

AMERICAN REALTY INVESTORS INC
Form 10-Q
May 15, 2008
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 March 31, 2008

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)

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

Nevada
(State or Other Jurisdiction of
Incorporation or Organization)

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

1800 Valley View Lane, Suite 300

Dallas, Texas 75234

(Address of principal executive offices)

(Zip Code)

(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 an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

Smaller reporting company

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)**

**10,443,842
(Outstanding at April 30, 2008)**

Table of Contents

AMERICAN REALTY INVESTORS, INC.

FORM 10-Q

TABLE OF CONTENTS

	PAGE
PART I: <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	3
<u>Consolidated Balance Sheets at March 31, 2008 (unaudited) and December 31, 2007</u>	3
<u>Consolidated Statements of Operations for the three months ended March 31, 2008 and 2007 (unaudited)</u>	4
<u>Consolidated Statement of Shareholders' Equity for the three months ended March 31, 2008 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2008 and 2007 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	21
Item 4. <u>Controls and Procedures</u>	21
PART II. <u>OTHER INFORMATION</u>	
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	22
Item 6. <u>Exhibits</u>	23
<u>SIGNATURE PAGES</u>	24

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

	March 31, 2008	December 31, 2007
	(dollars in thousands)	
Assets		
Real estate held for investment	\$ 1,517,196	\$ 1,508,815
Less accumulated depreciation	(149,323)	(148,404)
	1,367,873	1,360,411
Real estate held for sale, net of depreciation	33,939	61,128
Real estate subject to sales contracts	63,894	64,320
Notes and interest receivable		
Performing (including \$38,730 in 2008 and \$28,976 in 2007 from affiliates and related parties)	69,130	69,977
Non-performing	16,468	16,468
	85,598	86,445
Less allowance for estimated losses	(9,478)	(2,978)
	76,120	83,467
Cash and cash equivalents	7,838	11,560
Restricted cash	1,881	2,556
Marketable securities, at market value	6,205	13,157
Investments in equity investees	22,476	23,867
Other assets (including \$56,025 in 2008 and \$63,519 in 2007 from affiliates and related parties)	166,483	157,388
	\$ 1,746,709	\$ 1,777,854
Liabilities and Stockholders Equity		
Liabilities:		
Notes and interest payable (including \$8,755 in 2008 and \$6,766 in 2007 from affiliates and related parties)	\$ 1,205,266	\$ 1,221,987
Liabilities related to assets held-for-sale	31,900	116,377
Liabilities subject to sales contracts	63,387	62,513
Stock-secured notes payable	17,546	17,546
Accounts payable and other liabilities (including \$2,322 in 2008 and \$10,752 in 2007 from affiliates and related parties)	99,060	104,884
	1,417,159	1,523,307
Commitments and contingencies		
Minority interest	75,558	62,161
Stockholders equity:		
Preferred Stock, \$2.00 par value, authorized 15,000,000 shares, issued and outstanding Series A, 3,390,316 shares in 2008 and 2007 (liquidation preference \$33,909), including 900,000 shares in 2008 and 2007 held by subsidiaries	4,979	4,979

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

Common Stock, \$.01 par value, authorized 100,000,000 shares; issued 11,592,272 shares in 2008 and 2007	114	114
Treasury stock at cost; 1,144,930 and 1,129,530 shares in 2008 and 2007, respectively	(12,876)	(12,664)
Paid-in capital	99,558	100,277
Retained earnings	159,256	99,452
Accumulated other comprehensive income (loss)	2,961	228
	253,992	192,386
	\$ 1,746,709	\$ 1,777,854

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 Ended March 31,	
	2008	2007
	(dollars in thousands)	
Revenues:		
Rental and other property revenues (including \$258 in 2008 and \$350 in 2007 from affiliates and related parties)	\$ 44,463	\$ 41,748
Expenses:		
Property operating expenses (including \$2,218 in 2008 and \$2,120 in 2007 from affiliates and related parties)	30,253	25,897
Depreciation and amortization	6,780	5,147
General and administrative (including \$1,111 in 2008 and \$2,181 in 2007 from affiliates and related parties)	4,330	4,478
Advisory fee to affiliate	3,975	3,299
Total operating expenses	45,338	38,821
Operating income (loss)	(875)	2,927
Other income (expense):		
Interest income (including \$1,173 in 2008 and \$538 in 2007 from affiliates and related parties)	2,100	1,554
Other income (including \$877 in 2008 and \$1,168 in 2007 from affiliates and related parties)	1,588	2,544
Mortgage and loan interest (including \$258 in 2008 and \$59 in 2007 from affiliates and related parties)	(22,357)	(22,223)
Net income fee to affiliate		704
Bad debt and allowance	(12,000)	
Litigation settlement		24
Total other income (expense)	(30,669)	(17,397)
Loss before gain on land sales, minority interest, and equity in earnings (loss) of investees	(31,544)	(14,470)
Gain on land sales	1,275	4,898
Minority interest	(11,877)	(224)
Equity in income (loss) of investees	4,951	
Loss from continuing operations before income tax benefit	(37,195)	(9,796)
Income tax benefit	34,168	468
Net loss from continuing operations	(3,027)	(9,328)
Income from discontinued operations before income tax expense	97,622	1,338
Income tax expense	(34,168)	(468)
Net income from discontinuing operations	63,454	870
Net income	60,427	(8,458)
Preferred dividend requirement	(623)	(622)

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

Net income (loss) applicable to common shares	\$ 59,804	\$ (9,080)
Earnings per share - basic		
Income (loss) from continuing operations	\$ (0.35)	\$ (0.98)
Discontinued operations	6.07	0.09
Net income (loss) applicable to common shares	\$ 5.72	\$ (0.89)
Earnings per share - diluted		
Income (loss) from continuing operations	\$ (0.35)	\$ (0.98)
Discontinued operations	6.07	0.09
Net income (loss) applicable to common shares	\$ 5.72	\$ (0.89)
Weighted average common share used in computing earnings per share	10,451,042	10,147,848
Weighted average common share used in computing diluted earnings per share	10,451,042	10,147,848
Series A Cumulative Convertible Preferred Stock (2,491,000) 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 months ended March 31, 2008 and March 31, 2007 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 Three Months Ended March 31, 2008

(dollars in thousands)

(unaudited)

	Series A	Series E				Accumulated		
	Preferred	Preferred	Common	Treasury	Paid-in	Retained	Other	
	Stock	Stock	Stock	Stock	Capital	Earnings	Comprehensive	Stockholders
							Income/(Loss)	Equity
Balance, December 31, 2007	\$ 4,979	\$	\$ 114	\$ (12,664)	\$ 100,277	\$ 99,452	\$ 228	\$ 192,386
Unrealized gain on foreign currency translation							9,685	9,685
Unrealized gain on marketable securities							(6,952)	(6,952)
Unrealized gain								
Net income						60,427		60,427
Acquisition of Minority Interest						(719)		(719)
Repurchase of Common Stock				(212)				(212)
Series A preferred stock cash dividend (\$1.00 per share)						(623)		(623)
Balance, March 31, 2008	\$ 4,979	\$	\$ 114	\$ (12,876)	\$ 99,558	\$ 159,256	\$ 2,961	\$ 253,992

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)**

	For the Three Months Ended March 31,	
	2008	2007
	(dollars in thousands)	
Cash Flow From Operating Activities:		
Net income (loss) applicable to common shares	\$ 59,804	\$ (9,080)
Adjustments to reconcile net loss applicable to common shares to net cash used in operating activities:		
Gain on sale of land	(1,275)	(4,898)
Depreciation and amortization	7,084	6,798
Provision for allowance of notes receivable and impairment	12,000	
Amortization of deferred borrowing costs	2,860	1,332
Equity in (income) loss of investees	(4,951)	
Gain (loss) on foreign currency transaction		(131)
Gain on sale of income producing properties	(111,370)	
(Increase) decrease in assets:		
Accrued interest receivable	(1,194)	(646)
Other assets	(3,356)	(6,654)
Prepaid expense	(48)	
Escrow	(2,916)	
Earnest Money	2,801	4,728
Rent receivables	(6,744)	
(Increase) decrease in liabilities:		
Accrued interest payable	(1,258)	3,116
Other liabilities	(5,824)	(5,108)
Net cash used in operating activities	(54,387)	(10,543)
Cash Flow From Investing Activities:		
Collections on notes receivables	3,541	1,205
Funding of notes receivable		(1,447)
Acquisition of land held for development	(12,023)	(109,911)
Proceeds from sales of income producing properties	152,392	22,754
Proceeds from sale of land	2,873	9,609
Investment in unconsolidated real estate entities	(1,391)	(9,298)
Improvement of income producing properties	(2,036)	
Acquisition of Minority Interest	11,877	(205)
Distributions of Equity Investee		(3,544)
Construction and development of new properties	(32,109)	(38,349)
Net cash provided by (used in) investing activities	123,124	(129,186)
Cash Flow From Financing Activities:		
Proceeds from notes payable	76,558	213,335
Recurring amortization of principal on notes payable	(5,264)	(3,018)
Increase in due from affiliates	(2,083)	(9,554)
Payments on maturing notes payable	(144,312)	(57,954)
Deferred financing costs	2,179	(6,352)
Restricted cash	675	1,222
Purchase of treasury stock	(212)	(31)
Net cash provided by (used in) financing activities	(72,459)	137,648

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

Net decrease in cash and cash equivalents	(3,722)	(2,081)
Cash and cash equivalents, beginning of period	11,560	7,035
Cash and cash equivalents, end of period	\$ 7,838	\$ 4,954

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

Table of Contents**AMERICAN REALTY INVESTORS, INC.****SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION****(unaudited)**

	For the Three Months Ended March 31,	
	2008	2007
	(dollars in thousands)	
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 26,944	\$ 16,695
Cash paid for taxes, net of refunds		
Schedule of noncash investing and financing activities:		
Unrealized foreign currency translation loss	\$ 9,685	\$
Unrealized gain on marketable securities	\$ (6,952)	\$
Note receivable allowance	\$ (1,500)	\$

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

American Realty Investors, Inc. (**ARI**, **We**, **The Company**, **Our** or **Us**) is a Nevada corporation and invest in real estate through direct ownership, leases and partnerships.

The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange under the symbol **ARL**. **ARI** owns approximately 82.2 percent of the outstanding shares of common stock of Transcontinental Realty Investors, Inc., (**TCI**) a Nevada corporation which has its common stock listed and traded on the New York Stock Exchange, Inc. under the symbol **TCI** . 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 March 31, 2008, **TCI** owned approximately 24.8 percent 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.

Properties

The Company owns or had interests in a total property portfolio of 86 and 109 income producing properties as of March 31, 2008 and December 31, 2007, respectively. The commercial properties aggregate approximately 5.8 million and 5.9 million net rentable square feet as of March 31, 2008 and December 31, 2007, respectively. At March 31, 2008 the properties consisted of:

29 commercial buildings, which consists of 16 Office buildings, 7 commercial warehouses, and 6 retail centers.

5 hotels.

52 Apartment communities.

11,027 Acres of developed and undeveloped land.

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

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

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 statements 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 disclosures 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, 2007.

Newly issued accounting standards.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS 141R), *Business Combinations*. SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combinations. SFAS

Table of Contents

141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company engages in will be recorded and disclosed following existing accounting principles until January 1, 2009. The Company expects SFAS 141R will affect the Company's consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, term and size of the acquisitions, if any, the Company consummates after the effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, effective for financial statements issued for fiscal years beginning after December 15, 2008. SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, and will impact the recording of minority interest. The Company is currently evaluating the effects the adoption of SFAS No. 160 will have on its financial position and results of operations.

NOTE 2. REAL ESTATE ACTIVITY

	Cost		Capital Development			Reclassifications		Accumulated	
	Beginning	Acquisitions	Improvements	Costs	Property	and Other	Cost	Depreciation	
	of Year				Sales	Adjustments	3/31/2008	3/31/2008	
Apartments	\$ 473,593	\$	\$	\$	\$	\$ 110,138	\$ 583,731	\$ 52,597	
Apartments under construction	153,144			25,955			179,099		
Other developments in progress	110,321			6,154			116,475		
Commercial properties	357,283		2,036			60,117	419,436	83,725	
Hotels	72,156					(35,358)	36,798	12,809	
Land held for development	193,914	12,023			(2,873)	(21,407)	181,657	192	
Real estate held for investment	\$ 1,360,411	\$ 12,023	\$ 2,036	\$ 32,109	\$ (2,873)	\$ 113,490	\$ 1,517,196	\$ 149,323	
Real estate held for sale	\$ 61,128	\$	\$	\$	\$ (152,392)	\$ 129,827	\$ 38,563	\$ 4,624	
Real estate subject to sales contract	\$ 64,320	\$	\$	\$	\$	\$ 8,713	\$ 73,033	\$ 9,139	

On January 15, 2008, we purchased 4.0 acres of land in Dallas, Texas known as Woodmont TCI XIV for \$6.4 million. We financed the transaction with \$1.9 million cash, a new mortgage of \$4.1 million with a commercial lender and accrued \$400,000 in commissions payable. The mortgage is secured by the property, accrues interest at 7.5% or prime plus .75% whichever is higher.

On January 25, 2008, we sold 15 apartment complexes in a single transaction for an aggregate sales price of \$98.3 million, recording a gain on sale of \$72.1 million. We received cash of \$28.4 million after paying off existing mortgages of \$62.1 million, and \$7.8 million in commissions and other closing costs. The properties consisted of:

4400 apartments, a 92 unit complex located in Midland, Texas

Arbor Pointe, a 194 unit complex located in Odessa, Texas

Ashton Way, a 178 unit complex located in Midland, Texas

Autumn Chase, a 94 unit complex located in Midland, Texas

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

Courtyard Apartments, a 133 unit complex located in Midland, Texas

Coventry Point, a 120 unit complex located in Midland, Texas

Fairway, a 152 unit complex located in Longview, Texas

Fountains at Waterford, a 172 unit complex located in Midland, Texas

Hunters Glen, a 260 unit complex located in Midland, Texas

Southgate, a 180 unit complex located in Odessa, Texas

Sunchase, a 300 unit complex located in Odessa, Texas

Thornwood, a 109 unit complex located in Midland, Texas

Westwood, a 79 unit complex located in Odessa, Texas

Woodview, a 232 unit complex located in Odessa, Texas

Sunset, a 240 unit complex located in Odessa, Texas

On January 31, 2008, we sold the Lexington office building, a 75,000 square foot commercial building located in Colorado Springs, Colorado for \$5.4 million, receiving cash of \$1.6 million after paying off the existing mortgage of \$3.5 million and \$300,000 in closing costs. We recorded a \$700,000 gain on sale.

Table of Contents

On February 6, 2008, we sold the Fairway View Apartments, a 264 unit complex located in El Paso, Texas, for \$10.3 million recording a gain on sale of \$6.0 million. We received \$4.8 million in cash after paying off the existing mortgage of \$5.3 million and closing costs.

On February 14, 2008, we sold the Governors Square apartments, a 169 unit complex located in Tallahassee, Florida, for \$8.5 million, recording a gain on sale of \$5.7 million. We received \$4.7 million in cash after paying off the existing mortgage of \$2.9 million and \$900,000 in closing costs.

On February 14, 2008, we sold 3 hotels all located in Chicago, Illinois in a single transaction for \$30.0 million recording a gain on sale of \$18.4 million. We received cash of \$9.8 million after paying off existing mortgages of \$18.5 million and closing costs. The properties consisted of:

City Suites Hotel, a 45 room hotel

Majestic Hotel, a 55 room hotel

Willows Hotel, a 52 room hotel

On March 28, 2008 we sold all of our shares in S.P. Zoo (a Polish Corporation) for \$11.8 million. The sale of the shares represented our 66.67% interest in the Radisson-SAS Hotel Akademia, a 161 room hotel located in Wroclaw, Poland. We received cash of \$11.8 million upon sale of our shares and recorded a gain on sale of \$7.7 million.

NOTE 3. NOTES AND INTEREST RECEIVABLE

Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
400 St. Paul	10/08	9.25%	\$ 3,612	Office building, Dallas, TX
Basic Capital Management ⁽¹⁾	10/08	9.50	1,252	Industrial building, Arlington, TX
Basic Capital Management ⁽¹⁾	10/08	9.50	1,523	Retail building, Cary, NC
Dallas Fund XVII LP	10/08	9.00	4,598	Assignment of partnership interests
Garden Centura LP	09/08	7.00	5,007	Excess cash flow from partnership
Miscellaneous non-related party notes	Various	Various	6,514	Various Security Interests
Miscellaneous related party notes	Various	Various	8,824	Various Security Interests
Thornwood Wrap Note, ICC Surfwood	07/08	7.50	1,638	Unsecured
Synteck Acquisition Corp (1)	08/08	Prime + 1	3,354	Unsecured
One Realco	02/09	10.50	9,949	Unsecured
Pioneer Austin Development	10/08	10.50	2,407	33 acres undeveloped land, Austin, TX
Realty Advisors (1)	11/08	9.50	5,633	850 shares of ARI stock owned by BCM
Unified Housing of Harvest Hill	10/13	12.00	7,891	Surplus cash note
Accrued interest			6,928	
Total Performing			69,130	
Non-Performing loans:				
Blue Lake at Marine Creek ⁽¹⁾	12/13	12.00%	106	Surplus Cash Note
HAF of Dallas LLC ⁽¹⁾	08/11	12.00	452	Surplus Cash Note
HFS of Humble LLC ⁽¹⁾	12/17	12.00	2,220	Surplus Cash Note
Tracy Suttles	01/09	12.00	835	Unsecured
UH OF Burluson ⁽¹⁾	08/13	12.00	785	Surplus Cash Note
UH OF Chase Oaks ⁽¹⁾	12/08	12.00	398	Surplus Cash Note

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

UH OF Inwood ⁽¹⁾	12/13	12.00	4,213	Surplus Cash Note
UH OF Kensington ⁽¹⁾	03/14	12.00	4,300	Surplus Cash Note
UH OF McKinney ⁽¹⁾	12/13	12.00	2,003	Surplus Cash Note
UH OF Samsung I ⁽¹⁾	12/08	12.00	584	Surplus Cash Note
UH OF Walnut Park Crossing ⁽¹⁾	12/08	12.00	300	Surplus Cash Note
UHF Parkside Advances ⁽¹⁾	12/13	12.00	272	Surplus Cash Note
Total Non-Performing			16,468	
Allowance for estimated losses			(9,478)	
Total			\$ 76,120	

(1) Related Party Notes

Table of Contents**NOTE 4. INVESTMENTS IN UNCONSOLIDATED ENTITIES**

ARI's investment in real estate entities at March 31, 2008 was as follows:

Investee	Carrying Value of Investment at March 31, 2008	Market Value of Investment at March 31, 2007
IORI	\$ 11,109	\$ 6,109
Garden Centura, L.P	1,944	
Gruppa Fiorentina, LLC (Gruppa ⁽¹⁾)	4,957	
LK-Four Hickory, LLC ⁽¹⁾	88	
Other ⁽¹⁾	11,378	
Allowance	(7,000)	
	\$ 22,476	

(1) The entity is not publicly traded and no readily determinable market value exists.

Set forth below are summarized results of operations of investments in unconsolidated entities for the three months ended March 31, 2008 and 2007:

	2008	2007
Restaurant Sales	\$ 3,377	\$ 9,418
Revenues	1,239	2,089
	4,616	11,507
Cost of Sales	(944)	(7,119)
Operating Expenses	(7,446)	(1,659)
	(8,390)	(8,778)
Income from operations	(3,774)	2,729
Other income (expense):		
General and Administrative	(318)	(1,437)
Depreciation	(178)	(38)
Interest Expense	(3,080)	(1,693)
Other Income	82	1,342
Income before taxes	(7,268)	903
Income tax	(122)	(280)
Income (loss) from discontinued operations	31,000	
Net Income(loss)	\$ 23,610	\$ 623

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. Included in other comprehensive income for the three month period ended March 31, 2008 are unrealized losses from marking these investments to market of \$7.0 million.

NOTE 6. NOTES PAYABLE

	Balance	Additional Borrowings				Repayments		Reclassifications	Balance 3/31/2008
	Beginning of Year	Acquisition	Developments	Refinancing	Amortization	Property Sales	Refinancings	and Other Adjustments	
Apartments	\$ 361,037	\$	\$	\$	\$ (1,375)	\$	\$	\$ (3,358)	\$ 356,304
Apartments under construction	130,699		23,770						154,469
Other developments in progress	176,934		13,965					(13,837)	177,062
Commercial properties	272,067	10		4,000	(865)		(2,000)	34	273,246
Hotels	82,233				(184)			(42,917)	39,132
Land held for development	206,491	8,906		25,907	(2,708)	(1,406)	(26,645)	738	211,283
Corporate and other	(13,403)				(18)			5	(13,416)
Accrued interest	5,929							1,257	7,186
Real estate held for investment	\$ 1,221,987	\$ 8,916	\$ 37,735	\$ 29,907	\$ (5,150)	\$ (1,406)	\$ (28,645)	\$ (58,078)	\$ 1,205,266
Real estate held for sale	\$ 116,377	\$	\$	\$	\$ (114)	\$ (114,261)	\$	\$ 29,898	\$ 31,900
Real estate subject to sales contract	\$ 62,513	\$	\$	\$	\$	\$	\$	\$ 874	\$ 63,387

Table of Contents

In connection with the purchase of Woodmont TCI land in Dallas, Texas on January 15, 2008, we partially financed the acquisition with a new mortgage loan of \$4.1 million collateralized by the land property purchased. The note accrues interest at the higher of prime plus 1% or 7.5%. The note is payable in monthly installments of interest only with the balance due along with all unpaid and accrued interest due at maturity on July 25, 2009.

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 were \$17.5 million at March 31, 2008 and December 31, 2007.

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 March 31, 2008.

Balance, December 31, 2007	\$ 56,340
Cash Transfers	42,683
Cash Repayments	(35,321)
Advisory Fees Payable to Prime	(5,215)
Payments clearing through affiliates	(2,462)
Balance, March 31, 2008	\$ 56,025

At March 31, 2008, ARI's other assets include \$343,376 due from affiliates for rent and interest. Also at March 31, 2008, ARI owed \$1.1 million to Regis Property Management for management fees and sales commissions.

NOTE 9. OPERATING SEGMENTS

The Company's segments are based on the Company's method of internal reporting which classifies its operations by property type. The Company's segments are commercial, apartments, hotels and land. 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.

Presented below are the Company's reportable segments' operating income for the three months ended March 31, 2008 and 2007, including segment assets and expenditures.

Table of Contents

	Commercial Properties	Apartments	Hotels	Land	Other	Total
3/31/2008						
Operating revenue	\$ 18,531	\$ 19,820	\$ 4,577	\$ 1,508	\$ 27	\$ 44,463
Operating expenses	11,806	12,029	3,569	2,905	(56)	30,253
Depreciation and amortization	3,152	3,265	361	2		6,780
Mortgage and loan interest	5,265	9,209	790	5,023	2,070	22,357
Interest income					2,100	2,100
Gain on land sales				1,275		1,275
Segment operating income (loss)	\$ (1,692)	\$ (4,683)	\$ (143)	\$ (5,147)	\$ 113	\$ (11,552)
Capital expenditures	1,521		1,146	331		2,998
Assets	340,856	647,214	27,872	366,463	77,133	1,459,538
Property Sales						
Sales price	\$ 5,797	\$ 117,038	\$ 41,749	\$ 2,873	\$	\$ 167,457
Cost of sale	5,372	32,242	15,600	1,598		54,812
Deferred current gain						
Recognized prior deferred gain						
Gain on sale	\$ 425	\$ 84,796	\$ 26,149	\$ 1,275	\$	\$ 112,645

	Commercial Properties	Apartments	Hotels	Land	Other	Total
3/31/2007						
Operating revenue	\$ 19,152	\$ 16,284	\$ 6,119	\$ 148	\$ 45	\$ 41,748
Operating expenses	10,547	9,161	4,724	1,440	25	25,897
Depreciation and amortization	2,228	2,566	347	6		5,147
Mortgage and loan interest	4,324	6,904	2,584	5,708	2,703	22,223
Interest income					1,554	1,554
Gain on land sales				4,898		4,898
Segment operating income (loss)	\$ 2,053	\$ (2,347)	\$ (1,536)	\$ (2,108)	\$ (1,129)	\$ (5,067)
Capital expenditures	1,700	824	312	3,731		6,567
Assets	326,012	615,782	27,498	434,107	105,689	1,509,088
Property Sales						
Sales price	\$	\$ 28,760	\$	\$ 9,701	\$	\$ 38,461
Cost of sale		24,368		4,803		29,171
Deferred current gain						
Recognized prior deferred gain						
Gain on sale	\$	\$ 4,392	\$	\$ 4,898	\$	\$ 9,290

Table of Contents

The tables below reconcile the segment information to the corresponding amounts in the Consolidated Statements of Operations and Consolidated Balance sheet:

	3/31/2008	3/31/2007
Segment operating income (loss)	\$ (11,552)	\$ (5,067)
Other non-segment items of income/(expense)		
General and administrative	(4,330)	(4,478)
Advisory fees	(3,975)	(3,299)
Litigation Settlement		24
Bad Debt and Allowance	(12,000)	
Net income fee		704
Other income (expense)	1,588	2,544
Equity in earnings of investees	4,951	
Minority interest	(11,877)	(224)
Income (loss) from continuing operations	\$ (37,195)	\$ (9,796)

SEGMENT ASSET RECONCILIATION TO TOTAL ASSETS

	3/31/2008	3/31/2007
Segment assets	\$ 1,459,538	\$ 1,509,088
Investments in real estate partnerships	28,681	25,467
Other Assets and Receivables	160,657	(4,349)
Assets held for sale	97,833	100,071
Total assets	\$ 1,746,709	\$ 1,630,277

NOTE 10. DISCONTINUED OPERATIONS

The Company applies the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires that long-lived assets that are to be disposed of by sale be measured at the lesser of (1) book value or (2) fair value less cost to sell. In addition, it requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions.

Discontinued operations relates to the sale of 21 apartments of which 17 were sold in 2008, 3 commercial buildings which were all sold in 2008, and 4 hotels which were all sold in 2008. Discontinued operations for 2007 relates to 28 apartments, 5 commercial buildings, and 5 hotels.

	For the Three Months Ended	
	March 31,	
	2008	2007
Revenue		
Rental	\$ 4,404	\$ 11,386
Property operations	2,607	8,172
	1,797	3,214
Expenses		
Interest	(5,845)	(4,456)
G&A	(59)	(12)
Depreciation	(304)	(1,800)
	(6,208)	(6,268)

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

Net loss from discontinued operations before gains on sale of real estate	(4,411)	(3,054)
Gain on sale of discontinued operations	111,370	4,392
Net sales fee to affiliate	(9,337)	
Income (loss) from discontinued operations	97,622	1,338
Tax benefit	(34,168)	(468)
Income (loss) from discontinued operations	\$ 63,454	\$ 870

Table of Contents

The Company's application of SFAS No. 144 results in the presentation of the net operating results of these qualifying properties sold or held for sale during 2008 as income from discontinued operations. The application of SFAS No. 144 does not have an impact on net income available to common shareholders. SFAS No. 144 only impacts the presentation of these properties within the Consolidated Statements of Operations.

NOTE 11. COMMITMENTS AND CONTINGENCIES

Partnership Obligations. ARI is the limited partner in twelve 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.

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. In 2008, ARI will rely on aggressive land sales, selected income producing property sales and, to the extent necessary, additional borrowings to meet its cash requirement.

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

On April 2, 2008, we acquired the Bridgewood Ranch apartments, a 106 unit complex located in Kaufman, Texas for \$7.6 million. We financed the purchase with a new mortgage (secured by the property) of \$5.1 million, cash of \$1.7 million, and \$800,000 in liabilities. The mortgage accrues interest at the higher of 6.75% or prime plus .25% and matures in January of 2019.

On April 16, 2008, we acquired the Quail Hollow apartments, a 200 unit complex located in Holland, Ohio, for \$14.1 million. We financed the purchase with a new mortgage (secured by the property) of \$11.5 million, cash of \$77,000, and \$2.6 million in liabilities. The mortgage accrues interest at 7% and matures in October 2011.

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 refer 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;

Table of Contents

risks and uncertainties affecting property development and construction (including, without limitation, construction delays, cost overruns, inability to obtain necessary permits and public opposition to such activities);

risks associated with downturns in the national and local economies, increases in interest rates, and volatility in the securities markets;

costs of compliance with the Americans with Disabilities Act and other similar laws and regulations;

potential liability for uninsured losses and environmental contamination;

risks associated with our dependence on key personnel whose continued service is not guaranteed; and

the other risk factors identified in this Form 10-Q, including those described under the caption "Risk Factors."

The risks included here are not exhaustive. Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements, include among others, the factors listed and described at 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, 2007 (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 possible for management to predict all such matters: nor can we assess the impact of all such matter 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 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 2008, and acquired over \$12 million and sold over \$169 million of land and income-producing properties.

As of March 31, 2008, the Company owned 9,850 units in 52 residential apartment communities, 29 commercial properties comprising almost 5.8 million rentable square feet and 5 hotels containing a total of 812 rooms. In addition, at March 31, 2008, ARI owned 11,027 acres of land held for development and had 19 apartment projects under construction. The Company currently owns income-producing properties and land in 21 states as well as in the U.S. Virgin Islands.

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 converted to 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%

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

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. ARI does not qualify as a Real Estate Investment Trust (REIT) for federal income tax purposes primarily due to ARI's majority ownership of the Company.

At March 31, 2008, ARI subsidiaries owned approximately 82% 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

Table of Contents

open market purchases of TCI shares in December 2003. ARI has consolidated TCI's accounts and operations since March 31, 2003. At March 31, 2008, TCI owned approximately 25% 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.

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 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 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 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.

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

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgment. Our capitalization policy on development properties is guided by 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

Table of Contents

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 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.

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 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

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

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.

Table of Contents

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

The following discussion is based on our Consolidated Financial Statements for the three months ended March 31, 2008 and 2007. As of March 31, 2008 and 2007, we had or owned interests in a portfolio (the Total Property Portfolio) of 86 and 109, respectively.

Comparison of the three months ended March 31, 2008 to the three months ended March 31, 2007

We define Same Property Portfolio for each income-producing asset type (apartments, commercial, and hotels) as properties with stabilized occupancy owned and operated for the entire three months compared for both periods. A stabilized occupancy is defined as a property whose occupancy has reached 85% or more since being developed or acquired. The same property portfolio consisted of 46 apartments, 5 hotels and 28 commercial buildings.

We had net income applicable to common shares of \$59.8 million which includes gain on land sales of \$1.3 million and net income from discontinued operations of \$63.5 million for the three months ended March 31, 2008, as compared to a net loss applicable to common shares of (\$9.1 million) which includes gain on land sales of \$4.9 million and income from discontinued operations of \$870,000 for the same period ended 2007.

Rents and other property revenues were \$44.5 million for the three months ended 2008 as compared to \$41.8 million for the same period ended 2007, an increase of \$2.7 million. The majority of the increase is from the continued lease up of our developed properties of \$2.0 million. The remaining \$700,000 is from the additional leases obtained within our property portfolio.

Property operating expenses were \$30.3 million for the three months ended 2008 as compared to \$25.9 million for the same period ended 2007 an increase of \$4.4 million. Our developed properties in the lease up phase account for \$1.7 million and new acquired properties accounted for another \$1.4 million of the increase. Land holding and other cost increased by \$1.3 million while the expenses within our same property portfolio remained relatively constant.

Depreciation and amortization expenses were \$6.8 million for the three months ended March 31, 2008 as compared to \$5.2 million for the same period ended 2007 an increase of \$1.6 million. The increase was primarily due to newly developed properties and current acquisitions which increase depreciation by \$1.3 million. Capital improvements within the same property portfolio attributed approximately \$300,000 to the increase.

General and administrative expenses were \$4.3 million for the three months ended 2008 as compared to \$4.5 million for the same period ended 2007, a decrease of \$200,000. This is consistent with our efforts to maintain costs.

Bad debt and allowance was \$12.0 million in 2008. We set up a \$5.0 million allowance account for doubtful receivables. In addition we set up an allowance of \$7.0 million for the doubtful collectability of certain investments within our portfolio.

Minority interest expenses were \$11.9 million for the three months ended March 31, 2008, as compared to an expense of \$224,000 for the same period ended 2007. The vast majority of the amount is to account for the 20% of Transcontinental Realty Investors, Inc. held by minority interests.

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

Equity in income of investee was \$5.0 million in 2008. This is due to the pickup of our portion of the income associated with our investments in various entities. The income from these entities has substantially increased from the prior period.

Gain on land sales were \$1.3 million for 2008 as compared to \$4.9 million for 2007. In 2008, we sold 14 acres of land in McKinney, Texas for \$2.9 million or \$207,000 per acre.

Table of Contents

Income from discontinued operations was \$63.5 million for the three months ended March 31, 2008 as compared to \$870,000 for the same period ended 2007. Discontinued operations relates to the sale of 21 apartments of which 17 were sold in 2008, 3 commercial buildings which were all sold in 2008, and 4 hotels which were all sold in 2008. Discontinued operations for 2007 relates to 28 apartments, 5 commercial buildings, and 5 hotels.

	For the Three Months Ended March 31,	
	2008	2007
Revenue		
Rental	\$ 4,404	\$ 11,386
Property operations	2,607	8,172
	1,797	3,214
Expenses		
Interest	(5,845)	(4,456)
G&A	(59)	(12)
Depreciation	(304)	(1,800)
	(6,208)	(6,268)
Net loss from discontinued operations before gains on sale of real estate	(4,411)	(3,054)
Gain on sale of discontinued operations	111,370	4,392
Net sales fee to affiliate	(9,337)	
Income (loss) from discontinued operations	97,622	1,338
Tax benefit	(34,168)	(468)
Income (loss) from discontinued operations	\$ 63,454	\$ 870

Liquidity and Capital Resources

Our principal sources of cash have historically been and will continue to be;

Property operations;

Proceeds from land and income-producing property sales;

The collection of mortgage notes receivable;

Receivables from affiliated companies;

Refinancing of existing mortgage notes payable; and

Additional borrowing, including mortgage notes payable, lines of credit.

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

Our principal liquidity needs over the next twelve months include;

Funding of normal recurring expenses and obligations;

Funding current development costs not covered by construction loans;

Meeting debt service requirements including loan maturities;

Funding capital expenditures; and

Funding acquisition costs for land and income-producing properties not covered by acquisition financing.

We draw on multiple financing sources to fund our long-term capital needs. We generally fund our development projects with construction loans.

Management anticipates that our available cash from property operations may not be sufficient to meet all of our cash requirements. Management intends to selectively sell land and income producing assets, refinance or extend real estate debt and seek additional borrowing secured by real estate to meet its liquidity requirements. Historically, management has been successful at extending a portion of the Company's current maturity obligations. Management also anticipates funding ongoing real estate development projects and the acquisition of new real estate from cash generated by sales of land and income-producing properties, debt refinancings or extensions and additional borrowings.

Table of Contents

Cash flow summary

The following summary discussion of our cash flows is based on the statements of cash flows as presented in ITEM 1 and is not meant to be an all inclusive discussion of the changes in our cash flow.

Cash and cash equivalents were \$7.8 million and \$5.0 million as of March 31, 2008 and 2007, respectively. Our cash provided by investing activities for the three months ended March 31, 2008 was \$123.1 million. This was offset by cash used in operating activities of (\$54.4 million) and cash used in financing activities of (\$72.5 million) which caused an overall decrease in cash of (\$3.7 million).

We used (\$54.4 million) in cash for our operating activities for the first three months ended March 31, 2008. Our primary source of cash from operating activities is rental income from properties. Our primary use of cash for operations is from daily operating costs, general and administrative, interest expense, and land holding costs. In addition, we paid \$9.4 million in sales fees to our Advisor.

Our cash provided by investing activities was \$123.1 million. The majority was from the proceeds from the sale of income producing properties of \$152.4 million. This was from the following sales transactions; the sale of the Midland/Odessa properties which involved 15 apartment complexes, providing \$98.3 million; the sale of the Lexington Office building, providing \$5.4 million; the sale of the Fairway View apartments, providing \$10.3 million; the sale of three hotels, City Suites, Majestic and Willows, providing \$30.0 million; and the sale of an apartment, Governors Square for \$8.4 million. We invested \$12.0 million to acquire approximately 32.6 acres of land in and around Dallas, Texas. We invested \$32.1 million in our various developments.

We used (\$72.5 million) in our financing activities. The majority was used to pay off maturing notes payable which consisted of the existing notes on properties sold of \$144.3 million. This was offset by the receipt \$76.6 million which consisted of \$50.7 million from the proceeds from new construction debt and the refinancing of existing debt of \$25.9 million. In addition, we paid down \$5.3 million in existing mortgages.

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

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

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, after the use of net operating loss carryforwards for federal income tax purposes in the first three months of 2008 and a loss in the first three months of 2007, therefore, it recorded no provision for income taxes.

Table of Contents

At March 31, 2008, ARI had a net deferred tax asset of \$82.9 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At March 31, 2008, 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	\$ 333,117	5.82%	\$ 3,331
Total decrease in ARI's annual net income			3,331
Per share			\$.33

ITEM 4. CONTROLS AND PROCEDURES

- (a) As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Principal Executive Officer and Interim Chief Financial Officer per the Company's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the Company's Principal Executive Officer and Interim Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.
- (b) There have been no changes in the Company's internal controls over financial reporting during the quarter ended March 31, 2008, that have materially affected or are reasonably likely to materially affect the Company's internal controls 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. did not repurchase any of its equity securities. The following table sets forth a summary by month for the quarter indicating no repurchases were made, and that at the end of the period covered by this report, a specified number of shares may yet be purchased under the programs specified below:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program⁽¹⁾
January 2008	11,800	\$ 9.45	904,865	95,135
February 2008	3,300	\$ 9.38	908,165	91,835
March 2008			908,165	91,835
Total	15,100			

- (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 Number	Description of Exhibit
3.0	Certificate of Restatement of Articles of Incorporation of American Realty Investors, Inc. dated August 3, 2000 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
3.1	Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc. dated August 29, 2000 (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q dated September 30, 2000).
3.2	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc. decreasing the number of authorized shares of and eliminating Series B Cumulative Convertible Preferred Stock dated August 23, 2003 (incorporated by reference to Exhibit 3.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
3.3	Articles of Amendment to the Restated Articles of Incorporation of American Realty Investors, Inc., decreasing the number of authorized shares of and eliminating Series I Cumulative Preferred Stock dated October 1, 2003 (incorporated by reference to Exhibit 3.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
3.4	Bylaws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement on Form S-4 filed December 30, 1999).
4.1	Certificate of Designations, Preferences and Relative Participating or Optional or Other Special Rights, and Qualifications, Limitations or Restrictions Thereof of Series F Redeemable Preferred Stock of American Realty Investors, Inc., dated June 11, 2001 (incorporated by reference to Exhibit 4.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
4.2	Certificate of Withdrawal of Preferred Stock, Decreasing the Number of Authorized Shares of and Eliminating Series F Redeemable Preferred Stock, dated June 18, 2002 (incorporated by reference to Exhibit 3.0 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002).
4.3	Certificate of Designation, Preferences and Rights of the Series I Cumulative Preferred Stock of American Realty Investors, Inc., dated February 3, 2003 (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002).
4.4	Certificate of Designation for Nevada Profit Corporations designating the Series J 8% Cumulative Convertible Preferred Stock as filed with the Secretary of State of Nevada on March 16, 2006 (incorporated by reference to Registrant 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 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* 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: May 15, 2008

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

Date: May 15, 2008

By: /s/ Gene S. Bertcher
Gene S. Bertcher
Executive Vice President and Interim Chief Financial Officer

Table of Contents

AMERICAN REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q

For the Quarter Ended March 31, 2008

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 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Filed herewith