiliate		4,000
Unrealized loss foreign currency translation	(380)	(194)
Unrealized gain on marketable securities	503	864
Note receivable received from affiliate	22,111	

The accompanying notes are an integral part of these Consolidated Financial Statements.



**Table of Contents**

**AMERICAN REALTY INVESTORS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

American Realty Investors, Inc. a Nevada corporation ( ARI , The Company , We , Our or Us ) was organized in 1999. In 2002, the Company, through mergers into wholly-owned subsidiaries acquired several entities. In 2003, the Company acquired 82.2% of the outstanding shares of Transcontinental Realty Investors, Inc. ( TCI ) a Nevada Corporation which is traded on the New York Stock Exchange, Inc. ( NYSE ) under the ticker symbol TCI . TCI 's operations are fully consolidated in our financial statements.

We are an externally advised real estate investment company and have no employees. We own a diverse portfolio of residential apartment communities, office buildings, hotels and other commercial properties. At June 30, 2007, the Company owned approximately 14,000 units in 77 residential apartment communities, 33 commercial properties comprising 5.3 million rentable square feet and ten hotels containing a total of 1,235 rooms. We own 10,900 acres of undeveloped land and have over 2,500 apartment units in 14 projects under construction. The Company currently owns operating properties or land in 20 states as well as in Poland and the U.S. Virgin Islands. American Realty Investors, Inc. is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange under the symbol ARL . Prime Income Asset Management, LLC ( Prime ) is the Company 's external advisor. Regis Property Management, LLC, an affiliate of Prime, manages the Company 's commercial properties. Regis Hotel I, LLC, another Prime affiliate, manages the Company 's hotel investments. ARI engages various third-party companies to lease and manage its apartment properties. In addition, we have a 20% interest in Milano Restaurants International Corporation.

The accompanying interim financial statements are unaudited; however, the financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in conjunction with the rules and regulations of the Securities Exchange Commission. Accordingly, they do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring matters) necessary for a fair presentation of the financial statement for these interim periods have been included. The results of operations for the interim periods are not necessarily indicative of the results to be obtained for other interim periods or for the full fiscal year. The year end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosure required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the Company 's financial statements and notes thereto contained in the Company 's Annual Report on Form 10-K for its fiscal year ended December 31, 2006.

*Newly issued accounting standards.* In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 ( FIN No. 48 ). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in a company 's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 was effective for fiscal years beginning after December 15, 2006. FIN No. 48, which was adopted by the Company effective January 1, 2007, did not have a material impact on the Company 's cash flows, results of operations, financial position or liquidity.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS No. 157 to have a material impact on the Company 's cash flows, results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 ( SFAS No. 159 ). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating and assessing the impact of this statement.

**NOTE 2. REAL ESTATE**

At June 30, 2007, ARI 's real estate consisted of the following:

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

	Cost	Accumulated Depreciation
Apartments	\$ 422,584	\$ 59,446
Apartments under construction	128,658	
Commercial buildings	443,402	100,974
Hotels	88,650	24,439
Land held for development	419,997	187
<b>Total</b>	<b>\$ 1,503,291</b>	<b>\$ 185,046</b>

In 2007, ARI purchased the following properties:

Property	Location	Acres/ Sq. Ft./Units	Purchase Price	Net Cash Paid	Debt Incurred	Debt Paid	Interest Rate	Maturity Date
<b>First Quarter</b>								
<b>Land</b>								
Audubon Terrace	Natchez, MS	48.2 Acres	\$ 285	\$ 504	\$	\$	%	
Keller Springs	Addison, TX	5.6 Acres	2,526	539	2,021		9.25 <sup>(1)</sup>	2/08
			2,811	1,043	2,021			
<b>Buildings</b>								
Parkwest I	Farmers Branch, TX	383,114 Sq. Ft.	40,604	1,587	35,000	5,750	6.06	1/09
Parkwest II	Farmers Branch, TX	707,559 Sq. Ft.	69,694	8,106	62,000		9.32 <sup>(1)</sup>	1/13
			110,298	9,693	97,000	5,750		
			113,109	10,736	99,021	5,750		
<b>Second Quarter</b>								
<b>Land</b>								
Hines Meridian	Las Colinas, TX	40.1 Acres	7,900	2,998	5,000		9.25 <sup>(1)</sup>	6/10
Senlac Land	Farmers Branch, TX	4.0 Acres	1,003					
Waco Land	Waco, TX	151.0 Acres	2,000	453	1,300		9.25 <sup>(1)</sup>	4/10
William Sprowles	Irving, TX	1.2 Acres	210	277				
			11,113	3,728	6,300			
<b>Apartments</b>								
Thornwood	Midland, TX	109 Units	1,895		1,638	1,638		
			13,008	3,728	7,938	1,638		
			\$ 126,117	\$ 7,976	\$ 106,959	\$ 7,388		

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

In 2006, ARI purchased the following properties:

Property	Location	Acres/Units	Purchase Price	Net Cash Paid	Debt Incurred	Interest Rate	Maturity Date
<b>First Quarter</b>							
<b>Land</b>							
Circle C Ranch	Austin, TX	1,092.0 Acres	\$ 21,000	\$	\$ 21,000	8.75% <sup>(1)</sup>	03/08
Pioneer Crossing	Austin, TX	38.5 Acres	614	614	1,515	8.75 <sup>(1)</sup>	06/08
Southwood 1394	Tallahassee, FL	14.5 Acres	1,150	477	748	8.50 <sup>(1)</sup>	02/08
Valley Ranch 20	Farmers Branch, TX	20.0 Acres	4,673	1,892	3,038	8.50 <sup>(1)</sup>	02/08
Polo Estates at Bent Tree	Dallas, TX	5.9 Acres	3,833	1,014	3,000	8.25 <sup>(1)</sup>	01/08
Polo Estates at Park Forest	Dallas, TX	9.3 Acres	4,560	1,868	2,964	8.00	12/07
			35,830	5,865	32,265		
<b>Apartments</b>							
Anderson Estates	Oxford, MS	48 Units	1,144 <sup>(2)</sup>	148	996	9.50 <sup>(1)</sup>	12/20
David Jordan Phase II	Greenwood, MS	32 Units	743 <sup>(2)</sup>	98	645	8.50 <sup>(1)</sup>	04/19
David Jordan Phase III	Greenwood, MS	40 Units	812 <sup>(2)</sup>	122	690	8.75 <sup>(1)</sup>	07/22
Leflore Estates	Greenwood, MS	104 Units	2,114 <sup>(2)</sup>	337	1,777	7.00	02/22
Monticello III Estates	Monticello, AR	32 Units	644 <sup>(2)</sup>	96	548	7.00	01/22
Riverwalk Phase I	Greenwood, MS	32 Units	455 <sup>(2)</sup>	99	356	8.50	02/19
Riverwalk Phase II	Greenwood, MS	72 Units	1,584 <sup>(2)</sup>	226	1,358	8.25 <sup>(1)</sup>	02/19
			7,496	1,126	6,370		
			43,326	6,991	38,635		
<b>Second Quarter</b>							
<b>Land</b>							
Forney Land	Forney, TX	34.8 Acres	3,945	3,926			
Parc at Clarksville	Clarksville, TN	10.4 Acres	541		547	8.00	08/06 <sup>(3)</sup>
Senlac Hutton	Farmers Branch, TX	5.9 Acres	1,050	949			
Waco 42	Waco, TX	42.8 Acres	531	112	398	8.00	05/09
			6,067	4,987	945		
			\$ 49,393	\$ 11,978	\$ 39,580		

(1) Variable interest rate.

(2) Net of minority interest and other liabilities assumed.

(3) ARI is negotiating with Lender to extend this loan.

In January 2007, the Company acquired four office buildings containing approximately 1,090,000 rentable square feet and a 4.7 acre tract of undeveloped land located in Farmers Branch, TX, known as Park West. The properties were acquired for a total purchase price of \$110 million plus closing costs. The acquisition was financed with a two year, \$62 million loan from a commercial bank and a six year, \$35 million loan from



## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

a life insurance company. The combined weighted average interest rate at closing was approximately 8.15%. The loans are collateralized by the properties and guaranteed by ARI.

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

On May 8, 2007, we purchased 40.1 acres of land in Las Colinas, Texas known as Hines Meridian for \$7.9 million. The acquisition was financed with \$3.0 million cash and a new note for \$5.0 million. The note accrues interest at 9.25%, is payable in installments of interest only for 12 months, then installments of principal and interest for 23 months and one final payment of all accrued, unpaid interest and the outstanding principal balance on maturity in May 2010.

In 2007, ARI sold the following properties:

<b>Property</b>	<b>Location</b>	<b>Acres/ Sq. Ft./Units</b>	<b>Sales Price</b>	<b>Net Cash Received/Paid</b>	<b>Debt Discharged</b>	<b>Gain On Sale</b>
<b>First Quarter</b>						
<b>Land</b>						
Grapevine Yards	Grapevine, TX	4.6 Acres	\$ 2,928	\$ 1,015	\$ 1,758	\$ 1,040
McKinney Ranch Land	McKinney, TX	15.1 Acres	2,785	793	1,850	1,122
Metro Center Land	Nashville, TN	22.4 Acres	3,896	706	2,985	2,728
			9,609	2,514	6,593	4,890
<b>Apartments</b>						
Bluffs at Vista Ridge	Lewisville, TX	272 Units	24,650	3,126	15,518	3,648
Mediterranean Villa	San Antonio, TX	140 Units	4,110	1,039	2,598	744
			28,760	4,165	18,116	4,392
			38,369	6,679	24,709	9,282
<b>Second Quarter</b>						
<b>Land</b>						
Denton Coonrod	Denton, TX	82.2 Acres	1,895		1,637	
Palm Desert	Palm Desert, CA	1.2 Acres	900			
			2,795		1,637	
<b>Buildings</b>						
Durham Center	Durham, NC	207,171 Sq. Ft.	19,200	3,409	10,638	(2,368)
			21,995	3,409	12,275	(2,368)
			\$ 60,364	\$ 10,088	\$ 36,984	\$ 6,914

In 2006, ARI sold the following properties:

<b>Property</b>	<b>Location</b>	<b>Acres/Units</b>	<b>Sales Price</b>	<b>Net Cash Received/Paid</b>	<b>Debt Discharged</b>	<b>Gain</b>
-----------------	-----------------	--------------------	------------------------	-----------------------------------	----------------------------	-------------

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

On Sale

**First Quarter**

<b>Land</b>						
Hollywood Casino	Farmers Branch, TX	10.5 Acres	\$ 3,225	\$ 1,297	\$	\$ 331
Vineyards II	Grapevine, TX	1.5 Acres	1,272	429	745	578
			4,497	1,726	745	909

**Second Quarter**

<b>Land</b>						
Elm Fork	Carrollton, TX	27.6 Acres	3,500	(827)	2,800	1,596
Elm Fork	Carrollton, TX	8.5 Acres	1,674	(755)	1,135	1,030
McKinney Ranch Land	McKinney, TX	123.9 Acres	16,591	6,004	10,051	3,389
McKinney Ranch Land	McKinney, TX	44.5 Acres	10,289	10,031		5,301
Nashville	Nashville, TN	16.4 Acres	2,512		2,416	1,700
Nashville	Nashville, TN	2.4 Acres	462		429	323
Stagliano	Farmers Branch, TX	3.1 Acres	1,373	187		715
			36,401	14,640	16,831	14,054

**Apartments**

Plantation Apartments	Tulsa, OK	138 Units	2,750	638	2,191	432
Willo-Wick Apartments	Pensacola, FL	152 Units	6,500	2,806	2,827	2,860
			9,250	3,444	5,018	3,292
			45,651	18,084	21,849	17,346
			\$ 50,148	\$ 19,810	\$ 22,594	\$ 18,255

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

At June 30, 2007, ARI had the following apartment properties under construction:

Property	Location	Units	Amount Expended	Additional Amount to Expend	Construction Loan Funding
<b>Apartments</b>					
Bolivar Homes	Cleveland, MS	65 Units	\$ 2,481	\$ 6,128	\$ 1,619
Broadway Estates	Greenville, MS	104 Units	2,066	6,291	1,190
Lago Vista	Farmers Branch, TX	212 Units	15,831	10,619	6,691
Legends of El Paso	El Paso, TX	240 Units	17,812	4,079	15,166
Longfellow Arms	Longview, TX	216 Units	5,025	3,286	4,046
Mason Park	Houston, TX	312 Units	1,991	17,409	1,567
Mission Oaks	San Antonio, TX	228 Units	15,980		13,688
Parc at Clarksville	Clarksville, TN	206 Units	11,437	2,455	10,659
Parc at Maumelle	Maumelle, AR	240 Units	19,701		15,847
Parc at Metro Center	Nashville, TN	144 Units	12,578		9,927
Parc at Rogers	Rogers, AR	152 Units	12,048	8,777	10,589
Pecan Pointe	Temple, TX	232 Units	8,158	8,679	7,095
Sunflower Estates	Indianola, MS	65 Units	1,494	6,936	902
Yazoo Estates	Yazoo City, MS	96 Units	2,056	6,289	1,176
Total		2,512 Units	\$ 128,658	\$ 80,948	\$ 100,162

**NOTE 3. NOTES AND INTEREST RECEIVABLE**

Borrower	Maturity Date	Interest Rate	Amount	Security
<b>Performing loans:</b>				
400 St. Paul	10/08	8.00%	\$ 3,612	Office building, Dallas, TX
Basic Capital Management <sup>(1)</sup>	4/08	9.25 <sup>(3)</sup>	1,252	Industrial building, Arlington, TX
Basic Capital Management <sup>(1)</sup>	4/08	9.25 <sup>(3)</sup>	1,523	Retail building, Cary, NC
Carrollton TH, LP	3/09	15.00	1,728	27.5 acres Elm Fork Ranch, Carrollton, TX
Dallas Fund XVII LP <sup>(2)</sup>	10/06	9.00	3,907	Partnership interests and lawsuit proceeds
Garden Centura LP	N/A	7.00	6,372	Excess cash flow from partnership
Miscellaneous related party notes	Various	Various	8,514	Various security interests
One Realco <sup>(2)</sup>	2/07	9.25 <sup>(3)</sup>	9,949	Subordinate pledge of One Realco Stock
Pioneer Austin Development	10/08	10.00	3,178	33 acres undeveloped land, Austin, TX
Realty Advisors	11/08	9.25 <sup>(3)</sup>	5,633	850 shares of ARI stock owned by BCM
Unified Housing of Harvest Hill	10/13	12.00	7,034	Surplus cash note
Accrued interest			5,560	
Total			\$ 58,262	

(1) Related party.

(2) Currently negotiating extension of this note.

(3) Variable rate.

**NOTE 4. INVESTMENTS IN UNCONSOLIDATED REAL ESTATE ENTITIES**

ARI's investment in real estate entities at June 30, 2007 was as follows:

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

<b>Investee</b>	<b>Percentage of Ownership at June 30, 2007</b>	<b>Carrying Value of Investment at June 30, 2007</b>	<b>Market Value<sup>(1)</sup> of Investment at June 30, 2007</b>
IORI	24.8%	\$6,370	\$4,079
Garden Centura, L.P. <sup>(2)</sup>	5.0	1,944	4,404
Gruppa Florentina, LLC ( Gruppa <sup>(2)</sup> )	20.0	4,750	N/A
Other <sup>(2)</sup>		18,196	N/A
		<b>\$31,260</b>	

(1) Based on stock closing price on June 30, 2007 and is not necessarily indicative of the fair market value of the investee's net assets.

(2) No readily determinable market value.

Set forth below are summarized results of operations of IORI and Garden Centura for the six months ended June 30, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
Revenues	\$ 11,087	\$ 66,802
Equity in loss of partnership		81
Property operating expenses	(5,442)	(52,499)
Depreciation	(1,760)	(5,341)
Interest	(5,226)	(16,474)
Income before gain on sale of real estate	(1,341)	(7,431)
Gain on sale of real estate		4,314
Net loss	\$ (1,341)	\$ (3,117)

**NOTE 5. MARKETABLE EQUITY SECURITIES**

ARI owns equity securities of Realty Korea CR-REIT Co., Ltd. No. 1 representing approximately a 9.2% ownership interest. This investment is considered an available for sale security. ARI recognized an unrealized gain of \$791,000 for the six month period ending June 30, 2007 due to an increase in market price.

**NOTE 6. NOTES PAYABLE**

On February 23, 2007, ARI received \$4.9 million in proceeds from a \$5.0 million loan with a commercial bank. The note accrues interest at prime plus 1% which is payable monthly, commencing April 1, 2007, until maturity in February 2008. At maturity all accrued and unpaid interest and outstanding principal are due. The loan is secured by 235.0 acres in Farmers Branch, Texas, known as Mercer Crossing and 97.3 acres in Austin, Texas, known as Pioneer Crossing.

On March 16, 2007, ARI refinanced the note secured by Piccadilly Shaw Hotel through a commercial bank. The Company received \$6.5 million in proceeds, paid down a \$5.2 million note and acquired new debt of \$12.8 million. The note accrues interest at 8%. The note is payable in monthly principal payments of \$16,234 plus accrued interest. The payments commence April 1, 2007 and are payable through maturity, in February 2012. At maturity, all accrued and unpaid interest and outstanding principal are due.

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

On March 16, 2007, ARI refinanced the note secured by Piccadilly Airport Hotel through a commercial bank. The Company received \$6.8 million in proceeds, paid down a \$4.5 million note and acquired new debt of \$12.2 million. The note accrues interest at 8%. The note is payable in monthly principal payments of \$16,994 plus accrued interest. The payments commence April 1, 2007 and are payable through maturity, in February 2012. At maturity, all accrued and unpaid interest and outstanding principal are due.

On March 22, 2007, ARI entered into a promissory note with an unrelated individual lender. The Company received \$6.5 million in proceeds and acquired \$6.5 million in debt. The note accrues interest at 12.5%, and matures April 26, 2007, at which time all accrued and unpaid interest and outstanding principal are due.

In 2007, ARI obtained mortgage financing on the following:

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

	Location	Acres/Rooms Sq. Ft./Units	Debt Incurred	Debt Discharged	Net Cash Received/Paid	Interest Rate	Maturity Date
<b>First Quarter</b>							
<b>Land</b>							
Crowley & Wilmer Land	Crowley & Wilmer, TX	142.6 Acres	\$ 3,390	\$	\$ 2,633	10.00% <sup>(1)</sup>	7/07
Grapevine Vineyard	Grapevine, TX	6.2 Acres	1,758	265	1,385	9.75 <sup>(1)</sup>	7/07
Manhattan Land	Farmers Branch, TX	112.0 Acres	7,000		6,620	10.00 <sup>(1)</sup>	1/08
Payne I Land	Irving, TX	109.8 Acres	6,500		6,500	12.00 <sup>(1)</sup>	
Pioneer Crossing	Austin, TX	97.3 Acres	5,000		4,916 <sup>(2)</sup>	9.25 <sup>(1)</sup>	2/08
			23,648	265	22,054		
<b>Hotels</b>							
City Suites Hotel	Chicago, IL	45 Rooms	7,300	3,551	3,700	8.25	2/12
Piccadilly Airport Hotel	Fresno, CA	185 Rooms	12,200	4,478	6,778	8.00	2/12
Piccadilly Chateau Hotel	Fresno, CA	78 Rooms	3,700	1,884	1,436	8.00	2/12
Piccadilly Shaw Hotel	Fresno, CA	194 Rooms	12,800	5,200	6,451	8.00	2/12
The Majestic Hotel	Chicago, IL	55 Rooms	6,000	3,100	2,866	7.76	3/10
Willows Surf Hotel	Chicago, IL	52 Rooms	5,160		1,529	7.76	3/10
			47,160	18,213	22,760		
			70,808	18,478	44,814		
<b>Second Quarter</b>							
<b>Apartments</b>							
Arbor Pointe	Odessa, TX	194 Units	5,088	1,799	4,988	7.03	7/37
Autumn Chase	Midland, TX	64 Units	2,400	1,131	705	9.25 <sup>(1)</sup>	9/07
Courtyard	Midland, TX	133 Units	3,440	1,315	2,057	7.03	7/37
Coventry Point	Midland, TX	120 Units	3,120	1,137	1,858	7.03	7/37
Fountains at Waterford	Midland, TX	172 Units	5,920	1,525	252	7.03	7/37
Hunters Glen	Midland, TX	212 Units	4,462	2,448	938	9.25 <sup>(1)</sup>	9/07
Southgate	Odessa, TX	180 Units	4,614	1,867	2,671	7.03	7/37
Sunchase	Odessa, TX	300 Units	7,328	3,128	7,196	7.03	7/37
Sunset	Odessa, TX	240 Units	5,531	2,958	1,285	9.25 <sup>(1)</sup>	9/07
Thornwood	Midland, TX	109 Units	2,784	1,098	1,582	7.03	7/37
Westwood Square	Odessa, TX	79 Units	936	496	418	7.03	7/37
Whispering Pines	Topeka, KS	320 Units	8,300	7,076	970	7.00 <sup>(1)</sup>	4/08
			53,923	25,978	24,920		
<b>Land</b>							
Mercer Crossing	Farmers Branch, TX	235.0 Acres	3,000			9.25 <sup>(1)</sup>	5/08
Pioneer Crossing	Austin, TX	257.0 Acres	12,000		11,209	10.25	5/08
Polo Estates at Park Forest	Dallas, TX	9.3 Acres	3,107	2,982	76	9.25 <sup>(1)</sup>	12/07
Various tracts	Dallas, TX	35.9 Acres	4,193		6,019	12.50	4/09
			22,300	2,982	17,304		
<b>Commercial</b>							



Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

Hickory IV	Farmers Branch, TX	221,000 Sq. Ft.	26,000	12,178	13,153	8.67 <sup>(1)</sup>	6/10
			102,223	41,138	55,377		
			\$ 173,031	\$ 59,616	\$ 100,191		

In 2006, ARI financed/refinanced or obtained second mortgage financing on the following:

	Location	Acre/ Sq. Ft./Units	Debt Incurred	Debt Discharged	Net Cash Received/Paid	Interest Rate	Maturity Date
<b>First Quarter</b>							
<b>Apartments</b>							
Hunters Glen	Midland, TX	212 Units	\$ 2,475	\$ 1,804	\$ 421	7.23% <sup>(1)</sup>	2/09
<b>Land</b>							
Nashville	Nashville, TN	100.9 Acres	2,500		2,500 <sup>(2)</sup>	12.50 <sup>(1)</sup>	5/06 <sup>(4)</sup>
Palmer Lane	Austin, TX	367.4 Acres	14,000	14,300	(893)	8.50	8/07
Pioneer Crossing	Austin, TX	235.0 Acres	11,750 <sup>(3)</sup>	4,000		12.50 <sup>(1)</sup>	4/07 <sup>(4)</sup>
West End	Dallas, TX	5.3 Acres	9,000	2,000	6,079	8.00	3/07 <sup>(4)</sup>
			37,250	20,300	7,686		
			39,725	22,104	8,107		
<b>Second Quarter</b>							
<b>Land</b>							
Nashville Land	Nashville, TN	82.2 Acres	6,500	2,776	3,561	7.50	7/08
<b>Office Buildings</b>							
University Square	Anchorage, AK	20,215 Sq. Ft.	1,360	1,079	257	8.25	5/16
			7,860	3,855	3,818		
			\$ 47,585	\$ 25,959	\$ 11,925		

(1) Variable rate.

(2) Cash received by affiliate, increasing ARI's affiliate receivable.

(3) Various affiliate notes extended and collateralized by ARI, increasing ARI affiliate receivable.

(4) ARI is negotiating with Lender to extend this loan.

**Table of Contents**

**AMERICAN REALTY INVESTORS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

On April 30, 2007, we refinanced the existing mortgage of \$7.1 million on Whispering Pines Apartments, a 320 unit apartment complex located in Topeka, Kansas, with a new note for \$8.3 million and received \$1.0 million in cash. The new note accrues interest at 7.0% with interest only payments due monthly and all unpaid accrued interest and the not balance payable on maturity, in April 2008.

On May 3, 2007, we obtained a \$12 million loan secured by 257.0 acres of land in Austin, Texas known as Pioneer Crossing. The note accrues interest 10.25%, is payable in monthly installments of interest only and all accrued and unpaid interest and the remaining principal balance are due on maturity in May 2008.

On May 31, 2007, we refinanced the existing mortgage of \$12.2 million on Hickory IV, a 221,000 square foot commercial building located in Farmers Branch, Texas for \$26.0 million. The note accrues interest at LIBOR plus 3.75% with interest only payments due monthly and all unpaid accrued interest and the outstanding principal payable on maturity in May 2009.

On June 6, 2007 we refinanced \$12.4 million in existing mortgages on eight apartment complexes; Arbor Pointe, Courtyard, Coventry Pointe, Fountains at Waterford, Southgate, Sunchase, Thornwood, and Westwood apartments consisting of 1,287 units located throughout Midland and Odessa, Texas for new loans totaling \$33.2 million receiving \$21.0 million in cash and paid down property debt and defeasance costs totaling \$4.1 million. The loans accrue interest at 7.03% is payable in monthly installments of interest and principal, and all accrued and unpaid interest and the outstanding principal balance are due on maturity, July 2037.

On June 28, 2007 we refinanced the existing notes of \$6.5 million on three apartment complexes; Autumn Chase, Hunters Glen and Sunset apartments consisting of 516 units in total located throughout Midland and Odessa, Texas for new loans totaling \$12.4 million, receiving \$3.0 million in cash. The loans accrue interest at prime plus 25 points with interest only payments due monthly and all unpaid accrued interest and the outstanding principal balance payable on maturity in September 2007.

**NOTE 7. STOCK-SECURED NOTES PAYABLE**

ARI has margin arrangements with various financial institutions and brokerage firms, which provide for borrowings of up to 50.0% of the market value of marketable equity securities. ARI also has other notes payable secured by stock. The borrowings under such margin arrangements and notes are secured by the equity securities of IORI and TCI, and ARI's trading portfolio securities and bear interest rates ranging from 9.5% to 24.0% per annum. Stock-secured notes payable and margin borrowings totaled \$22.5 million at June 30, 2007 and December 31, 2006.

**NOTE 8. RELATED PARTY TRANSACTIONS**

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable to) affiliates as of June 30, 2007.

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

Balance, January 1, 2007	\$ 44,739
Cash transfers to affiliates	122,672
Cash transfers from affiliates	(60,255)
Advances through receipt of financing proceeds	(57,366)
Payables clearing through affiliates	(3,972)
 Balance, June 30, 2007	 \$ 45,818

At June 30, 2007, ARI's other assets include \$248,000 due from affiliates for rent and interest. Also at June 30, 2007, ARI owed \$1.2 million to Regis Property Management for management fees and sales commissions.

**NOTE 9. OPERATING SEGMENTS**

Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative and other expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their net operating income and cash flow. Excluded from operating segment assets are assets of \$295.7 million in 2007 and \$221.2 million in 2006. There are no intersegment revenues and expenses, and ARI conducted all of its business within the United States, with the exception of Hotel Akademia (Poland), which began operations in 2002.

Presented below are ARI's reportable segments' operating income for the three and six months ended June 30, 2007 and 2006, and segment assets at June 30, 2007 and 2006.

	For the Three Months Ended		Commercial				Receivables/	Total				
	June 30, 2007		Properties	Apartments	Hotels	Land	Other					
Operating revenue	\$	17,738	\$	23,739	\$	10,400	\$	247	\$	(13)	\$	52,111
Operating expenses		11,200		13,547		6,877		1,523		555		33,702
Depreciation		3,594		3,129		850		14		(2)		7,585
Mortgage and loan interest		6,349		9,942		1,454		6,580		702		25,027
Interest income				(5)				59		1,423		1,477
Gain on land sales*												
 Segment operating income (loss)	\$	(3,405)	\$	(2,884)	\$	1,219	\$	(7,811)	\$	155	\$	(12,726)
 Capital expenditures	\$	3,168	\$	509	\$	1,320	\$	3,369	\$		\$	7,055
Assets		342,428		491,796		64,211		419,810				1,318,245
<b>Property Sales:</b>												
Sales price	\$	19,200	\$		\$		\$		\$		\$	19,200
Cost of sale		16,832										16,832
Recognized prior deferred gain												
 Gain on sale**	\$	2,368	\$		\$		\$		\$		\$	2,368

	For the Three Months Ended		Commercial	Apartments	Hotels	Land	Receivables/	Total
--	----------------------------	--	------------	------------	--------	------	--------------	-------

Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

June 30, 2006	Properties				Other	
Operating revenue	\$ 13,263	\$ 21,820	\$ 7,639	\$ 185	\$ 222	\$ 43,129
Operating expenses	9,858	12,763	5,740	1,784	16	30,161
Depreciation	3,146	2,549	520	2	2	6,219
Mortgage and loan interest	3,734	7,556	760	5,895	1,489	19,434
Interest income					2,093	2,093
Gain on land sales*				10,668		10,668
<b>Segment operating income (loss)</b>	<b>\$ (3,475)</b>	<b>\$ (1,048)</b>	<b>\$ 619</b>	<b>\$ 3,172</b>	<b>\$ 808</b>	<b>\$ 76</b>
Capital expenditures	\$ 4,056	\$ 2,413	\$ 99	\$ 1,655	\$	\$ 8,223
Assets	155,110	360,269	78,359	330,601		924,339
<b>Property Sales:</b>						
Sales price	\$	\$	\$	\$ 60,351	\$	\$ 60,351
Cost of sale				46,347		46,347
Recognized prior deferred gain				3,336		3,336
Gain on sale**	\$	\$	\$	\$ 10,668	\$	\$ 10,668

**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

	For the Six Months Ended		Commercial				Receivables/					
	June 30, 2007		Properties	Apartments	Hotels	Land	Other	Total				
Operating revenue	\$	38,246	\$	47,128	\$	17,423	\$	398	\$	23	\$	103,218
Operating expenses		22,612		27,323		12,572		3,120		578		66,205
Depreciation		6,490		6,375		1,495		20		3		14,383
Mortgage and loan interest		12,049		18,563		4,373		12,656		2,779		50,420
Interest income								121		2,910		3,031
Gain on land sales*								4,897				4,897
Segment operating (loss)	\$	(2,905)	\$	(5,133)	\$	(1,017)	\$	(10,380)	\$	(427)	\$	(19,862)
Capital expenditures	\$	6,063	\$	775	\$	1,358	\$	3,369	\$		\$	11,565
Assets		342,428		491,796		64,211		419,810				1,318,245
<b>Property Sales:</b>												
Sales price	\$	19,200	\$	24,650	\$		\$	9,697	\$		\$	53,547
Cost of sale		21,568		21,002				4,800				47,370
Recognized prior deferred gain												
Gain on sale**	\$	(2,368)	\$	3,648	\$		\$	4,897	\$		\$	6,177
<b>For the Six Months Ended</b>												
<b>June 30, 2006</b>												
Operating revenue	\$	27,487	\$	44,218	\$	14,349	\$	349	\$	477	\$	86,880
Operating expenses		16,900		27,587		11,120		2,617		(110)		58,114
Depreciation		6,011		5,052		1,222		14		5		12,304
Mortgage and loan interest		8,654		15,089		1,804		9,099		2,573		37,219
Interest income										3,238		3,238
Gain on land sales*								13,408				13,408
Segment operating income (loss)	\$	(4,078)	\$	(3,510)	\$	203	\$	2,027	\$	1,247	\$	(4,111)
Capital expenditures	\$	6,209	\$	4,159	\$	349	\$	2,000	\$		\$	12,717
Assets		155,110		360,269		78,359		330,601				924,339
<b>Property Sales:</b>												
Sales price	\$		\$		\$		\$	65,462	\$		\$	65,462
Cost of sale								50,549				50,549
Deferred current gain								3,336				3,336
Recognized prior deferred gain								1,831				1,831
Gain on sale**	\$		\$		\$		\$	13,408	\$		\$	13,408

\* Does not include gains from sale of income producing properties.

\*\* Includes gains from sale of income producing properties.



**Table of Contents****AMERICAN REALTY INVESTORS, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

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

	<b>For the Six Months</b>	
	<b>Ended June 30, 2007</b>	<b>2006</b>
Segment operating loss	\$ (19,862)	\$ (4,111)
Other non-segment items of income (expense):		
General and administrative	(8,513)	(4,831)
Advisory fee	(7,133)	(6,310)
Gain (loss) on foreign currency transaction	(4)	4
Other income	4,270	2,013
Net income fee	705	
Litigation settlement	24	1,804
Equity in income of investees		261
Minority interest	(505)	32
Loss from continuing operations	\$ (31,018)	\$ (11,138)

**NOTE 10. DISCONTINUED OPERATIONS**

For the six months ended June 30, 2007 and 2006, income from discontinued operations relates to 15 properties ARI sold during 2006 and eight properties ARI sold or held for sale in 2007. The following table summarizes revenue and expense information for these properties sold and held for sale.

	<b>For the Three Months</b>		<b>For the Six Months</b>	
	<b>Ended June 30, 2007</b>	<b>2006</b>	<b>Ended June 30, 2007</b>	<b>2006</b>
Revenue:				
Rental	\$ 2,342	\$ 6,344	\$ 5,228	\$ 11,944
Restaurant operations		9,388		18,924
	2,342	15,732	5,228	30,868
Expenses:				
Property Operations	1,997	4,657	3,966	11,640
Restaurant cost of sales		6,915		13,805
	1,997	11,572	3,966	25,445
Other (expenses):				
Interest	(1,007)	(2,066)	(2,425)	(4,458)
Depreciation	(363)	(1,456)	(708)	(2,342)
	345	4,160	1,262	5,423

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

Income (loss) from discontinued operations	(1,025)	638	(1,871)	(1,377)
Gain (loss) on sale of real estate	(2,392)	3,776	1,991	5,214
Income (loss) from discontinued operations	\$ (3,417)	\$ 4,414	\$ 120	\$ 3,837

### NOTE 11. COMMITMENTS AND CONTINGENCIES

*Liquidity.* ARI's principal liquidity needs are funding normal recurring expenses, meeting debt service requirements, funding capital expenditures, funding development costs not otherwise covered by construction loans and funding new property acquisitions not otherwise covered by acquisition financing. ARI intends to rely on aggressive land sales, selected income producing property sales and to the extent necessary, additional borrowings to meet its cash requirements.



---

**Table of Contents**

**AMERICAN REALTY INVESTORS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS    *Continued***

*Partnership Obligations.* ARI is the limited partner in ten partnerships that are currently constructing residential properties. As permitted in the respective partnership agreements, ARI presently intends to purchase the interests of the general and any other limited partners in these partnerships subsequent to the final completion of these construction projects. The amounts paid to buyout the non-affiliated partners are limited to development fees earned by the non-affiliated partners and are set forth in the respective partnership agreements. The total amount of the expected buyouts as of June 30, 2007 is approximately \$3.0 million.

*Litigation.* ARI is involved in various lawsuits arising in the ordinary course of business. In the opinion of management, the outcome of these lawsuits will not have a material impact on ARI's financial condition, results of operations or liquidity.

**NOTE 12. SUBSEQUENT EVENTS**

Events occurring after the date of these financial statements are included within each note, as appropriate.

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

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. This Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws, principally, but not only, under the captions Business, Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations. We caution investors that any forward-looking statements in this report, or which management may make orally or in writing from time to time, are based on management's beliefs and on assumptions made by and information currently available to, management. When used, the words anticipate, believe, expect, intend, may, might, plan, estimate, project, should, will, result and similar expressions which do not relate 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 financing and the use of debt to fund acquisitions and developments;

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-K, 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 Item 1A Risk Factors in the Company's Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company's Form 10-K for the fiscal year ended December 31, 2006 (the Form 10-K).

Other sections of this report may also include suggested factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not

---

## Table of Contents

possible for management to predict all such matters; nor can we assess the impact of all such matters on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these uncertainties, investors should not place undue reliance on forward-looking statements as prediction of actual results. Investors should also refer to our quarterly reports on Form 10-Q for future periods and to other materials we may furnish to the public from time to time through Forms 8-K or otherwise as we file them with the SEC.

### **Overview**

ARI was organized in 1999. In August 2000, ARI acquired American Realty Trust, Inc. ( ART ) and National Realty, L.P. ( NRLP ). ART was the successor to a business trust organized in 1961 to provide investors with a professionally managed, diversified portfolio of real estate and mortgage loan investments selected to provide opportunities for capital appreciation as well as current income. The business trust merged into ART in 1987. ART owns a portfolio of real estate and mortgage loan investments. NRLP was organized in 1987 and subsequently acquired all of the assets and assumed all of the liabilities of 35 public and private limited partnerships. NRLP also owned a portfolio of real estate and mortgage loan investments.

At June 30, 2007, ARI subsidiaries owned approximately 82.2% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc., a Nevada corporation ( TCI ), which has its common stock listed and traded on the New York Stock Exchange, Inc. ( NYSE ). The ownership of the TCI shares was achieved through a series of transactions, including a cash tender offer completed March 19, 2003, an exchange by certain ARI subsidiaries of securities with Basic Capital Management, Inc. ( BCM ) and a sale of a participating interest in a line of credit receivable from One Realco Corporation ( One Realco ) to BCM, as well as certain open market purchases of TCI shares in December 2003. ARI has consolidated TCI s accounts and operations since March 31, 2003. At June 30, 2007, TCI owned approximately 24.8% of the outstanding common stock of Income Opportunity Realty Investors, Inc., ( IORI ), a public company whose shares are listed and traded on the American Stock Exchange.

ARI is an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties and land held for development. The Company s portfolio of income-producing properties includes residential apartment communities, office buildings, hotels, a trade mart located in Denver, Colorado and other commercial properties. ARI s 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. ARI acquires land primarily in in-fill locations or high-growth suburban markets. ARI is an active buyer and seller and during 2007 acquired over \$123.0 million and sold over \$60.4 million of land and income-producing properties. As of June 30, 2007, the Company owned approximately 14,000 units in 77 residential apartment communities, 33 commercial properties comprising almost 5.3 million rentable square feet and ten hotels containing a total of 1,235 rooms. In addition, at June 30, 2007, ARI owned almost 10,900 acres of land held for development and had over 2,500 apartment units in 14 projects under construction. The Company currently owns income-producing properties and land in 20 states as well as in the U.S. Virgin Islands and Wroclaw, Poland. ARI finances its acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. ARI finances its development projects principally with short-term, variable interest rate construction loans that are refinanced with long-term, fixed rate amortizing mortgages when the development project is completed and occupancy has been stabilized. The Company will, from time to time, also enter into partnerships with various investors to acquire income-producing properties or land and to sell interests in certain of its wholly-owned properties. When the Company sells assets, it may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. The Company generates operating revenues primarily by leasing apartment units to residents; leasing office, retail and industrial space to commercial tenants; and renting hotel rooms to guests. ARI is advised by Prime under a contractual arrangement that is reviewed annually by ARI s Board of Directors. ARI s commercial properties are managed by Regis Commercial while the Company s hotels are managed by Regis Hotel. ARI currently contracts with five third-party companies to manage the Company s apartment communities. Approximately 62% of ARI s common stock is owned by BCM; an additional 13% is owned by Prime and TCI owns approximately seven percent of the outstanding common shares of ARI. Other affiliated companies own approximately two percent of ARI s outstanding common shares. ARI is a C Corporation for U.S. federal income tax purposes and files an annual consolidated income tax return with TCI.

The highlights of the six months ended June 30, 2007 included the following:

On January 1, 2007, we obtained a \$7.0 million loan secured by 109 acres and 3 acres of land located in Farmers Branch, Texas. The note accrues interest at 10% and matures in January 2008.

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

On January 17, 2007, we refinanced the existing \$3.6 million mortgage on City Suites Hotel in Chicago, Illinois for a new note of \$7.3 million and receiving \$3.7 million in cash. The note accrues interest at 8.25% and matures in February 2012.

On January 19, 2007, we acquired a 383,114 and a 707,599 square foot office building in Farmers Branch, Texas known as Park West I and Park West II, respectively and a 4.7 acre tract of undeveloped land at an aggregate purchase price of \$110 million. The acquisition was financed with \$9.7 million in cash and \$97.0 million in new debt. Two separate notes were obtained on this acquisition; a \$35.0 million note which accrues interest at 6.06% maturing January 2013 and a \$62.0 million note which accrues interest at a variable rate (currently 9.32%) maturing in January 2009.

## **Table of Contents**

On February 16, 2007, we sold the Bluffs at Vista Ridge, a 272 unit apartment complex in Lewisville, Texas for \$24.6 million. The proceeds were used to pay down the existing mortgage of \$15.5 million receiving \$3.1 million in cash. A gain of \$3.6 million was recorded on this sale.

On February 23, 2007, we obtained a \$5.0 million loan secured by 97 acres of Pioneer Crossing land located in Austin, Texas. The note accrues interest at prime plus 1% and matures in February 23, 2008.

On March 5, 2007, we refinanced the existing \$3.1 million mortgage on the Majestic Hotel in Chicago, Illinois, a 55 room hotel with a new note for \$6.0 million receiving \$2.9 million in cash. The note accrues interest at 7.76% and matures in March 2010.

On March 16, 2007, we refinanced the existing \$5.2 million mortgage on the Piccadilly Shaw, a 194 room hotel, located in Fresno, California with a \$12.8 million note, receiving \$6.5 million in cash. The new note accrues interest at 8.00% and matures in February 2012.

On March 16, 2007, we refinanced the existing \$4.5 million mortgage on the Piccadilly Airport, a 185 room hotel, located in Fresno, California with a \$12.2 million note, receiving \$6.8 million in cash. The new note accrues interest at 8.0% and matures in February 2012.

On April 30, 2007, we refinanced the existing debt of \$7.1 million on the Whispering Pines Apartments, a 320 unit complex in Topeka, Kansas for a new note of \$8.3 million, receiving \$1.0 million in cash. The new note accrues interest at 7.0% and matures in April 2008.

On May 3, 2007, we obtained a loan for \$12.0 million receiving \$11.2 million in cash. The loan is secured by 257 acres of land in Austin, Texas known as Pioneer Crossing. The loan accrues interest at 10.25% and matures in May 2008.

On May 8, 2007, we acquired 40.1 acres of land in Las Colinas, Texas known as Hines Meridian for \$7.9 million. The purchase was financed with \$3.0 million in cash and a note payable of \$5.0 million. The note accrues interest at 9.25% and matures in June 2010.

On May 31, 2007, we refinanced the existing debt of \$12.2 million on the Hickory IV building, a 221,000 square foot commercial building in Farmers Branch, Texas for a new note of \$26.0 million. The note accrues interest at 8.67% and matures in May 2009.

On June 6, 2007 we refinanced \$12.4 million in existing mortgages with a commercial lender. The mortgages relate to eight different apartment complexes, totaling 1,287 units, located throughout Midland and Odessa, Texas. The new loans total \$33.2 million. We received \$21.0 million in cash and paid down property debt and defeasance costs totaling \$4.1 million. The notes accrue interest at 7.03% and mature in July 2037.

On June 28, 2007 we refinanced \$6.5 million in existing mortgages with a commercial lender. The mortgages relate to three apartment complexes, totaling 516 units, located throughout Midland and Odessa, Texas. The new loans total \$12.4 million. We received \$3.0 million in cash. The notes accrue interest at 9.25% and mature in September of 2007.

## **Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or GAAP, requires management to use judgment in the application of accounting policies, including making estimates and assumptions. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. These judgments affect

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of our financial statements. From time to time, we evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. Below is a discussion of accounting policies that we consider critical in that they may require complex judgment in their application or require estimates about matters that are inherently uncertain.

### **Real Estate**

Upon acquisitions of real estate, ARI assesses the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, above-market and below-market leases, origination costs, acquired in-place leases, other identified

**Table of Contents**

intangible assets and assumed liabilities in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 141, Business Combinations and allocates the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

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

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

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

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

SFAS No. 144 requires that qualifying assets and liabilities and the results of operations that have been sold, or otherwise qualify as held for sale, be presented as discontinued operations in all periods presented if the property operations are expected to be eliminated and the Company will not have significant continuing involvement following the sale. The components of the property s net income that is reflected as discontinued operations include the net gain or loss upon the disposition of the property held for sale, operating results, depreciation and interest expense (if the property is subject to a secured loan). We generally consider assets to be held for sale when the transaction has been approved by our Board of Directors, or a committee thereof, and there are no known significant contingencies relating to the sale, such that the property sale within one year is considered probable. Following the classification of a property as held for sale, no further depreciation is recorded on the assets.

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgement. Our capitalization policy on development properties is guided by SFAS No. 34 Capitalization of Interest Cost and SFAS No. 67 Accounting for Costs and the Initial Rental Operations of Real Estate Properties. The costs of land and buildings under development include specifically identifiable costs. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. We consider a construction project as substantially completed and held available for occupancy upon the receipt of certificates of occupancy, but no later than one year from cessation of major construction activity. We cease capitalization on the portion (1) substantially completed and (2) occupied or held available for occupancy and we capitalize only those costs associated with the portion under construction.

**Investment in Unconsolidated Real Estate Ventures**

Except for ownership interests in variable interest entities, ARI accounts for our investments in unconsolidated real estate ventures under the equity method of accounting because the Company exercises significant influence over, but does not control, these entities. These investments are recorded initially at cost, as investments in unconsolidated real estate ventures and subsequently adjusted for equity in earnings and cash contributions and distributions. Any difference between the carrying amount of these investments on the Company s balance sheet and the underlying equity in net assets is amortized as an adjustment to equity in earnings of unconsolidated real estate ventures over the life of the related asset. Under the equity method of accounting, ARI s net equity is reflected within the Consolidated Balance Sheets and our share of net income or loss from the joint ventures is included within the Consolidated Statements of Operations. The joint venture agreements may designate different percentage allocations among investors for profits and losses; however, ARI s recognition of joint venture income or loss

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

generally follows the joint venture's distribution priorities, which may change upon the achievement of certain investment return thresholds. For ownership interests in variable interest entities, the Company consolidates those in which we are the primary beneficiary.



## **Table of Contents**

### **Recognition of Rental Income**

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. In accordance with SFAS 141, we recognize rental revenue of acquired in-place above-market and below-market leases at their fair values over the terms of the respective leases. On our Consolidated Balance Sheets we include as a receivable, the excess of rental income recognized over rental payments actually received pursuant to the terms of the individual commercial lease agreements.

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

Rental income for residential property leases is recorded when due from residents and is recognized monthly as earned, which is not materially different than on a straight-line basis as lease terms are generally for periods of one year or less.

For hotel properties, revenues for room sales and guest services are recognized as rooms are occupied and as services are rendered.

An allowance for doubtful accounts is recorded for all past due rents and operating expense reimbursements considered to be uncollectible.

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

Sales of real estate are recognized when and to the extent permitted by Statement of Financial Accounting Standards No. 66, Accounting for Sales of Real Estate ( SFAS No. 66 ), as amended by SFAS No. 144. Until the requirements of SFAS No. 66 for full profit recognition have been met, transactions are accounted for using the deposit, installment, cost recovery or financing method, whichever is appropriate. When ARI provides seller financing, gain is not recognized at the time of sale unless the buyer's initial investment and continuing investment are deemed to be adequate as determined by SFAS 66 guidelines.

### **Non-performing Notes Receivable**

ARI considers a note receivable to be non-performing when the maturity date has passed without principal repayment and the borrower is not making interest payments. Any new note receivable that results from a modification or extension of a note considered non-performing will also be considered non-performing, without regard to the borrower's adherence to payment terms.

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

Interest income is not recognized on notes receivable that have been delinquent for 60 days or more. In addition, accrued but unpaid interest income is only recognized to the extent that the net realizable value of the underlying collateral exceeds the carrying value of the receivable.

### **Allowance for Estimated Losses**

A valuation allowance is provided for estimated losses on notes receivable considered to be impaired. Impairment is considered to exist when it is probable that all amounts due under the terms of the note will not be collected. Valuation allowances are provided for estimated losses on notes receivable to the extent that the investment in the note exceeds management's estimate of fair value of the collateral securing such note.

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

The following assumptions were used in estimating the fair value of ARI's notes receivable, marketable equity securities and notes payable. For performing notes receivable, the fair value was estimated by discounting future cash flows using current interest rates for similar loans. For non-performing notes receivable, the estimated fair value of ARI's interest in the collateral property was used. For marketable equity securities, fair value was based on the year-end closing market price of each security. For notes payable, the fair value was estimated using current rates for mortgages with similar terms and maturities.

### ***Results of Operations***

*For the three months ended June 30, 2007*

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

ARI had a net loss of \$23.1 million for the three months ended June 30, 2007, including a loss from discontinued operations of \$2.2 million, as compared to a net loss of \$143,000 for the three months ended June 30, 2006, including income from discontinuing operations of \$2.9 million and a gain on sale of land of \$10.7 million. Fluctuations in this and other components of revenues and expense between the three month period ended June 30, 2007 and 2006 are discussed below.

**Table of Contents**

Rents increased to \$52.1 million in 2007 as compared to \$43.1 million in 2006 due to additional rental income from the completion of new apartment construction projects, increased occupancy from commercial and hotel properties and various market rate increases in apartment complexes.

Property operating expenses increased to \$33.7 million in 2007 as compared to \$30.2 million in 2006. This increase is due to the completion of new apartment construction projects and acquisition of new properties.

Depreciation and amortization increased to \$7.6 million in 2007 as compared to \$6.2 million in 2006. This increase is mainly due to the completion of new construction projects in the current period.

General and administrative expense increased to \$3.7 million in 2007 as compared to \$2.0 million in 2006. This increase is due to a \$1.7 million legal settlement received in prior year.

Other income increased to \$1.7 million in 2007 as compared to \$405,000 in 2006. This increase is due to an increase in investment income from Milano restaurant.

Mortgage and loan interest expense increased to \$25.0 million in 2007 as compared to \$19.4 million in 2006. This increase is due to the increase in mortgages payable.

There were no litigation proceeds in 2007 as compared to \$1.4 million received in 2006.

No gain on land sales was recorded in 2007 as compared to \$10.7 million in 2006. The decrease was due to no land being sold in 2007, that resulted in a gain on sale.

Income from discontinued operations decreased to a net loss of \$2.2 million in 2007 as compared to a net income of \$2.9 million in 2006. This decrease is due to discontinued operations including 16 properties in 2006 as compared to 11 properties in 2007, and eight of the properties in 2007 having a net loss.

***For the six months ended June 30, 2007***

ARI had a net loss of \$32.1 million for the six months ended June 30, 2007, including income from discontinued operations of \$78,000 and gain on land sales of \$4.9 million, as compared to a net loss of \$8.5 million for the six months ended June 30, 2006, including income from discontinuing operations of \$2.5 million and a gain on sale of land of \$13.4 million. Fluctuations in this and other components of revenues and expense between the six month period ended June 30, 2007 and 2006 are discussed below.

Rents increased to \$103.2 million in 2007 as compared to \$86.9 million in 2006. This increase is due to additional rental income from the completion of new apartment construction projects and the acquisition of commercial properties and the increase in hotel revenues due to increased occupancies.

Property operating expenses increased to \$66.2 million in 2007 as compared to \$58.1 million in 2006. This increase is due to the completion of new apartment construction projects and acquisition of commercial properties.

Depreciation and amortization increased to \$14.4 million in 2007 as compared to \$12.3 million in 2006. This increase is mainly due to the completion of new construction projects in the current period.

General and administrative expenses increased to \$8.5 million in 2007 as compared to \$4.8 million in 2006. This increase is due to prior year amount including \$1.7 million in litigation settlement and current year increase in legal expense of \$700,000, increase in appraisal and consulting fees of \$500,000 and reclassification of transactions of \$500,000.

Other income increased to \$4.3 million in 2007 as compared to \$2.0 million in 2006. This increase is due to income from investment in Milano restaurant.

Mortgage and loan interest increased to \$50.4 million in 2007 as compared to \$37.2 million in 2006. This increase is due to the increase in notes payable to \$1.3 billion in 2007 as compared to \$40.2 million in 2006.

## Edgar Filing: AMERICAN REALTY INVESTORS INC - Form 10-Q

Income from litigation settlements decreased to \$24,000 in 2007 as compared to \$1.8 million in 2006. This decrease is due to non-recurring settlements in the prior period.

Gain on land sales decreased to \$4.9 million in 2007 as compared to \$13.4 million in 2006. The 2007 gain is comprised of the sale of 15 acres of McKinney Ranch land in Texas, 4.6 acres of Grapevine land in Texas and 22.4 acres of Metro Center land in Tennessee.

Net income (loss) for the three and six months ended June 30, 2007 and 2006 from discontinued operations relates to properties ARI sold or intends to sell in 2007 as well as properties ARI sold during 2007 and 2006 or intends to sell in 2007. The following table summarizes revenue and expense information for the properties sold and held for sale.

**Table of Contents**

	For the Three Months		For the Six Months	
	Ended June 30, 2007	2006	Ended June 30, 2007	2006
<b>Revenue:</b>				
Rental	\$ 2,342	\$ 6,344	\$ 5,228	\$ 11,944
Restaurant operations		9,388		18,924
	2,342	15,732	5,228	30,868
<b>Expenses:</b>				
Property Operations	1,997	4,657	3,966	11,640
Restaurant cost of sales		6,915		13,805
	1,997	11,572	3,966	25,445
	345	4,160	1,262	5,423
<b>Other (expenses):</b>				
Interest	(1,007)	(2,066)	(2,425)	(4,458)
Depreciation	(363)	(1,456)	(708)	(2,342)
Income (loss) from discontinued operations	(1,025)	638	(1,871)	(1,377)
Gain (loss) on sale of real estate	(2,392)	3,776	1,991	5,214
Income (loss) from discontinued operations	\$ (3,417)	\$ 4,414	\$ 120	\$ 3,837

**Liquidity and Capital Resources**

Cash and cash equivalents at June 30, 2007 totaled \$5.5 million, compared with \$7.0 million at December 31, 2006. ARI's principal sources of cash have been and will continue to property operations, proceeds from property sales, and the collection of mortgage notes receivable, borrowings and, to a lesser extent, distributions from partnerships. Management anticipates that ARI's cash at June 30, 2007, along with cash that will be generated in from property operations, may not be sufficient to meet all of ARI's cash requirements. Management intends to selectively sell land and income producing assets, refinance or extend real estate debt and seek additional borrowings secured primarily by real estate to meet its liquidity requirements. Historically, management has been successful at extending its current maturity obligations. Management also anticipates funding ongoing real estate construction projects and the acquisition of new real estate from cash generated by property sales, debt refinancings or extensions, and additional borrowings.

Net cash used by operating activities was \$90.2 million for the six month period ended June 30, 2007 as compared to \$13.1 million for the six month period ended June 30, 2006. Cash flow from operations is largely comprised of rental income less operating expenses, general and administrative expenses and interest expense. Net cash used by operating activities increased \$77.1 million due primarily to increases in other assets of \$36.2 million, increases in notes receivable of \$22.9 million, increases in prepaid expenses of \$2.6 million and decreases in notes payable of \$15.8 million and increased interest expense of \$13.2 million, offset by increases in other liabilities of \$11.9 million and increased operating income of \$1.7 million.

ARI expects that funds from existing cash resources, aggressive sales of land and selected income producing property sales, refinancing of real estate, and borrowings against its real estate will be sufficient to meet the cash requirements associated with ARI's current and anticipated level of operations, maturing debt obligations and existing commitments. To the extent that ARI's liquidity permits or financing sources are available, ARI will make investments in real estate, primarily in improved and unimproved land, will continue making investments in real estate entities and marketable equity securities, and will develop and construct income-producing properties.

Net cash used in investing activities was \$184.5 million for the six months ended June 30, 2007, as compared to \$22.1 million for the six months ended June 30, 2006. Net cash used in investing activities increased \$162.5 million due to an increase in investments in real estate (including investments in income-producing properties, land held for development, residential and other development projects) of \$186.2 million, decreased collections of notes receivable of \$5.9 million and lower proceeds from fewer land sales of \$11.9 million, offset by higher proceeds

from sales of income-producing properties of \$41.5 million.

---

## **Table of Contents**

Net cash provided by financing activities was \$275.0 million for the six months ended June 30, 2007 compared to \$46.6 million for the six months ended June 30, 2006. Cash provided by financing activities increased \$228.4 million due primarily to proceeds from additional borrowings of \$275.2 million (net of deferred financing costs), advances from affiliates of \$17.8 million and a decrease in restricted cash of \$1.9 million, offset by loan payoffs related to property sales and refinancings of \$64.6 million and increased preferred dividends of \$1.9 million.

Net cash used in discontinued operations was \$1.9 million for the six months ended June 30, 2007 compared to \$9.0 million for the same period in 2006. The \$7.1 million decline was due principally to a increase in cash provided by operations from properties actually sold or held for sale of \$11.4 million offset by reduced proceeds from property sales of \$4.3 million.

*Equity Investments.* Since 1988, ARI has from time to time purchased shares of IORI and TCI, both of which had the same advisor as ARI until June 2003. The Company may purchase additional equity securities of IORI and TCI through open market and negotiated transactions to the extent ARI's liquidity permits.

Equity securities of TCI held by ARI (and of IORI held by TCI) may be deemed restricted securities under Rule 144 of the Securities Act of 1933 ( Securities Act ). Accordingly, ARI may be unable to sell such equity securities other than in a registered public offering or pursuant to an exemption under the Securities Act for a one-year period after they are acquired. Such restrictions may reduce ARI's ability to realize the full fair market value of such investments if ARI attempted to dispose of such securities in a short period of time.

Management reviews the carrying values of ARI's properties and mortgage notes receivable at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow from the property (undiscounted and without interest) is less than the carrying amount of the property. For notes receivable, impairment is considered to exist if it is probable that all amounts due under the terms of the note will not be collected. If impairment is found to exist, a provision for loss is recorded by a charge against earnings to the extent that the investment in the note exceeds management's estimate of the fair value of the collateral securing such note. The mortgage note receivable review includes an evaluation of the collateral property securing each note. The property review generally includes: (1) selective property inspections, (2) a review of the property's current rents compared to market rents, (3) a review of the property's expenses, (4) a review of maintenance requirements, (5) a review of the property's cash flow, (6) discussions with the manager of the property, and (7) a review of properties in the surrounding area.

## **Environmental Matters**

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

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

## **Inflation**

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

## **Tax Matters**

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. ARI had a loss for federal income tax purposes in the first six months of 2007 and a loss in the first six months of 2006, after the use of net operating loss carry forwards; therefore, it recorded no provision for income taxes.

At June 30, 2007, ARI had a net deferred tax asset of \$124.9 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that ARI will realize the benefit of the deferred tax assets, a 100% valuation allowance has been established.





**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

At June 30, 2007, ARI's exposure to a change in interest rates on its debt is as follows (dollars in thousands except per share):

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
Notes payable:			
Variable rate	\$ 412,832	9.77%	\$ 4,128
Total decrease in ARI's annual net income			4,128
Per share			\$ .41

**ITEM 4. CONTROLS AND PROCEDURES****(a) Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, our management, with the participation of our Chief Operating Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Operating Officer and Chief Financial Officer concluded that these disclosure controls and procedure were effective as of the end of the period covered by this report.

**(b) Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchanges act of 1934) occurred during the second quarter of our fiscal year ending December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the period of time covered by this report, American Realty Investors, Inc. repurchased equity securities. The following table sets forth by month repurchases made during the second quarter and the number of shares that may yet be repurchased:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>Maximum Number of Shares that May Yet be Purchased Under the Program<sup>(1)</sup></b>
Balance as of March 31, 2007		\$	874,607	125,393
April 2007	2,648	8.78	2,648	122,745
May 2007	2,790	9.39	2,790	119,955
June 2007	1,347	8.33	1,347	118,608
<b>Total</b>	<b>6,785</b>	<b>\$ 8.61</b>	<b>881,392</b>	

- (1) The repurchase program was announced in September, 2000. A total of 1,000,000 shares may be repurchased through the program. The program has no expiration date.

**Table of Contents**

**ITEM 6. EXHIBITS**

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

**Exhibit**

<b>Number</b>	<b>Description of Exhibit</b>
3.0	Certificate of Restatement of Articles of Incorporation of American Realty Investors, Inc. dated August 3, 2000 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
3.1	Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc. dated August 29, 2000 (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q dated September 30, 2000).
3.2	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc. decreasing the number of authorized shares of and eliminating Series B Cumulative Convertible Preferred Stock dated August 23, 2003 (incorporated by reference to Exhibit 3.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
3.3	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc., decreasing the number of authorized shares of and eliminating Series I Cumulative Preferred Stock dated October 1, 2003 (incorporated by reference to Exhibit 3.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
3.4	Bylaws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement on Form S-4 filed December 30, 1999).
4.1	Certificate of Designations, Preferences and Relative Participating or Optional or Other Special Rights, and Qualifications, Limitations or Restrictions Thereof of Series F Redeemable Preferred Stock of American Realty Investors, Inc., dated June 11, 2001 (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
4.2	Certificate of Withdrawal of Preferred Stock, Decreasing the Number of Authorized Shares of and Eliminating Series F Redeemable Preferred Stock, dated June 18, 2002 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002).
4.3	Certificate of Designation, Preferences and Rights of the Series I Cumulative Preferred Stock of American Realty Investors, Inc., dated February 3, 2003 (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002).
4.4	Certificate of Designation for Nevada Profit Corporations designating the Series J 8% Cumulative Convertible Preferred Stock as filed with the Secretary of State of Nevada on March 16, 2006 (incorporated by reference to Registrant current report on Form 8-K for event of March 16, 2006).
10.1	Advisory Agreement between American Realty Investors, Inc. and Prime Income Asset Management, LLC, dated October 1, 2003 (incorporated by reference to Exhibit 10.0 to the Registrant's Current Report on Form 8-K, dated October 1, 2003).
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 pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
31.2*	Certification 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.

\*Filed herewith

**Table of Contents**

**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: August 14, 2007

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

Date: August 14, 2007

By: /s/ Steven A. Abney  
Steven A. Abney  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

**Table of Contents**

**AMERICAN REALTY INVESTORS, INC.**

**EXHIBITS TO**

**QUARTERLY REPORT ON FORM 10-Q**

**For the Quarter Ended June 30, 2007**

**Exhibit**

**Number**

**Description of Exhibits**

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

---

\*Filed herewith