

AMERICAN REALTY INVESTORS INC  
Form 10-K  
April 02, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

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

**For the fiscal year ended December 31, 2017**

**OR**

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

**Commission File Number 001-15663**

**American Realty Investors, Inc.**

**(Exact name of registrant as specified in its charter)**

<b>Nevada</b> <b>(State or other jurisdiction of</b>	<b>75-2847135</b> <b>(IRS Employer</b>
<b>Incorporation or organization)</b> <b>1603 LBJ Freeway, Suite 300</b>	<b>Identification Number)</b> <b>75234</b>
<b>Dallas, Texas</b> <b>(Address of principal executive offices)</b>	<b>(Zip Code)</b>
<b>(469) 522-4200</b>	

**Registrant's Telephone Number, including area code**

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

<i>Title of Each Class</i>	<i>Name of each exchange on which registered</i>
Common Stock, \$0.01 par value	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes    No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes    No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).    Yes    No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

<b>Large accelerated filer</b>	<b>Accelerated filer</b>
<b>Non-accelerated filer</b>	<b>Smaller reporting company</b>
<b>(Do not check if smaller reporting company)</b>	<b>Emerging growth Company</b>

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes  
No  5

The aggregate market value of the shares of voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the closing price at which the common equity was last sold which was the sales price of the Common stock on the New York Stock Exchange as of December 31, 2017 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$9,793,299 based upon a total of 2,019,327 shares held as of December 31, 2017 by persons believed to be non-affiliates of the Registrant. The basis of the calculation does not constitute a determination by the Registrant as defined in Rule 405 of the Securities Act of 1933, as amended, such calculation, if made as of a date within sixty days of this filing, would yield a different value.

As of March 30, 2018, there were 15,997,076 shares of common stock outstanding.

**Documents Incorporated By Reference:**

Consolidated Financial Statements of Income Opportunity Realty Investors, Inc.; Commission File No. 001-14784

Consolidated Financial Statements of Transcontinental Realty Investors, Inc.; Commission File No. 001-09240

**INDEX TO**

**ANNUAL REPORT ON FORM 10-K**

	<b>Page</b>
<b><u>PART I</u></b>	
<u>Item 1.</u> <u>Business</u>	3
<u>Item 1A.</u> <u>Risk Factors</u>	9
<u>Item 1B.</u> <u>Unresolved Staff Comments</u>	13
<u>Item 2.</u> <u>Properties</u>	14
<u>Item 3.</u> <u>Legal Proceedings</u>	17
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	18
<b><u>PART II</u></b>	
<u>Item 5.</u> <u>Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u>	19
<u>Item 6.</u> <u>Selected Financial Data</u>	20
<u>Item 7.</u> <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
<u>Item 8.</u> <u>Consolidated Financial Statements and Supplementary Data</u>	33
<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	70
<u>Item 9A.</u> <u>Controls and Procedures</u>	70
<u>Item 9B.</u> <u>Other Information</u>	70
<b><u>PART III</u></b>	
<u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</u>	71
<u>Item 11.</u> <u>Executive Compensation</u>	77
<u>Item 12.</u>	78



## FORWARD-LOOKING STATEMENTS

Certain Statements in this Form 10-K are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. The words “estimate,” “plan,” “intend,” “expect,” “anticipate,” “believe,” and similar expressions are intended to identify forward-looking statements. The forward-looking statements are found at various places throughout this Report and in the documents incorporated herein by reference. The Company disclaims any intention or obligations to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that our expectations are based upon reasonable assumptions, we can give no assurance that our goals will be achieved. Important factors that could cause our actual results to differ from estimates or projections contained in any forward-looking statements are described in Part I, Item 1A. “Risk Factors”.

## PART I

### ITEM 1. BUSINESS

#### General

As used herein, the terms “ARL,” “the Company,” “We,” “Our,” or “Us” refer to American Realty Investors, Inc., a Nevada corporation, which was formed in 1999.

The Company is headquartered in Dallas, Texas and its common stock is listed and trades on the New York Stock Exchange (“NYSE”) under the symbol “ARL”. Over 80% of ARL’s stock is owned by related parties. ARL and a subsidiary own approximately 77.68% 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 NYSE under the symbol “TCI”. TCI’s financial results are consolidated with those of ARL. In 2012, May Realty Holdings, Inc. (“MRHI”) subsidiaries acquired more than 80% of ARL stock and as a result, ARL is included in the MRHI consolidated group for federal income tax reporting. We have no employees.

TCI owns approximately 81.25% of the common stock of Income Opportunity Realty Investors, Inc. (“IOR”). IOR’s financial results are consolidated with those of TCI and its subsidiaries. Shares of IOR are listed and traded on the NYSE American under the symbol “IOR”.

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

Pillar, the sole shareholder of which is Realty Advisors, LLC, a Nevada limited liability company, the sole member of which is Realty Advisors, Inc. ("RAI"), a Nevada corporation, the sole shareholder of which is May Realty Holdings, Inc. ("MRHI"), a Nevada corporation, the sole shareholder of which is a trust known as the May Trust, became the Company's external Advisor and Cash Manager. Pillar's duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities. Pillar also arranges, for the Company's benefit, debt and equity financing with third party lenders and investors. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. "Directors, Executive Officers and Corporate Governance – The Advisor". ARL has no employees. Employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Regis Realty Prime, LLC, dba Regis Property Management, LLC ("Regis"), manages our commercial properties and provides brokerage services. Regis receives property management fees, construction management fees and leasing commissions in accordance with the terms of its property-level management agreement. Regis is also entitled to receive real estate brokerage commissions in accordance with the terms of a non-exclusive brokerage agreement. See Part III, Item 10. "Directors, Executive Officers and Corporate Governance – Property Management and Real Estate Brokerage". ARL engages third-party companies to lease and manage its apartment properties.

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

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

ARL through subsidiaries invests in real estate through direct ownership, leases, and partnerships and also invests in mortgage loans on real estate. Our primary business is the acquisition, development and ownership of income-producing residential and commercial real estate. In addition, we opportunistically acquire land for future development in in-fill or high-growth suburban markets. From time to time and when we believe it appropriate to do so, we will also sell land and income-producing properties. We generate revenues by leasing apartment units to residents; and by leasing office, industrial and retail space to various for-profit businesses as well as certain local, state and federal agencies.



At December 31, 2017, our income-producing properties (most of which were owned by subsidiaries of TCI) consisted of:

Seven commercial properties consisting of five office buildings and two retail properties comprising in aggregate of approximately 1.7 million square feet;

A golf course comprising approximately 96.09 acres; and

Fifty one residential apartment communities comprising 8,427 units, excluding apartments being developed.

The following table sets forth the location of our real estate held for investment (income-producing properties only) by asset type as of December 31, 2017:

Location	Apartments		Commercial	
	No.	Units	No.	SF
Alabama	1	168	—	—
Arkansas	5	938	—	—
Colorado	2	260	—	—
Florida	3	198	1	6,722
Georgia	1	222	—	—
Louisiana	2	384	—	—
Mississippi	9	924	—	—
North Carolina	1	201	—	—
Tennessee	4	708	—	—
Texas-Greater Dallas-Ft Worth	11	1,962	4	1,473,634
Texas-Greater Houston	2	416	1	95,329
Texas-San Antonio	2	468	—	—
Texas-Other	8	1,578	—	—
Wisconsin	—	—	1	122,205
Total	51	8,427	7	1,697,890

We finance our acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific, first-lien mortgage loans from commercial banks and institutional lenders. We finance our development projects principally with short-term, variable-rate construction loans that are refinanced with the proceeds of long-term, fixed-rate amortizing mortgages when the development has been completed and occupancy has been stabilized. When we sell properties, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable, secured by the property being sold. We may also from time to time enter into partnerships or joint ventures with various investors to acquire land or income-producing properties or to sell interests in some of our properties.

We join with various third-party development companies to construct residential apartment communities. At December 31, 2017, we have fourteen apartment projects in development. The third-party developer typically holds a general partner as well as a limited partner interest in a limited partnership formed for the purpose of building a single property while we generally take a limited partner interest in the limited partnership. We may contribute land to the partnership as part of our equity contribution or we may contribute the necessary funds to the partnership to acquire the land. We are required to fund all required equity contributions while the third-party developer is responsible for obtaining construction financing, hiring a general contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our consolidated financial statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer's partnership interests in exchange for any remaining unpaid developer fees.

At December 31, 2017, our apartment projects in development included (dollars in thousands):

Property	Location	No. of Units	Costs to Date <sup>(1)</sup>	Total Projected Costs <sup>(1)</sup>
Terra Lago	Rowlett, TX	447	\$42,136	\$66,375
Parc at Bentonville	Bentonville, AR	216	\$85	\$27,710
Lakeside Lofts	Farmers Branch, TX	494	\$5,079	\$78,550
Eagle Crossing	Dallas, TX	153	\$81	\$20,670
Parc at Garland	Garland, TX	198	\$81	\$26,007
Parc at Wylie	Wylie, TX	198	\$195	\$28,212
Apalache Point	Tallahassee, FL	200	\$149	\$30,251
Overlook at Allensville Square II	Sevierville, TN	144	\$525	\$20,244
McKinney Point	McKinney, TX	198	\$137	\$29,846
Dominion at Mercer Crossing	Farmers Branch, TX	256	\$2,995	\$46,115
Abode Red Rock Properties	Las Vegas, NV	308	\$28,095	\$58,880
Oak Hollow Phase II	Seguin, TX	96	\$5,535	\$10,723
Sawgrass Phase II	New Point Richey, FL	80	\$3,772	\$20,719
Forest Pines	Bryan, TX	240	\$269	\$31,535
Total		3,228	\$89,134	\$495,837

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

We have made investments in a number of large tracts of undeveloped and partially developed land and intend to a) continue to improve these tracts of land for our own development purposes or b) make the improvements necessary to ready the land for sale to other developers.

At December 31, 2017, our investments in undeveloped and partially developed land consisted of the following (dollars in thousands):

Location	Acquired	Acres	Cost	Intended Use
McKinney, TX	1997-2008	10	\$613	Mixed use
Dallas, TX	1996-2013	165	13,674	Mixed use
Kaufman County, TX	2008	25	2,547	Multi-family residential
Farmers Branch, TX	2008	240	32,183	Mixed use

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

Kaufman County, TX <sup>(1)</sup>	2006	2,884	43,817	Mixed use
Various	1990-2008	342	35,273	Various
Total Land Holdings		3,666	\$128,107	

<sup>(1)</sup> Windmill Farms Land was acquired by a subsidiary of ARL in 2006 and 2,900 acres were subsequently sold to TCI in 2011.

### **Significant Real Estate Acquisitions/Dispositions and Financings**

A summary of some of the significant transactions for the year ended December 31, 2017 are discussed below:

#### **Purchases**

During the year ended December 31, 2017, subsidiaries acquired one income-producing apartment property from third parties in the state of North Carolina, increasing the total number of units by 201, for a combined purchase price of \$36.7 million. In addition, we acquired one land parcel for future development for a total purchase price of \$5.04 million, adding 18.5 acres to the development portfolio.

### **Sales**

As of December 31, 2017, subsidiaries hold approximately 66.7 acres of land, at various locations that were sold to related parties in multiple transactions. These transactions are treated as “subject to sales contract” on the Consolidated Balance Sheets. Due to the related party nature of the transactions ARI has deferred the recording of the sales in accordance with ASC 360-20.

We continue to invest in the development of apartment projects. For the year ended December 31, 2017, we have expended \$69.8 million related to the construction or predevelopment of various apartment complexes and capitalized \$2.4 million of interest costs.

### **Business Plan and Investment Policy**

Our business objective is to maximize long-term value for our stockholders by investing in residential and commercial real estate through the acquisition, development and ownership of apartments, commercial properties, and land. We intend to achieve this objective through acquiring and developing properties in multiple markets and operating as an industry-leading landlord. We believe this objective will provide the benefits of enhanced investment opportunities, economies of scale and risk diversification, both in terms of geographic market and real estate product type. We believe our objective will also result in continuing access to favorably priced debt and equity capital. In pursuing our business objective, we seek to achieve a combination of internal and external growth while maintaining a strong balance sheet and employing a strategy of financial flexibility. We maximize the value of our apartments and commercial properties by maintaining high occupancy levels while charging competitive rental rates, controlling costs and focusing on tenant retention. We also pursue attractive development opportunities either directly or in partnership with other investors.

For our portfolio of commercial properties, we generate increased operating cash flow through annual contractual increases in rental rates under existing leases. We also seek to identify best practices within our industry and across our business units in order to enhance cost savings and gain operating efficiencies. We employ capital improvement and preventive maintenance programs specifically designed to reduce operating costs and increase the long-term value of our real estate investments.

We seek to acquire properties consistent with our business objectives and strategies. We execute our acquisition strategy by purchasing properties which management believes will create stockholder value over the long-term. We will also sell properties when management believes value has been maximized or when a property is no longer considered an investment to be held long-term.

We are continuously in various stages of discussions and negotiations with respect to development, acquisition, and disposition projects. The consummation of any current or future development, acquisition, or disposition, if any, and the pace at which any may be completed cannot be assured or predicted.

Substantially all of our properties are owned by subsidiary companies, many of which are single-asset entities. This ownership structure permits greater access to financing for individual properties and permits flexibility in negotiating a sale of either the asset or the equity interests in the entity owning the asset. From time-to-time, our subsidiaries have invested in joint ventures with other investors, creating the possibility of risks that do not exist with properties solely owned by an ARL subsidiary. In those instances where other investors are involved, those other investors may have business, economic, or other objectives that are inconsistent with our objectives, which may in turn require us to make investment decisions different from those if we were the sole owner.

Real estate generally cannot be sold quickly. We may not be able to promptly dispose of properties in response to economic or other conditions. To offset this challenge, selective dispositions have been a part of our strategy to maintain an efficient investment portfolio and to provide additional sources of capital. We finance acquisitions through mortgages, internally generated funds, and, to a lesser extent, property sales. Those sources provide the bulk of funds for future acquisitions. We may purchase properties by assuming existing loans secured by the acquired property. When properties are acquired in such a manner, we customarily seek to refinance the asset in order to properly leverage the asset in a manner consistent with our investment objectives.

Our businesses are not generally seasonal with regard to real estate investments. Our investment strategy seeks both current income and capital appreciation. Our plan of operation is to continue, to the extent our liquidity permits, to make equity investments in income-producing real estate such as apartments, and commercial properties. We may also invest in the debt or equity securities of real estate-related entities. We intend to pursue higher risk, higher reward investments, such as improved and unimproved land where we can obtain reasonably-priced financing for substantially all of a property's purchase price. We intend to continue the development of apartment properties in selected markets in Texas and in other locations where we believe adequate levels of demand exist. We intend to pursue sales opportunities for properties in stabilized real estate markets where we believe our properties' value has been maximized. We also intend to be an opportunistic seller of properties in markets where demand exceeds current supply. Although we no longer actively seek to fund or purchase mortgage loans, we may, in selected instances, originate mortgage loans or we may provide purchase money financing in conjunction with a property sale.

Our Board of Directors has broad authority under our governing documents to make all types of investments, and we may devote available resources to particular investments or types of investments without restriction on the amount or percentage of assets that may be allocated to a single investment or to any particular type of investment, and without limit on the percentage of securities of any one issuer that may be acquired. Investment objectives and policies may be changed at any time by the Board without stockholder approval.

The specific composition from time-to-time of our real estate portfolio owned by ARL directly and through our subsidiaries depends largely on the judgment of management to changing investment opportunities and the level of risk associated with specific investments or types of investments. We intend to maintain a real estate portfolio that is diversified by both location and type of property.

## Competition

The real estate business is highly competitive and we compete with numerous companies engaged in real estate activities (including certain entities described in Part III, Item 13. “Certain Relationships and Related Transactions, and Director Independence”), some of which have greater financial resources than ARL. We believe that success against such competition is dependent upon the geographic location of a property, the performance of property-level managers in areas such as leasing and marketing, collection of rents and control of operating expenses, the amount of new construction in the area and the maintenance and appearance of the property. Additional competitive factors include ease of access to a property, the adequacy of related facilities such as parking and other amenities, and sensitivity to market conditions in determining rent levels. With respect to apartments, competition is also based upon the design and mix of the units and the ability to provide a community atmosphere for the residents. We believe that beyond general economic circumstances and trends, the degree to which properties are renovated or new properties are developed in the competing submarket are also competitive factors. See also Part I, Item 1A. “Risk Factors”.

To the extent that ARL seeks to sell any of its properties, the sales prices for the properties may be affected by competition from other real estate owners and financial institutions also attempting to sell properties in areas where ARL’s properties are located, as well as aggressive buyers attempting to dominate or penetrate a particular market.

As described above and in Part III, Item 13. “Certain Relationships and Related Transactions, and Director Independence,” the officers and directors of ARL serve as officers and directors of TCI and IOR. TCI and IOR have business objectives similar to those of ARL. ARL’s officers and directors owe fiduciary duties to both IOR and TCI as well as to ARL under applicable law. In determining whether a particular investment opportunity will be allocated to ARL, IOR, or TCI, management considers the respective investment objectives of each Company and the appropriateness of a particular investment in light of each Company’s existing real estate and mortgage notes receivable portfolio. To the extent that any particular investment opportunity is appropriate to more than one of the entities, the investment opportunity may be allocated to the entity which has had funds available for investment for the longest period of time, or, if appropriate, the investment may be shared among all three or two of the entities.

In addition, as described in Part III, Item 13. “Certain Relationships and Related Transactions, and Director Independence,” ARL competes with related parties of Pillar having similar investment objectives related to the acquisition, development, disposition, leasing and financing of real estate and real estate-related investments. In resolving any potential conflicts of interest which may arise, Pillar has informed ARL that it intends to exercise its best judgment as to what is fair and reasonable under the circumstances in accordance with applicable law.

We have historically engaged in and will continue to engage in certain business transactions with related parties, including but not limited to asset acquisitions and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm’s length basis due to the absence of free market forces that naturally exist in



business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in the best interests of the Company.

### **Available Information**

ARL maintains an Internet site at [www.americanrealtyinvest.com](http://www.americanrealtyinvest.com). Available through the website, free of charge, are Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, reports filed pursuant to Section 16, and amendments to those reports, as soon as reasonably practicable after they are electronically filed or furnished to the Securities and Exchange Commission. In addition, we have posted the charters for the Audit Committee, Compensation Committee, and Governance and Nominating Committee, as well as the Code of Business Conduct and Ethics, Corporate Governance Guidelines on Director Independence, and other information on the website. These charters and principles are not incorporated in this report by reference. We will also provide a copy of these documents free of charge to stockholders upon written request. The Company issues Annual Reports containing audited financial statements to its common shareholders.

## **ITEM 1A. RISK FACTORS**

An investment in our securities involves various risks. All investors should carefully consider the following risk factors in conjunction with the other information in this report before trading our securities.

### **Risk Factors Related to our Business**

*Adverse events concerning our existing tenants or negative market conditions affecting our existing tenants could have an adverse impact on our ability to attract new tenants, release space, collect rent or renew leases, and thus could adversely affect cash flow from operations and inhibit growth.*

Cash flow from operations depends in part on the ability to lease space to tenants on economically favorable terms. We could be adversely affected by various facts and events over which the Company has limited or no control, such as:

lack of demand for space in areas where the properties are located;

inability to retain existing tenants and attract new tenants;

oversupply of or reduced demand for space and changes in market rental rates;

defaults by tenants or failure to pay rent on a timely basis;

the need to periodically renovate and repair marketable space;

physical damage to properties;

economic or physical decline of the areas where properties are located; and

potential risk of functional obsolescence of properties over time.

At any time, any tenant may experience a downturn in its business that may weaken its financial condition. As a result, a tenant may delay lease commencement, fail to make rental payments when due, decline to extend a lease upon its expiration, become insolvent or declare bankruptcy. Any tenant bankruptcy or insolvency, leasing delay or failure to make rental payments when due could result in the termination of the tenant's lease and material losses to the Company.

If tenants do not renew their leases as they expire, we may not be able to rent the space. Furthermore, leases that are renewed, and some new leases for space that is re-let, may have terms that are less economically favorable than expiring lease terms, or may require us to incur significant costs, such as renovations, tenant improvements or lease transaction costs. Any of these events could adversely affect cash flow from operations and our ability to make distributions to shareholders and service indebtedness. A significant portion of the costs of owning property, such as real estate taxes, insurance, and debt service payments, are not necessarily reduced when circumstances cause a decrease in rental income from the properties.

***We may not be able to compete successfully with other entities that operate in our industry.***

We experience a great deal of competition in attracting tenants for the properties and in locating land to develop and properties to acquire.

In our effort to lease properties, we compete for tenants with a broad spectrum of other landlords in each of the markets. These competitors include, among others, publicly-held REITs, privately-held entities, individual property owners and tenants who wish to sublease their space. Some of these competitors may be able to offer prospective tenants more attractive financial terms than we are able to offer.

If the availability of land or high quality properties in our markets diminishes, operating results could be adversely affected.

***We may experience increased operating costs which could adversely affect our financial results and the value of our properties.***

Our properties are subject to increases in operating expenses such as insurance, cleaning, electricity, heating, ventilation and air conditioning, administrative costs and other costs associated with security, landscaping, repairs, and maintenance of the properties. While some current tenants are obligated by their leases to reimburse us for a portion of these costs, there is no assurance that these tenants will make such payments or agree to pay these costs upon renewal or new tenants will agree to pay these costs. If operating expenses increase in our markets, we may not be able to increase rents or reimbursements in all of these markets to offset the increased expenses, without at the same time decreasing occupancy rates. If this occurs, our ability to make distributions to shareholders and service

indebtedness could be adversely affected.

*Our ability to achieve growth in operating income depends in part on its ability to develop additional properties.*

We intend to continue to develop properties where warranted by market conditions. We have a number of ongoing development and land projects being readied for commencement.

Additionally, general construction and development activities include the following risks:

construction and leasing of a property may not be completed on schedule, which could result in increased expenses and construction costs, and would result in reduced profitability for that property;

construction costs may exceed original estimates due to increases in interest rates and increased cost of materials, labor or other costs, possibly making the property less profitable because of inability to increase rents to compensate for the increase in construction costs;

some developments may fail to achieve expectations, possibly making them less profitable;

we may be unable to obtain, or face delays in obtaining, required zoning, land-use, building, occupancy, and other governmental permits and authorizations, which could result in increased costs and could require us to abandon our activities entirely with respect to a project;

we may abandon development opportunities after the initial exploration, which may result in failure to recover costs already incurred. If we determine to alter or discontinue its development efforts, future costs of the investment may be expensed as incurred rather than capitalized and we may determine the investment is impaired resulting in a loss;

we may expend funds on and devote management's time to projects which will not be completed; and

occupancy rates and rents at newly-completed properties may fluctuate depending on various factors including market and economic conditions, and may result in lower than projected rental rates and reduced income from operations.

*We face risks associated with property acquisitions.*

We acquire individual properties and various portfolios of properties and intend to continue to do so. Acquisition activities are subject to the following risks:

when we are able to locate a desired property, competition from other real estate investors may significantly increase the seller's offering price;

acquired properties may fail to perform as expected;

the actual costs of repositioning or redeveloping acquired properties may be higher than original estimates;

acquired properties may be located in new markets where we face risks associated with an incomplete knowledge or understanding of the local market, a limited number of established business relationships in the area and a relative unfamiliarity with local governmental and permitting procedures; and

we may be unable to quickly and efficiently integrate new acquisitions, particularly acquisitions of portfolios of properties, into existing operations, and results of operations and financial condition could be adversely affected.

We may acquire properties subject to liabilities and without any recourse, or with limited recourse, with respect to unknown liabilities. However, if an unknown liability was later asserted against the acquired properties, we might be required to pay substantial sums to settle it, which could adversely affect cash flow.

***Many of our properties are concentrated in our primary markets and the Company may suffer economic harm as a result of adverse conditions in those markets.***

Our properties are located principally in specific geographic areas in the southwestern, southeastern, and mid-western United States. The Company's overall performance is largely dependent on economic conditions in those regions.

***We are leveraged and may not be able to meet our debt service obligations.***

We had total indebtedness at December 31, 2017 of approximately \$901.1 million. Substantially all assets have been pledged to secure debt. These borrowings increase the risk of loss because they represent a prior claim on assets and most require fixed payments regardless of profitability. Our leveraged position makes us vulnerable to declines in the general economy and may limit the Company's ability to pursue other business opportunities in the future.



*We may not be able to access financial markets to obtain capital on a timely basis, or on acceptable terms.*

We rely on proceeds from property dispositions and third party capital sources for a portion of our capital needs, including capital for acquisitions and development. The public debt and equity markets are also among the sources upon which the Company relies. There is no guarantee that we will be able to access these markets or any other source of capital. The ability to access the public debt and equity markets depends on a variety of factors, including:

general economic conditions affecting these markets;

our own financial structure and performance;

the market's opinion of real estate companies in general; and

the market's opinion of real estate companies that own similar properties.

*We may suffer adverse effects as a result of terms and covenants relating to the Company's indebtedness.*

Required payments on our indebtedness generally are not reduced if the economic performance of the portfolio declines. If the economic performance declines, net income, cash flow from operations and cash available for distribution to stockholders may be reduced. If payments on debt cannot be made, we could sustain a loss or suffer judgments, or in the case of mortgages, suffer foreclosures by mortgagees. Further, some obligations contain cross-default and/or cross-acceleration provisions, which means that a default on one obligation may constitute a default on other obligations.

We anticipate only a small portion of the principal of our debt will be repaid prior to maturity. Therefore, we are likely to refinance a portion of our outstanding debt as it matures. There is a risk that we may not be able to refinance existing debt or the terms of any refinancing will not be as favorable as the terms of the maturing debt. If principal balances due at maturity cannot be refinanced, extended, or repaid with proceeds from other sources, such as the proceeds of sales of assets or new equity capital, cash flow may not be sufficient to repay all maturing debt in years when significant "balloon" payments come due.

Our credit facilities and unsecured debt contain customary restrictions, requirements and other limitations on the ability to incur indebtedness, including total debt to asset ratios, secured debt to total asset ratios, debt service



coverage ratios, and minimum ratios of unencumbered assets to unsecured debt. Our continued ability to borrow is subject to compliance with financial and other covenants. In addition, failure to comply with such covenants could cause a default under credit facilities, and we may then be required to repay such debt with capital from other sources. Under those circumstances, other sources of capital may not be available, or be available only on terms that are detrimental to the Company.

***Our degree of leverage could limit our ability to obtain additional financing or affect the market price of our common stock.***

The degree of leverage could affect our ability to obtain additional financing for working capital, capital expenditures, acquisitions, development or other general corporate purposes. The degree of leverage could also make us more vulnerable to a downturn in business or the general economy.

***An increase in interest rates would increase interest costs on variable rate debt and could adversely impact the ability to refinance existing debt.***

We currently have, and may incur more, indebtedness that bears interest at variable rates. Accordingly, if interest rates increase, so will the interest costs, which could adversely affect cash flow and the ability to pay principal and interest on our debt and the ability to make distributions to shareholders. Further, rising interest rates could limit our ability to refinance existing debt when it matures.

***Unbudgeted capital expenditures or cost overruns could adversely affect business operations and cash flow.***

If capital expenditures for ongoing or planned development projects or renovations exceed expectations, the additional cost of these expenditures could have an adverse effect on business operations and cash flow. In addition, we might not have access to funds on a timely basis to pay for the unexpected expenditures.

Construction costs are funded in large part through construction financing, which the Company may guarantee. The Company's obligation to pay interest on this financing continues until the rental project is completed, leased-up and permanent financing is obtained, or the project is sold, or the construction loan is otherwise paid. Unexpected delays in completion of one or more ongoing projects could also have a significant adverse impact on business operations and cash flow.

***We may need to sell properties from time to time for cash flow purposes.***

Because of the lack of liquidity of real estate investments generally, our ability to respond to changing circumstances may be limited. Real estate investments generally cannot be sold quickly. In the event that we must sell assets to generate cash flow, we cannot predict whether there will be a market for those assets in the time period desired, or whether we will be able to sell the assets at a price that will allow the Company to fully recoup its investment. We may not be able to realize the full potential value of the assets and may incur costs related to the early extinguishment of the debt secured by such assets.

*We intend to devote resources to the development of new projects.*

We plan to continue developing new projects as opportunities arise in the future. Development and construction activities entail a number of risks, including but not limited to the following:

we may abandon a project after spending time and money determining its feasibility;

construction costs may materially exceed original estimates;

the revenue from a new project may not be enough to make it profitable or generate a positive cash flow;

we may not be able to obtain financing on favorable terms for development of a property, if at all;

we may not complete construction and lease-ups on schedule, resulting in increased development or carrying costs;  
and

we may not be able to obtain, or may be delayed in obtaining, necessary governmental permits.

*The overall business is subject to all of the risks associated with the real estate industry.*

We are subject to all risks incident to investment in real estate, many of which relate to the general lack of liquidity of real estate investments, including, but not limited to:

our real estate assets are concentrated primarily in the southwest and any deterioration in the general economic conditions of this region could have an adverse effect;

changes in interest rates may make the ability to satisfy overall debt service requirements more burdensome;

lack of availability of financing may render the purchase, sale or refinancing of a property more difficult or unattractive;

changes in real estate and zoning laws;

increases in real estate taxes and insurance costs;

federal or local regulations or rent controls;

acts of terrorism, and

hurricanes, tornadoes, floods, earthquakes and other similar natural disasters.

***Our performance and value are subject to risks associated with our real estate assets and with the real estate industry.***

Our economic performance and the value of our real estate assets, and consequently the value of our securities, are subject to the risk that if our properties do not generate revenues sufficient to meet our operating expenses, including debt service and capital expenditures, our cash flow will be adversely affected. The following factors, among others, may adversely affect the income generated by our properties:

downturns in the national, regional and local economic conditions (particularly increases in unemployment);

competition from other office, apartment and commercial buildings;

local real estate market conditions, such as oversupply or reduction in demand for office, apartments or other commercial space;

changes in interest rates and availability of financing;

vacancies, changes in market rental rates and the need to periodically repair, renovate and re-let space;

increased operating costs, including insurance expense, utilities, real estate taxes, state and local taxes and heightened security costs;

civil disturbances, earthquakes and other natural disasters, or terrorist acts or acts of war which may result in uninsured or underinsured losses;

significant expenditures associated with each investment, such as debt service payments, real estate taxes, insurance and maintenance costs which are generally not reduced when circumstances cause a reduction in revenues from a property;

declines in the financial condition of our tenants and our ability to collect rents from our tenants; and

decreases in the underlying value of our real estate.

***Adverse economic and geopolitical conditions and dislocations in the credit markets could have a material adverse effect on our results of operations, and financial condition.***

Our business may be affected by market and economic challenges experienced by the U.S. economy or real estate industry as a whole or by the local economic conditions in the markets in which our properties are located, including the current dislocations in the credit markets and general global economic recession. These current conditions, or similar conditions existing in the future, may adversely affect our results of operations, and financial condition as a result of the following, among other potential consequences:

the financial condition of our tenants may be adversely affected which may result in tenant defaults under leases due to bankruptcy, lack of liquidity, operational failures or for other reasons;

significant job losses within our tenants may occur, which may decrease demand for our office space, causing market rental rates and property values to be negatively impacted;

our ability to borrow on terms and conditions that we find acceptable, or at all, may be limited, which could reduce our ability to pursue acquisition and development opportunities and refinance existing debt, reduce our returns from our acquisition and development activities and increase our future interest expense;

reduced values of our properties may limit our ability to dispose of assets at attractive prices or to obtain debt financing secured by our properties and may reduce the availability of unsecured loans; and

one or more lenders could refuse to fund their financing commitment to us or could fail and we may not be able to replace the financing commitment of any such lenders on favorable terms, or at all.

***Real estate investments are illiquid, and the Company may not be able to sell properties if and when it is appropriate to do so.***

Real estate generally cannot be sold quickly. We may not be able to dispose of properties promptly in response to economic or other conditions. In addition, provisions of the Internal Revenue Code may limit our ability to sell properties (without incurring significant tax costs) in some situations when it may be otherwise economically advantageous to do so, thereby adversely affecting returns to stockholders and adversely impacting our ability to meet our obligations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

13

**ITEM 2. PROPERTIES**

On December 31, 2017, our portfolio consisted of fifty nine income-producing properties consisting of fifty-one apartment communities totaling 8,427 units, seven commercial properties consisting of five office buildings and two retail centers; and a golf course. In addition, we own or control 3,613 acres of improved and unimproved land held for future development or sale. The average annual rental and other property revenue dollar per square foot is \$11.83 for the Company's residential apartment portfolio and \$18.55 for the commercial portfolio. The table below shows information relating to those properties in which we own or have an ownership interest, all of which are suitable and adequate for the purpose for which each is utilized:

Residential Apartments	Location	Units	Occupancy	
Anderson Estates	Oxford, MS	48	91.70	%
Blue Lake Villas I	Waxahachie, TX	186	98.90	%
Blue Lake Villas II	Waxahachie, TX	70	98.60	%
Breakwater Bay	Beaumont, TX	176	90.90	%
Bridgewood Ranch	Kaufman, TX	106	97.20	%
Capitol Hill	Little Rock, AR	156	92.90	%
Centennial Village	Oak Ridge TN	252	99.20	%
Crossing at Opelika	Opelika AL	168	98.20	%
Curtis Moore Estates	Greenwood, MS	104	77.90	%
Dakota Arms	Lubbock, TX	208	95.20	%
David Jordan Phase II	Greenwood, MS	32	78.10	%
David Jordan Phase III	Greenwood, MS	40	87.50	%
Desoto Ranch	DeSoto, TX	248	97.20	%
Falcon Lakes	Arlington, TX	248	98.00	%
Heather Creek	Mesquite, TX	200	98.50	%
Lake Forest	Houston, TX	240	95.80	%
Legacy at Pleasant Grove	Texarkana, TX	208	93.30	%
Lodge at Pecan Creek	Denton, TX	192	94.80	%
Lofts at Reynolds Village	Asheville, NC	201	97.50	%
Mansions of Mansfield	Mansfield, TX	208	97.60	%
Metropolitan	Little Rock, AR	260	87.30	%
Mission Oaks	San Antonio, TX	228	96.10	%
Monticello Estate	Monticello, AR	32	90.60	%
Northside on Travis	Sherman, TX	200	97.00	%
Oak Hollow	Seguin TX	160	94.40	%
Oceanaire	Biloxi, MS	196	94.40	%
Overlook at Allensville	Sevierville TN	144	96.50	%
Parc at Clarksville	Clarksville, TN	168	96.40	%
Parc at Denham Springs	Denham Springs, LA	224	94.60	%
Parc at Maumelle	Little Rock, AR	240	93.80	%
Parc at Metro Center	Nashville, TN	144	98.60	%
Parc at Rogers	Rogers, AR	250	96.40	%
Preserve at Pecan Creek	Denton, TX	192	94.30	%



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

Preserve at Prairie Point	Lubbock, TX	184	97.80	%
Residences at Holland Lake	Weatherford TX	208	97.60	%
Riverwalk Phase I	Greenville, MS	32	96.90	%
Riverwalk Phase II	Greenville, MS	72	91.70	%
Sawgrass Creek	New Port Richey, FL	45	95.56	%
Sonoma Court	Rockwall, TX	124	99.20	%
Sugar Mill	Baton Rouge, LA	160	100.00	%
Tattersall Village	Hinesville, GA	222	96.40	%
Toulon	Gautier, MS	240	92.10	%
Tradewinds	Midland TX	214	97.70	%
Villager Apts	Fort Walton FL	33	97.00	%
Villas at Park West I	Pueblo, CO	148	100.00	%
Villas at Park West II	Pueblo, CO	112	100.00	%
Vista Ridge	Tupelo MS	160	96.90	%
Vistas of Vance Jackson	San Antonio, TX	240	97.10	%
Waterford at Summer Park	Rosenberg TX	196	92.30	%
Westwood	Mary Ester FL	120	98.30	%
Windsong	Fort Worth, TX	188	98.40	%
51	Total Apartment Units	8,427	95.18	%
14				

Office Buildings	Location	SqFt	Occupancy	
600 Las Colinas	Las Colinas, TX	512,210	92.36	%
770 South Post Oak	Houston, TX	95,329	86.43	%
Browning Place (Park West I)	Farmers Branch, TX	625,378	77.53	%
Senlac (VHP)	Farmers Branch, TX	2,812	100.00	%
Stanford Center	Dallas, TX	333,234	97.79	%
5	Total Office Buildings	1,568,963		
Retail Centers	Location	<b>SqFt</b>	<b>Occupancy</b>	
Bridgeview Plaza	LaCrosse, WI	122,205	87.36	%
Fruitland Park	Fruitland Park, FL	6,722	100.00	%
2	Total Retail Centers	128,927		
	Total Commercial	1,697,890		
Golf Course	Location	<b>Acres</b>		
Mahogany Run Golf Course	St. Thomas, US Virgin Islands	96.09		
1	Total Golf Course	96.09		

## Lease Expirations

The table below shows the lease expirations of the commercial properties over a nine-year period and thereafter:

Year of Lease Expiration	Rentable Square Feet Subject to Expiring Leases	Current Annualized (1) Contractual Rent Under Expiring Leases	Current Annualized(1) Contractual Rent Under Expiring Leases (P.S.F.)	Percentage of Total Square Feet	Percentage of Gross Rentals
2018	172,297	3,647,957	\$ 21.17	10.1 %	13.5 %
2019	298,377	5,299,974	\$ 17.76	17.6 %	19.4 %
2020	119,770	2,523,397	\$ 21.07	7.1 %	9.3 %
2021	125,086	2,561,127	\$ 20.47	7.4 %	9.5 %
2022	236,901	5,118,961	\$ 21.61	14.0 %	18.9 %
2023	172,346	2,344,412	\$ 13.60	10.2 %	8.7 %
2024	61,044	996,807	\$ 16.33	3.6 %	3.7 %
2025	113,829	2,604,020	\$ 22.88	6.7 %	9.6 %
2026	14,445	375,570	\$ 26.00	0.9 %	1.4 %
Thereafter	80,074	1,627,426	\$ 20.32	4.7 %	6.0 %
Total	1,394,169	\$27,099,652		82.3 %	100 %

- (1) Represents the monthly contractual base rent and recoveries from tenants under existing leases as of December 31, 2017, multiplied by twelve. This amount reflects total rent before any rent abatements and includes expense reimbursements which may be estimates as of such date.

15

The table below shows information related to the land parcels we own as of December 31, 2017:

Land	Location	Acres
2427 Valley View Ln	Farmers Branch, TX	0.31
Audubon	Adams County, MS	48.20
Bonneau Land	Farmers Branch, TX	8.39
Cooks Lane	Fort Worth, TX	23.24
Dedeaux	Gulfport, MS	10.00
Denham Springs	Denham Springs, LA	4.38
Dominion Mercer	Farmers Branch, TX	5.29
Gautier	Gautier, MS	3.46
GNB Land	Farmers Branch, TX	45.00
Hollywood Casino Tract II	Farmers Branch, TX	11.36
Lacy Longhorn	Farmers Branch, TX	5.08
Lake Shore Villas	Humble, TX	19.51
Lubbock	Lubbock, TX	2.86
Manhattan Land	Farmers Branch, TX	8.79
McKinney 36	Collin County, TX	9.58
Meloy/Portage Land	Kent, OH	52.95
Mininvest	Dallas, TX	0.23
Nashville	Nashville, TN	6.25
Nicholson Croslin	Dallas, TX	0.80
Nicholson Mendoza	Dallas, TX	0.35
Ocean Estates	Gulfport, MS	12.00
Senlac	Farmers Branch, TX	8.49
Texas Plaza	Irving, TX	10.33
Travis Ranch	Kaufman County, TX	8.66
Travis Ranch Retail	Kaufman County, TX	8.13
Union Pacific Railroad	Dallas, TX	0.04
Valley View 34 (Mercer Crossing)	Farmers Branch, TX	2.19
Willowick	Pensacola, FL	39.78
Windmills Farm	Kaufman County, TX	2,863.87
	Total Land/Development	3,219.52

Land Subject to Sales Contract	Location	Acres
Dominion Tract	Dallas, TX	10.59
Hollywood Casino Tract I	Farmers Branch, TX	10.96
LaDue	Farmers Branch, TX	8.01
Three Hickory	Farmers Branch, TX	6.60
Travelers	Farmers Branch, TX	193.17
Valwood Land	Farmers Branch, TX	16.87
Walker/Cummings	Dallas County, TX	82.59
Whorton	Bentonville, AR	64.44
	Total Land Subject to Sales Contract	393.23

Total Land

3,612.75

### **ITEM 3. LEGAL PROCEEDINGS**

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

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

The Clapper Parties subsequently filed a new lawsuit against ARI, its subsidiary EQK Holdings, Inc. “EQK”, and ART. The Clapper Parties seek damages from ARL for payment by ART to ARL of ART’s stock in EQK in exchange for a release of the Antecedent Debt owed by ART to ARI. In February 2018 the court determined that this legal matter should not have been filed in federal court and therefore granted motions to dismiss on jurisdictional grounds. . The company has no knowledge as to whether the plaintiffs will attempt to refile their lawsuit in a state court.

In 2005, ART filed suit against a major national law firm over the initial transaction. That action was initially abated while the principal case with the Clapper Parties was pending, but the abatement was recently lifted. The trial court subsequently dismissed the case on procedural grounds, but ART has filed a notice of appeal. The appeal was heard in February 2018 and we are awaiting a ruling by the appeals court. In January 2012, the Company sold all of the issued and outstanding stock of ART to an unrelated party for a promissory note in the amount of \$10 million. At December 31, 2012, the Company fully reserved and valued such note at zero. In February 2018 the court determined that this legal matter should not have been filed in federal court and therefore dismissed the lawsuit. The company has no knowledge as to whether the plaintiffs will attempt to refile their lawsuit in a state court.

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

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

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

The Final Judgment entered against Dynex Commercial, Inc. on July 20, 2015 awarded Basic \$0.256 million in damages, plus pre-judgment interest of \$0.192 million for a total amount of \$0.448 million. The Judgment awarded ART \$14.2 million in damages, plus pre-judgment interest of \$10.6 million for a total amount of \$24.8 million. The Judgment awarded TCI \$11.1 million, plus pre-judgment interest of \$8.4 million for a total amount of \$19.5 million. The Judgment also awarded Basic, ART, and TCI post-judgment interest at the rate of 5% per annum from April 25, 2014 until the date their respective damages are paid. Lastly, the Judgment awarded Basic, ART, and TCI \$1.6 million collectively in attorneys' fees from Dynex Commercial, Inc.

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

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

#### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.



**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

ARL's common stock is listed and traded on the NYSE American under the symbol "ARL". The following table sets forth the high and low sales prices as reported in the consolidated reporting system of the NYSE American for the quarters ended:

	2017		2016	
	High	Low	High	Low
First Quarter	\$9.85	\$5.17	\$5.83	\$3.89
Second Quarter	\$9.99	\$7.00	\$7.05	\$4.44
Third Quarter	\$8.95	\$8.00	\$7.81	\$5.19
Fourth Quarter	\$14.50	\$8.67	\$7.93	\$4.92

On March 20, 2018, the closing market price of ARL's common stock on the NYSE American \$14.72 per share, and was held by approximately 2,832 stockholders of record.

ARL's Board of Directors has established a policy that dividend declarations on common stock would be determined on an annual basis following the end of each year. In accordance with that policy, the Board determined not to pay any dividends on common stock in 2017, 2016 or 2015. Future distributions to common stockholders will be determined by the Board of Directors in light of conditions then existing, including the Company's financial condition and requirements, future prospects, restrictions in financing agreements, business conditions and other factors deemed relevant by the Board.

Under ARL's Amended Articles of Incorporation, 15,000,000 shares of Series A 10.0% Cumulative Convertible Preferred Stock are authorized with a par value of \$2.00 per share and a liquidation preference of \$10.00 per share plus accrued and unpaid dividends. Dividends are payable at the annual rate of \$1.00 per share, or \$.25 per share quarterly, to stockholders of record on the last day of each March, June, September, and December, when and as declared by the Board of Directors. The Series A Preferred Stock may be converted into common stock at 90.0% of the average daily closing price of ARL's common stock for the prior 20 trading days. At December 31, 2017, 2,000,614 shares of Series A Preferred Stock were outstanding. Of the outstanding shares, 900,000 are held by ARL. Dividends are not paid on the shares owned by ARL.

Under ARL's Amended Articles of Incorporation, 91,000 shares of Series D 9.50% Cumulative Preferred Stock are authorized with a par value of \$2.00 per share, and a liquidation preference of \$20.00 per share. Dividends are payable at the annual rate of \$1.90 per year or \$0.475 per quarter to stockholders of record on the last day of each March, June, September and December when and as declared by the Board of Directors. The Series D Preferred Stock is reserved for the conversion of the Class A limited partner units of Ocean Beach Partners, L.P. The Class A units may be exchanged for Series D Preferred Stock at the rate of 20 Class A units for each share of Series D Preferred Stock. There are no outstanding shares of Series D Preferred Stock. On January 12, 2018 Realty Advisors converted 200,000 preferred shares, plus accrued dividends into 482,716 shares of common stock.

Under ARL's Amended Articles of Incorporation, 500,000 shares of Series E 6.0% Cumulative Preferred Stock are authorized with a par value \$2.00 per share and a liquidation preference of \$10.00 per share. Dividends are payable at the annual rate of \$0.60 per share or \$0.15 per quarter to stockholders of record on the last day of each March, June, September and December when and as declared by the Board of Directors. There are no Series E Preferred Stock outstanding. As an instrument amendatory to ARL's Amended Articles of Incorporation, 100,000 shares of Series J 8% Cumulative Convertible Preferred Stock have been designated pursuant to a Certificate of Designation filed March 16, 2006, with a par value of \$2.00 per share, and a liquidation preference of \$1,000 per share. Dividends are payable at the annual rate of \$80 per share, or \$20 per quarter, to stockholders of record on the last day of each of March, June, September and December, when and as declared by the Board of Directors. Although the Series J 8% Cumulative Convertible Preferred Stock has been designated, no shares have been issued.

The Company had 135,000 shares of Series K convertible preferred stock, which were held by TCI and used as collateral on a note. The note has been paid in full and the Series K preferred stock was cancelled May 7, 2014.

On September 1, 2000, the Board of Directors approved a share repurchase program authorizing the repurchase of up to a total of 1,000,000 shares of ARL common stock. This repurchase program has no termination date. In August 2010, the Board of Directors approved an increase in the share repurchase program for up to an additional 250,000 shares of common stock which results in a total authorization under the repurchase program for up to 1,250,000 shares. There were no shares repurchased during the year ended December 31, 2017.

**ITEM 6. SELECTED FINANCIAL DATA****AMERICAN REALTY INVESTORS, INC.**

	For the Years Ended December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands, except share and per share amounts)				
<b>EARNINGS DATA</b>					
Rental and other property revenues	\$ 126,221	\$ 119,663	\$ 104,188	\$ 79,412	\$ 80,750
Total operating expenses	108,793	105,029	97,880	82,611	96,426
Operating income (loss)	17,428	14,634	6,308	(3,199)	(15,676)
Other expenses	(47,706)	(36,325)	(31,622)	(15,511)	(35,264)
Income (loss) before gain on land sales, non-controlling interest, and taxes	(30,278)	(21,691)	(25,314)	(18,710)	(50,940)
Gain (loss) on income producing properties	16,698	16,207	—	—	—
Gain (loss) on land sales	4,884	3,121	21,648	561	(455)
Income tax benefit (expense)	(180)	(46)	(517)	20,413	40,513
Net income (loss) from continuing operations	(8,876)	(2,409)	(4,183)	2,264	(10,882)
Net income (loss) from discontinuing operations	—	(1)	896	37,909	62,606
Net income (loss)	(8,876)	(2,410)	(3,287)	40,173	51,724
Net income (loss) attributable to non-controlling interest	445	(322)	1,327	(9,288)	(10,448)
Net income (loss) attributable to American Realty Investors, Inc.	(8,431)	(2,732)	(1,960)	30,885	41,276
Preferred dividend requirement	(1,105)	(1,101)	(1,216)	(2,043)	(2,452)
Net income (loss) applicable to common shares	\$ (9,536)	\$ (3,833)	\$ (3,176)	\$ 28,842	\$ 38,824
<b>PER SHARE DATA</b>					
Earnings per share - basic					
Income (loss) from continuing operations	\$ (0.61)	\$ (0.25)	\$ (0.27)	\$ (0.71)	\$ (2.07)
Income (loss) from discontinued operations	—	—	0.06	2.99	5.43
Net income (loss) applicable to common shares	\$ (0.61)	\$ (0.25)	\$ (0.21)	\$ 2.28	\$ 3.36
Weighted average common shares used in computing earnings per share	15,514,360	15,514,360	15,111,107	12,683,956	11,525,389
Earnings per share - diluted					
Income (loss) from continuing operations	\$ (0.61)	\$ (0.25)	\$ (0.27)	\$ (0.71)	\$ (2.07)
Income (loss) from discontinued operations	—	—	0.06	2.99	5.43

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

Net income (loss) applicable to common shares	\$(0.61	) \$(0.25	) \$(0.21	) \$2.28	\$3.36
Weighted average common shares used in computing diluted earnings per share	15,514,360	15,514,360	15,111,107	12,683,956	11,525,389

BALANCE SHEET DATA

Real estate, net	\$988,117	\$901,006	\$853,507	\$699,763	\$700,294
Notes and interest receivable, net	112,095	126,564	120,243	134,366	136,815
Total assets	1,296,720	1,174,909	1,117,368	965,498	943,322
Notes and interest payables	1,014,132	851,095	804,760	659,059	659,042
Shareholders' equity	165,883	176,131	176,889	179,588	134,861
Book value per share	10.69	11.35	11.71	14.16	11.70

**ITEM 7. *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 Annual Report on Form 10-K 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 relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors, that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution you that, while forward-looking statements reflect our good faith beliefs when we make them, they are not guarantees of future performance and are impacted by actual events when they occur after we make such statements. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

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

general risks affecting the real estate industry (including, without limitation, the inability to enter into or renew leases, dependence on tenants' financial condition, and competition from other developers, owners and operators of real estate);

risks associated with the availability and terms of 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. Other sections of this report, including Part I, Item 1A. "Risk Factors," include additional factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Investors should also refer to our quarterly reports on Form 10-Q for future periods and current reports on Form 8-K as we file them with the SEC, and to other materials we may furnish to the public from time to time through Forms 8-K or otherwise.

## Overview

We are an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties and land held for development. Our portfolio of income-producing properties includes residential apartment communities, office buildings and a golf course. Our investment strategy includes acquiring existing income-producing properties as well as developing new properties on land already owned or acquired for a specific development project. We acquire land primarily in urban in-fill locations or high-growth suburban markets. We are an active buyer and seller of real estate and during 2017 we acquired \$41.7 million and sold \$11.2 million of land and income-producing properties. As of December 31, 2017, we owned 8,427 units in fifty-one residential apartment communities, seven commercial properties comprising approximately 1.7 million rentable square feet and a golf course. In addition, we own 3,613 acres of land held for development. The Company currently owns income-producing properties and land in eleven states as well as in the U.S. Virgin Islands.

We finance our acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. We finance our development projects principally with 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. We will, from time to time, also enter into partnerships with various investors to acquire income-producing properties or land and to sell interests in some of our wholly owned properties. When we sell assets, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. We generate operating revenues primarily by leasing apartment units to residents and leasing office, retail and industrial space to commercial tenants.

We have historically engaged in and may continue to engage in certain business transactions with related parties, including but not limited to asset acquisition and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in our best interest.

Since April 30, 2011, Pillar is the Company's external Advisor and Cash Manager under a contractual arrangement that is reviewed annually by our Board of Directors. Pillar's duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities. Pillar also arranges, for ARL's benefit, debt and equity financing with third party lenders and investors. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual Advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. "Directors, Executive Officers and Corporate Governance – The Advisor". ARL has no employees. Employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Effective since January 1, 2011, Regis manages our commercial properties and provides brokerage services. Regis is entitled to receive a fee for its property management and brokerage services. See Part III, Item 10. "Directors, Executive Officers and Corporate Governance – Property Management and Real Estate Brokerage". The Company contracts with third-party companies to lease and manage our apartment communities.

### **Critical Accounting Policies**

We present our financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). The accompanying Consolidated Financial Statements include our accounts, our subsidiaries, generally all of which are wholly-owned, and all entities in which we have a controlling interest.

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

The Company, in accordance with the VIE guidance in ASC 810 “Consolidations,” consolidated fifty-one and fifty multifamily residential properties located throughout the United States at December 31, 2017 and 2016, respectively, ranging from 32 units to 260 units. Assets totaling approximately \$484 million and approximately \$442 million at December 31, 2017 and 2016, respectively, are consolidated and included in “Real estate, at cost” on the balance sheet and are all collateral for their respective mortgage notes payable, none of which are recourse to the partnership in which they are in or to the Company.



## **Real Estate**

Upon acquisitions of real estate, we assess the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, “above-market” and “below-market” leases, origination costs, acquired in-place leases, other identified intangible assets and assumed liabilities in accordance with ASC Topic 805 “Business Combinations”, and allocate the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

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

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.

Other intangible assets acquired include amounts for in-place lease values that are based on our evaluation of the specific characteristics of each tenant’s lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider leasing commissions, legal and other related expenses.

## **Depreciation and Impairment**

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

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgment. Our capitalization policy on development properties is guided by ASC Topic 835-20 “Interest – Capitalization of Interest” and ASC Topic 970 “Real Estate - General”. The costs of land and buildings under development include specifically identifiable costs. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. We 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.

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. Fair value is determined by a recent appraisal, comparable based upon prices for similar assets, executed sales contract, a present value and/or a valuation technique based upon a multiple of earnings or revenue. 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. If we determine that impairment has occurred, the affected assets must be reduced to their face value.

### **Real Estate Assets Held for Sale**

We classify properties as held for sale when certain criteria are met in accordance with GAAP. At that time, we present the assets and obligations of the property held for sale separately in our consolidated balance sheet and we cease recording depreciation and amortization expense related to that property. Properties held for sale are reported at the lower of their carrying amount or their estimated fair value, less estimated costs to sell. We did not have any real estate assets classified as held for sale at December 31, 2017 or 2016.

Effective as of January 1, 2015, we adopted the revised guidance in Accounting Standards Update No. 2014-08 regarding discontinued operations. For sales of real estate or assets classified as held for sale after January 1, 2015, we will evaluate whether a disposal transaction meets the criteria of a strategic shift and will have a major effect on our operations and financial results to determine if the results of operations and gains on sale of real estate will be presented as part of our continuing operations or as discontinued operations in our consolidated statements of operations. If the disposal represents a strategic shift, it will be classified as discontinued operations for all periods presented; if not, it will be presented in continuing operations.

Any properties that are treated as “subject to sales contract” on the Consolidated Balance Sheets and are listed in detail in Schedule III, “Real Estate and Accumulated Depreciation” are those in which we have not recognized the legal sale according to the guidance in ASC 360-20 due to various factors, disclosed in Item 1 “Significant Real Estate Acquisitions/Dispositions and Financing.” Any sale transaction where the guidance reflects that a sale had not occurred, the asset involved in the transaction, including the debt, if appropriate, and property operations, remained on the books of the Company. We continue to charge depreciation to expense as a period costs for the property until such time as the property has been classified as held for sale in accordance with guidance reflected in ASC 360-10-45 “Impairment or Disposal of Long-Lived Assets.”

### **Investment in Unconsolidated Real Estate Ventures**

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

### **Recognition of Rental Income**

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. In accordance with ASC Topic 805 “Business Combinations”, 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. An allowance for doubtful accounts is recorded for all past due rents and operating expense reimbursements considered to be uncollectible.

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

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

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

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

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

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

### **Allowance for Estimated Losses**

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

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

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

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

Level 1 ~~U~~nadjusted quoted prices for identical and unrestricted assets or liabilities in active markets.

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

Level 3 ~~U~~nobservable inputs that are significant to the fair value measurement.

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

### **Related parties**

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

## **Results of Operations**

The discussion of our results of operations is based on management’s review of operations, which is based on our segments. Our segments consist of apartments, commercial buildings, hotels, land and other. For discussion purposes, we break these segments down into the following sub-categories; same property portfolio, acquired properties, and developed properties in the lease-up phase. The same property portfolio consists of properties that were held by us for the entire period for both years being compared. The acquired property portfolio consists of properties that we acquired but have not held for the entire period for both periods being compared. Developed properties in the lease-up phase consist of completed projects that are being leased-up. As we complete each phase of the project, we lease-up that phase and include those revenues in our continued operations. Once a developed property becomes leased-up (80% or more) and is held the entire period for both years under comparison, it is considered to be included in the same property portfolio. Income-producing properties that we have sold during the year are reclassified to discontinuing operations for all periods presented. The other segment consists of revenue and operating expenses related to the notes receivable and corporate entities.

The following discussion is based on our Consolidated Statements of Operations for the year ended December 31, 2017, 2016 and 2015 as included in Part II, Item 8. “Consolidated Financial Statements and Supplementary Data.” The prior year’s property portfolios have been adjusted for subsequent sales. Continued operations relates to income-producing properties that were held during those years as adjusted for sales in the subsequent years.

At December 31, 2017, 2016 and 2015, we owned or had interests in a portfolio of fifty-nine, fifty-nine and fifty-eight income-producing properties, respectively. The total property portfolio represents all income-producing properties held as of December 31 for the year presented. Sales subsequent to year end represent properties that were held as of year end for the years presented, but sold in subsequent years. Continued operations represents all properties that have not been reclassified to discontinued operations as of December 31, 2017 for the year presented. The table below shows the number of income-producing properties held by year.

	2017	2016	2015
Continued operations	59	59	58
Sales subsequent to year end	—	—	—
Total property portfolio	59	59	58

***Comparison of the year ended December 31, 2017 to the year ended December 31, 2016:***

For the year ended December 31, 2017, we reported net loss applicable to common shares of \$9.5 million or (\$0.61) per diluted earnings per share compared to a net loss applicable to common shares of \$3.8 million or (\$0.25) per diluted earnings per share for the year ended December 31, 2016. The current year net loss applicable to common shares of \$9.5 million includes gain on income-producing properties of \$16.7 million and gain on land sales of \$4.9 million compared to the prior year net loss applicable to common shares of \$3.8 million which includes gain on land sales of \$3.1 million.

**Revenues**

Rental and other property revenues were \$126.2 million for the year ended December 31, 2017. This represents an increase of \$6.5 million compared to the prior year revenues of \$119.7 million. The change by segment is an increase in the apartment portfolio of \$6.2 million and an increase in the commercial portfolio of 0.3 million, partially offset by a decrease of \$0.1 million in the other portfolio. We purchased four apartment communities during the year ended December 31, 2016, which produced rental revenue of \$8.3 million and \$2.0 million during the years ended December 31, 2017 and 2016, respectively, for a net increase of \$6.3 million. In addition, we purchased one apartment property during 2017 that produced \$0.8 million in rental revenue.

**Expenses**

Property operating expenses were \$64.1 million for the year ended December 31, 2017. This represents an increase of \$1.1 million compared to the prior year operating expenses of \$63.0 million. The change by segment is an increase in

the apartment portfolio of \$2.9 million, a decrease in the commercial portfolio of \$1.9 million and a decrease in the land portfolio of \$0.9 million, partially offset by a increase in the other portfolio of \$1.0 million. The Company added a net 723 apartment units during 2016 and 201 units during 2017. Property operating expenses for our commercial portfolio decreased \$1.8 million. In addition, we had a decrease in property operating expenses for our land portfolio of \$1.0 million.

Depreciation and amortization expenses were \$25.7 million for the year ended December 31, 2017. This represents an increase of \$1.9 million compared to prior year depreciation of \$23.8 million. The increase is primarily due to the growth in our apartment portfolio which had an increase of \$2.3 million year-over-year.

General and administrative expenses were \$7.7 million dollars for the year ended December 31, 2017. This represents an increase of \$0.6 million compared to the prior year general and administrative expenses of \$7.1 million.

There was no provision for impairment of notes receivable, investment in real estate partnerships and real estate assets for the years ended December 31, 2017 and December 31, 2016.

Net income fee was \$0.3 million for the year ended December 31, 2017 and December 31, 2016. The net income fee paid to Pillar is calculated at 7.5% of net income.

Advisory fees were \$11.1 million for the year ended December 31, 2017. This represents an increase of \$0.2 million compared to the prior year advisory fees of \$10.9 million. Advisory fees are computed based on a gross asset fee of 0.0625% per month (0.75% per annum) of the average of the gross asset value.



**Other income (expense)**

Interest income was \$18.9 million for the year ending December 31, 2017. This represents an decrease of \$1.6 million compared to the prior year interest income of \$20.5 million dollars. This decrease was primarily due to a decrease of \$2.3 in interest on notes receivable, partially offset by a \$1.3 million increase in interest on receivable owed from Advisor.

Other income was \$4.1 million for the year ending December 31, 2017. This represents a increase of \$2.0 million compared to prior year other income of \$2.1 million. The increase is primarily due to a property with a negotiated settlement of a debt with the lender during 2015.

Mortgage and loan interest expense was \$66.1 million for the year ended December 31, 2017. This represents an increase of \$6.7 million compared to the prior year expense of \$59.4 million. The change by segment is an increase in the other portfolio of \$7.4 million, an increase in the apartment portfolio of \$1.7 million and an increase in the commercial portfolio of \$0.3 million, partially offset by a decrease in the land portfolio of \$2.5 million. The increase in the apartment portfolio was primarily due to the acquisition of new properties, partially offset by the refinancing of five loans during 2016 at lower rates.

Gain on sale of income-producing properties was \$16.7 million, of that amount, \$14.1 million was attributable to recognition of deferred gains for the year ended December 31, 2017. During 2017, the Company sold one commercial property located in Mattoon, IL to an independent third party for a total sales price of \$5.1 million. We recorded an aggregate gain of \$2.6 million from the sale of this property. During 2016, the Company sold one apartment community located in Irving, Texas to an independent third party for a total sales price of \$8.1 million and one apartment community located in Topeka, Kansas to an independent third party for a total sales price of \$12.3 million. We recorded an aggregate gain of \$16.2 million from the sale of these two properties. The Company also sold an industrial warehouse consisting of approximately 177,805 square feet. The sale resulted in a loss of approximately \$0.2 million.

Gain on land sales was \$4.9 million and \$3.1 million for the years ended December 31, 2017 and 2016, respectively. During 2017, we sold 60.5 acres of land to an independent third party for total sales price of \$11.2 million. We recorded an aggregate \$4.9 million gain from the land sales. During 2016, we sold a combined 129.7 acres of land located in Forney, Texas, McKinney, Texas, Farmers Branch, Texas and Nashville, Tennessee to independent third parties for a total sales price of \$29.1 million. We recorded an aggregate \$3.1 million gain from the land sales.

***Comparison of the year ended December 31, 2016 to the year ended December 31, 2015:***

For the year ended December 31, 2016, we reported a net loss applicable to common shares of \$3.8 million or (\$0.25) per diluted earnings per share compared to a net loss applicable to common shares of \$3.2 million or (\$0.21) per diluted earnings per share for the same period ended 2015. The net loss applicable to common shares of \$3.8 million during the year ended December 31, 2016, includes gain on income-producing properties of \$16.2 million and gain on land sales of \$3.1 million compared to the prior year net loss applicable to common shares of \$3.2 million which includes gain on land sales of \$21.6 million, a provision on the impairment of real estate assets of \$5.3 million and net income from discontinued operations of \$0.9 million.

## Revenues

Rental and other property revenues were \$119.7 million for the year ended December 31, 2016. This represents an increase of \$15.5 million, as compared to the prior year revenues of \$104.2 million. The change by segment is an increase in the apartment portfolio of \$13.1 million and an increase in the commercial portfolio of \$2.5 million, partially offset by a decrease of \$0.1 million in the other portfolio. We purchased 12 apartment communities during the year ended December 31, 2015, which produced rental revenue of \$21.7 million and \$10.2 million during the years ended December 31, 2016 and 2015, respectively, for a net increase of \$11.5 million. In addition, we purchased four apartment properties during 2016 that produced revenues of \$2.0 million and we had a decrease in rental revenue of approximately \$0.9 million for two apartment communities sold during 2016. The \$2.5 million increase in revenues for the commercial portfolio was primarily due to the acquisition of a commercial building in Houston, Texas late in the second quarter of 2015.

## Expenses

Property operating expenses were \$63.0 million for the year ended December 31, 2016. This represents an increase of \$9.0 million compared to the prior year operating expenses of \$54 million. The change by segment is an increase in the apartment portfolio of \$5.8 million and an increase in the commercial portfolio of \$2.6 million and an increase in the land portfolio of \$0.7 million, partially offset by a decrease in the other portfolio of \$0.2 million. The Company added a net 2,145 apartment units during 2015 and 723 units during 2016. Property operating expenses for our commercial portfolio increased \$2.6 million due to the acquisition of an office building in Houston, Texas late in the second quarter of 2015.

Depreciation and amortization expenses were \$23.8 million for the year ended December 31, 2016. This represents an increase of \$2.4 million compared to prior year depreciation of \$21.4 million. The increase is primarily due to the growth in our apartment portfolio which had an increase of \$2.3 million year-over-year.

General and administrative expenses were \$7.1 million dollars for the year ended December 31, 2016. This represents an increase of \$0.2 million compared to the prior year general and administrative expenses of \$6.9 million.

There was no provision for impairment of notes receivable, investment in real estate partnerships and real estate assets for the year ended December 31, 2017.

Net income fee was \$0.3 million for the year ended December 31, 2016. This represents a decrease of \$0.2 million compared to the prior year net income fee of \$0.5 million. The net income fee paid to Pillar is calculated at 7.5% of net income.

Advisory fees were \$10.9 million for the year ended December 31, 2016. This represents an increase of \$1.1 million compared to the prior year advisory fees of \$9.8 million. Advisory fees are computed based on a gross asset fee of 0.0625% per month (0.75% per annum) of the average of the gross asset value.

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

Interest income was \$20.5 million for the year ending December 31, 2016. This represents an increase of \$3.8 million compared to the prior year interest income of \$16.7 million. This increase was primarily due to the year-over-year increase in the receivable from our Advisor.

Other income was \$2.1 million for the year ending December 31, 2016. This represents a decrease of \$2.0 million compared to the prior year other income of \$4.1 million. The increase is primarily due to a property with a negotiated settlement of a debt with the lender during 2015.

Mortgage and loan interest expense was \$59.4 million for the year ended December 31, 2016. This represents an increase of \$6.9 million compared to the prior year expense of \$52.5 million. The change by segment is an increase in the other portfolio of \$7.4 million, an increase in the apartment portfolio of \$1.7 million and an increase in the commercial portfolio of \$0.3 million, partially offset by a decrease in the land portfolio of \$2.5 million. Within the other portfolio, the increase is due to incurring new mezzanine debt obligations during 2015. The increase in the apartment portfolio was primarily due to the acquisition of new properties, partially offset by the refinancing of five loans during 2016 at lower rates.

Gain on land sales was \$3.1 million and \$21.6 million for the years ended December 31, 2016 and 2015, respectively. During 2016, we sold a combined 129.7 acres of land located in Forney, Texas, McKinney, Texas, Farmers Branch, Texas and Nashville, Tennessee to independent third parties for a total sales price of \$29.1 million. We recorded an aggregate \$3.1 million gain from the land sales. During 2015, we sold approximately 595 acres of land for a sales price of \$107.3 million and recorded a gain of \$18.9 million. In addition, we recognized \$2.7 million in deferred gain from prior years land sales during the year ended December 31, 2015.

## Discontinued Operations

Effective January 1, 2015, the Company adopted the provisions of ASU 2014-08, which changed the criteria of ASC360 related to determining which disposals qualify to be accounted for as discontinued operations and modified related reporting and disclosure requirements. Disposals representing a strategic shift in operations that have a major effect on a company's operations and financial results will be presented as discontinued operations.

There were no sales of income-producing properties during 2017 or 2016 that met the criteria for discontinued operations. Amounts included in discontinued operations represent the residual amounts from sales classified as discontinued operations prior to January 1, 2015. The following table summarizes revenue and expense information for the properties sold that qualified as discontinued operations (dollars in thousands):

	For the Year Ended December 31,		
	2017	2016	2015
Revenues:			
Rental and other property revenues	\$—	\$—	\$355
	—	—	355
Expenses:			
Property operating expenses	—	2	(345)
Depreciation	—	—	—
General and administrative	—	—	99
Total operating expenses	—	2	(246)
Other income (expense):			
Other income (expense)	—	—	45
Mortgage and loan interest	—	—	—
Loan charges and prepayment penalties	—	—	—
Litigation settlement	—	—	—
Total other expenses	—	—	43
Income (loss) from discontinued operations before gain on sale of real estate and taxes	—	(2)	644
Gain on sale of real estate from discontinued operations	—	—	735
Income tax expense	—	1	(483)
Income from discontinued operations	\$—	\$ (1)	\$896

## Liquidity and Capital Resources

### General

Our principal liquidity needs are:

fund normal recurring expenses;

meet debt service and principal repayment obligations including balloon payments on maturing debt;

fund capital expenditures, including tenant improvements and leasing costs;

fund development costs not covered under construction loans; and

fund possible property acquisitions.

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

property operations;

proceeds from land and income-producing property sales;

collection of mortgage notes receivable;

collections of receivables from related companies;

refinancing of existing debt; and

additional borrowings, including mortgage notes payable, and lines of credit.

It is important to realize that the current status of the banking industry has had a significant effect on our industry. The banks' willingness and/or ability to originate loans affects our ability to buy and sell property, and refinance existing debt. We are unable to foresee the extent and length of this down-turn. A continued and extended decline could materially impact our cash flows. We draw on multiple financing sources to fund our long-term capital needs. We generally fund our development projects with construction loans, which are converted to traditional mortgages upon completion of the project.

We may also issue additional equity securities, including common stock. Management anticipates that our cash as of December 31, 2017, along with cash that will be generated in 2018 from notes and interest receivables, will 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 borrowings secured by real estate to meet its liquidity requirements. Although history cannot predict the future, historically, we have been successful at refinancing and extending a portion of the Company's current maturity obligations.

Management reviews the carrying values of ARL'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. 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. 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.

### Cash Flow Summary

The following summary discussion of our cash flows is based on the Consolidated Statements of Cash Flows in Part II, Item 8. "Consolidated Financial Statements and Supplementary Data" and is not meant to be an all-inclusive discussion of the changes in our cash flows for the periods presented below (dollars in thousands):

	2017	2016	Variance
Net cash provided by (used in) operating activities	\$(37,345 )	\$17,446	\$(54,791 )
Net cash provided by (used in) investing activities	(90,028)	(61,100)	(28,928)
Net cash provided by (used in) financing activities	152,771	45,944	106,827

The primary use of cash for operations is daily operating costs, general and administrative expenses, advisory fees and land holding costs. Our primary source of cash from operating activities is from rental income on properties.





Our primary cash outlays for investing activities are for construction and development, acquisition of land and income-producing properties, and capital improvements to existing properties. Our primary sources of cash from investing activities are from the proceeds on the sale of land and income-producing properties. During the year ended December 31, 2017, we acquired four apartment properties and four developmental land properties.

Our primary sources of cash from financing activities are from proceeds on notes payables. Our primary cash outlays are for recurring debt payments and payments on maturing notes payable.

### Equity Investments.

ARL has from time to time purchased shares of IOR and TCI. The Company may purchase additional equity securities of IOR and TCI through open market and negotiated transactions to the extent ARL's liquidity permits.

Equity securities of TCI held by ARL (and of IOR held by TCI) may be deemed "restricted securities" under Rule 144 of the Securities Act of 1933 ("Securities Act"). Accordingly, ARL 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 ARL's ability to realize the full fair value of such investments if ARL attempted to dispose of such securities in a short period of time.

### Contractual Obligations

We have contractual obligations and commitments primarily with regards to the payment of mortgages. The following table aggregates our expected contractual obligations and commitments and includes items not accrued, per GAAP, through the term of the obligation such as interest expense and operating leases. Our aggregate obligations subsequent to December 31, 2017 are shown in the table below (dollars in thousands):

	Total	2018	2019	2020	2021-2022	Thereafter
Long-term debt obligation <sup>(1)</sup>	\$ 1,816,157	\$ 112,934	\$ 128,510	\$ 91,459	\$ 97,387	\$ 1,385,867
Operating lease obligation	30,941	504	514	524	1,603	27,796
Total	\$ 1,847,098	113,438	\$ 129,024	\$ 91,983	\$ 98,990	\$ 1,413,663

<sup>(1)</sup> ARL's long-term debt may contain financial covenants that, if certain thresholds are not met, could allow the lender to accelerate principal payments or cause the note to become due immediately.

## **Environmental Matters**

Under various federal, state and local environmental laws, ordinances and regulations, ARL 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 ARL's business, assets or results of operations.

## **Inflation**

The effects of inflation on ARL'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.

## **ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.***

ARL's primary market risk exposure consists of changes in interest rates on borrowings under our debt instruments that bear interest at variable rates that fluctuate with market interest rates and maturing debt that has to be refinanced. ARL's future operations, cash flow and fair values of financial instruments are also partially dependent on the then existing market interest rates and market equity prices.

As of December 31, 2017, our \$867.7 million debt portfolio consisted of approximately \$827.9 million fixed-rate debt and approximately \$39.8 million variable-rate debt with interest rates ranging from 4.75% to 12.0%. Our overall weighted average interest rate at December 31, 2017 and 2016 was 4.91% and 4.91%, respectively.

ARL's interest rate sensitivity position is managed by the capital markets department. Interest rate sensitivity is the relationship between changes in market interest rates and the fair value of market rate sensitive assets and liabilities. ARL's earnings are affected as changes in short-term interest rates affect its cost of variable-rate debt and maturing fixed-rate debt.



If market interest rates for variable-rate debt average 100 basis points more in 2017 than they did during 2016, ARL's interest expense would increase and net income would decrease by \$0.8 million. This amount is determined by considering the impact of hypothetical interest rates on ARL's borrowing cost. The analysis does not consider the effects of the reduced level of overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management would likely take actions to further mitigate its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no change in ARL's financial structure.

The following table contains only those exposures that existed at December 31, 2017. Anticipation of exposures of risk on positions that could possibly arise was not considered. ARL's ultimate interest rate risk and its effect on operations will depend on future capital market exposures, which cannot be anticipated with a probable assurance level (dollars are in thousands):

	2018	2019	2020	2021	2022	Thereafter	Total
<b>Assets</b>							
Market securities at fair value	—	—	—	—	—	—	\$—
Note Receivable							
Fixed interest rate - fair value							\$117,913
Instruments' maturities	\$47,013	\$496	\$5,907	\$174	\$—	\$64,322	\$117,913
Instruments' amortization	—	—	—	—	—	—	—
Interest	9,646	7,288	7,225	6,516	6,499	77,989	115,164
Average Rate	8.18 %	10.42 %	10.41 %	10.26 %	10.26 %	10.10 %	%
	2018	2019	2020	2021	2022	<b>Thereafter</b>	<b>Total</b>
<b>Notes Payable</b>							
Variable interest rate - fair value							\$40,035
Variable interest rate notes							
Instrument's maturities	\$—	\$30,816	\$—	\$—	\$—	\$—	\$30,816
Instrument's amortization	7,444	620	231	241	159	524	9,219
Interest	1,878	1,726	74	59	46	584	4,367
Average Rate	5.44 %	5.37 %	6.44 %	6.47 %	6.50 %	6.50 %	%
Fixed interest rate - fair value							\$876,702
Instrument's maturities	\$4,151	\$231	\$9,509	\$35,921	\$0	\$11,031	\$60,843
Instrument's amortization	68,244	69,467	60,386	12,644	11,045	594,073	815,859
Interest	32,167	26,600	21,259	19,617	17,655	779,749	897,047
Average Rate	5.91 %	5.19 %	4.10 %	3.80 %	3.67 %	3.57 %	%

**ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO FINANCIAL STATEMENTS**

	<b>Page</b>
<b>Financial Statements</b>	
<u>Report of Independent Registered Public Accounting Firm</u>	34
<u>Consolidated Balance Sheets—December 31, 2017 and 2016</u>	35
<u>Consolidated Statements of Operations—Years Ended December 31, 2017, 2016 and 2015</u>	36
<u>Consolidated Statements of Shareholders' Equity—Years Ended December 31, 2017, 2016 and 2015</u>	37
<u>Consolidated Statements of Cash Flows—Years Ended December 31, 2017, 2016 and 2015</u>	38
<u>Statements of Consolidated Comprehensive Income (Loss) —Years Ended December 31, 2017, 2016 and 2015</u>	39
<u>Notes to Consolidated Financial Statements</u>	40
<b>Financial Statement Schedules</b>	
<u>Schedule III—Real Estate and Accumulated Depreciation</u>	62
<u>Schedule IV—Mortgage Loan Receivables on Real Estate</u>	66

All other schedules are omitted because they are not required, are not applicable, or the information required is included in the Consolidated Financial Statements or the notes thereto.

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors of and

Stockholders of American Realty Investors, Inc.

Dallas, Texas

### **Opinion on the Financial Statements**

We have audited the accompanying consolidated balance sheets of American Realty Investors, Inc. and Subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes and schedules collectively referred to as the "consolidated financial statements." In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of American Realty Investors, Inc. as of December 31, 2017 and 2016 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017 in conformity with U.S. generally accepted accounting principles.

### **Basis of Opinion**

These consolidated financial statements are the responsibility of Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

### **Emphasis of Liquidity**

As described in the Note 14, American Realty Investors, Inc.'s management intends to sell land and income-producing properties and refinance or extend debt secured by real estate to meet the Company's liquidity needs.

### **Supplemental Information**

The supplemental information contained in Schedules III and IV has been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. The supplemental information is the responsibility of the Company's management. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information, we evaluated whether the supplemental information, including its form and content, is presented in conformity with the Security and Exchange Commission's rules. In our opinion, the supplemental information is fairly stated, in all material respects, the financial date required to be set forth therein in relation to the financial statements as a whole.

FARMER, FUQUA & HUFF, PC

Richardson, Texas

March 30, 2018

We have served as the Company's auditor since 2004.

**AMERICAN REALTY INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS**

	December 31, 2017	December 31, 2016
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	\$1,117,429	\$1,017,684
Real estate subject to sales contracts at cost, net of depreciation	48,234	48,919
Less accumulated depreciation	(177,546 )	(165,597 )
Total real estate	988,117	901,006
Notes and interest receivable		
Performing (including \$69,320 in 2017 and \$125,799 in 2016 from related parties)	97,775	143,601
Non-Performing (including \$30,090 in 2017 from related parties)	30,090	—
Less allowance for estimated losses (including \$14,269 in 2017 and \$15,537 in 2016 from related parties)	(15,770 )	(17,037 )
Total notes and interest receivable	112,095	126,564
Cash and cash equivalents	42,920	17,522
Restricted cash	45,618	38,399
Investments in unconsolidated subsidiaries and investees	6,396	6,087
Receivable from related party	38,311	24,672
Other assets	63,263	60,659
Total assets	\$1,296,720	\$1,174,909
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$898,750	\$845,107
Notes related to assets held for sale	376	376
Notes related to assets subject to sales contracts	1,957	5,612
Bonds and interest payable	113,049	—
Deferred revenue (including \$56,887 in 2017 and \$70,935 in 2016 from sales to related parties)	77,332	91,380
Accounts payable and other liabilities (including \$11,893 in 2017 and \$10,854 in 2016 to related parties)	39,373	56,303
	1,130,837	998,778
Shareholders' equity:		
Preferred stock, Series A: \$2.00 par value, authorized 15,000,000 shares, issued and outstanding 2,000,614 shares in 2017 and 2016 (liquidation preference \$10 per share), including 900,000 shares in 2017 and 2016 held by ARL	2,205	2,205
	159	159



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

Common stock, \$0.01 par value, authorized 100,000,000 shares; issued 15,930,145 shares and outstanding 15,514,360 shares in 2017 and 2016, including 140,000 shares held by TCI (consolidated) in 2017 and 2016		
Treasury stock at cost; 415,785 shares in 2017 and 2016, and 140,000 shares held by TCI (consolidated) as of 2017 and 2016	(6,395 )	(6,395 )
Paid-in capital	110,138	111,510
Retained earnings	5,967	14,398
Total American Realty Investors, Inc. shareholders' equity	112,074	121,877
Non-controlling interest	53,809	54,254
Total equity	165,883	176,131
Total liabilities and equity	\$ 1,296,720	\$ 1,174,909

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

**AMERICAN REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

	For the Years Ended December 31,		
	2017	2016	2015
	<b>(dollars in thousands, except per share amounts)</b>		
<b>Revenues:</b>			
Rental and other property revenues (including \$839, \$708 and \$726 for the year ended 2017, 2016 and 2015, respectively, from related parties)	\$ 126,221	\$ 119,663	\$ 104,188
<b>Expenses:</b>			
Property operating expenses (including \$959, \$900 and \$770 for the year ended 2017, 2016 and 2015, respectively, from related parties)	64,091	62,950	54,002
Depreciation	25,679	23,785	21,418
General and administrative (including \$3,225, \$4,053 and \$3,855 for the year ended 2017, 2016 and 2015, respectively, from related parties)	7,691	7,119	6,893
Provision on impairment of real estate assets	—	—	5,300
Net income fee to related party	250	257	492
Advisory fee to related party	11,082	10,918	9,775
Total operating expenses	108,793	105,029	97,880
Operating income	17,428	14,634	6,308
<b>Other income (expense):</b>			
Interest income (including \$16,298, \$18,864 and \$15,859 for the year ended 2017, 2016 and 2015, respectively, from related parties)	18,941	20,453	16,674
Other income	4,082	2,091	4,106
Mortgage and loan interest (including \$6,695, \$5,300 and \$3,774 for the year ended 2017, 2016 and 2015, respectively, from related parties)	(66,171 )	(59,362 )	(52,477 )
Loss on the sale of investments	(331 )	—	(1 )
Earnings from unconsolidated subsidiaries and investees	309	493	428
Foreign currency translation loss	(4,536 )	—	—
Litigation settlement	—	—	(352 )
Total other expenses	(47,706 )	(36,325 )	(31,622 )
Loss before gain on sales, non-controlling interest and taxes	(30,278 )	(21,691 )	(25,314 )
Gain on sale of income-producing properties (including recognition of \$14,048, \$0, and \$0 previously deferred gains in 2017, 2016, 2015, respectively)	16,698	16,207	—
Gain on land sales	4,884	3,121	21,648
Loss from continuing operations before tax	(8,696 )	(2,363 )	(3,666 )
Income tax benefit (expense)	(180 )	(46 )	(517 )
Net (loss) from continuing operations	(8,876 )	(2,409 )	(4,183 )
<b>Discontinued operations:</b>			
Income (loss) from discontinued operations	—	(2 )	644
Gain on sale of real estate from discontinued operations	—	—	735
Income tax expense from discontinued operations	—	1	(483 )

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

Net income (loss) from discontinued operations	—	(1	)	896	
Net (loss)	(8,876	)	(2,410	)	(3,287 )
Net income (loss) attributable to non-controlling interests	445	(322	)	1,327	
Net (loss) attributable to American Realty Investors, Inc.	(8,431	)	(2,732	)	(1,960 )
Preferred dividend requirement	(1,105	)	(1,101	)	(1,216 )
Net (loss) applicable to common shares	\$(9,536	)	\$(3,833	)	\$(3,176 )
Earnings per share - basic					
Loss from continuing operations	\$(0.61	)	\$(0.25	)	\$(0.27 )
Income from discontinued operations	—	—		0.05	
Net (loss) applicable to common shares	\$(0.61	)	\$(0.25	)	\$(0.22 )
Earnings per share - diluted					
Loss from continuing operations	\$(0.61	)	\$(0.25	)	\$(0.27 )
Income from discontinued operations	—	—		0.05	
Net (loss) applicable to common shares	\$(0.61	)	\$(0.25	)	\$(0.22 )
Weighted average common shares used in computing earnings per share	15,514,360	15,514,360	15,111,107		
Weighted average common shares used in computing diluted earnings per share	15,514,360	15,514,360	15,111,107		
Amounts attributable to American Realty Investors, Inc.					
Loss from continuing operations	\$(8,431	)	\$(2,731	)	\$(2,856 )
Income (loss) from discontinued operations	—	(1	)	896	
Net income (loss)	\$(8,431	)	\$(2,732	)	\$(1,960 )

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

## AMERICAN REALTY INVESTORS, INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the Three Years Ended December 31, 2017

(dollars in thousands)

	Total Capital	Comprehensive Loss	Preferred Stock	Common Stock Shares	Common Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings	Non-controlling Controlling Interest
Balance, December 31, 2014	\$179,588	\$(53,040 )	\$3,126	14,443,404	\$141	\$(6,395 )	\$108,378	\$19,090	\$55,248
Net (loss)	(3,287 )	(3,287 )	—	—	—	—	—	(1,960 )	(1,327 )
Contribution from non-controlling interests	11	—	—	—	—	—	—	—	11
Assumption of non-controlling interests	(470 )	—	—	—	—	—	(470 )	—	—
Conversion of preferred stock into common stock	2,263	—	(921 )	1,486,741	15	—	3,169	—	—
Series A preferred stock cash dividend (\$1.00 per share)	(1,216 )	—	—	—	—	—	(1,216 )	—	—
Balance, December 31, 2015	\$176,889	\$(56,327 )	\$2,205	15,930,145	\$156	\$(6,395 )	\$109,861	\$17,130	\$53,932
Net income (loss)	(2,410 )	(2,410 )	—	—	—	—	—	(2,732 )	322
Assumption of non-controlling interests	(268 )	—	—	—	—	—	(268 )	—	—
Sale of non-controlling interests	3,021	—	—	—	3	—	3,018	—	—
Series A preferred stock cash dividend (\$1.00 per share)	(1,101 )	—	—	—	—	—	(1,101 )	—	—
Balance, December 31,	\$176,131	\$(58,737 )	\$2,205	15,930,145	\$159	\$(6,395 )	\$111,510	\$14,398	\$54,254

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

2016										
Net (loss)	(8,876 )	(8,876 )	—	—	—	—	—	(8,431 )	(445 )	
Assumption of non-controlling interests	(267 )	—	—	—	—	—	(267 )	—	—	
Series A preferred stock cash dividend (\$1.00 per share)	(1,105 )	—	—	—	—	—	(1,105 )	—	—	
Balance, December 31, 2017	\$ 165,883	\$ (67,613 )	\$ 2,205	15,930,145	\$ 159	\$ (6,395)	\$ 110,138	\$ 5,967	\$ 53,809	

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

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

	For the Years Ended December		
	31,		
	2017	2016	2015
	(dollars in thousands)		
<b>Cash Flow From Operating Activities:</b>			
Net (loss)	\$(8,876 )	\$(2,410 )	\$(3,287 )
Adjustments to reconcile net income (loss) applicable to common shares to net cash provided by (used in) operating activities:			
Gain on sale of land	(4,884 )	(3,121 )	(21,648 )
Gain on sale of income-producing properties	(16,698 )	(16,207 )	(735 )
Depreciation and amortization	25,679	23,785	21,418
Provision on impairment of notes receivable and real estate assets	558	—	5,300
Amortization of deferred borrowing costs	3,591	4,357	2,842
Amortization of Series A bond issuance costs	971	—	—
Losses from unconsolidated subsidiaries and investees	(309 )	493	1,327
(Increase) decrease in assets:			
Accrued interest receivable	(581 )	(1,151 )	(1,242 )
Other assets	11,751	(2,343 )	2,683
Prepaid expense	(15,192 )	(9,222 )	(13,851 )
Escrow	(8,584 )	7,584	(1,261 )
Earnest money	856	(571 )	(1,193 )
Rent receivables	(425 )	2,844	(2,168 )
Increase (decrease) in liabilities:			
Accrued interest payable	4,599	3,475	(255 )
Related party payables	(12,871 )	(706 )	(11,027 )
Other liabilities	(16,930 )	10,639	(11,412 )
Net cash provided by (used in) operating activities	(37,345 )	17,446	(34,509 )
<b>Cash Flow From Investing Activities:</b>			
Proceeds from notes receivables	30,233	6,532	14,744
Origination of notes receivables	(15,741 )	(11,703 )	(18,055 )
Acquisition of land held for development	—	(12,508 )	—
Acquisition of income producing properties	(37,044 )	(79,736 )	(207,313 )
Proceeds from sale of income producing properties	4,623	21,850	—
Proceeds from sale of land	6,301	29,128	108,356
Investment in unconsolidated real estate entities	(267 )	2,278	4,086
Improvement of land held for development	(1,986 )	(3,023 )	(6,158 )
Improvement of income producing properties	—	(5,998 )	(8,955 )
Sale of non-controlling interest	—	—	(336 )
Sale of controlling interest	—	3,021	—
Construction and development of new properties	(76,147 )	(10,941 )	(16,717 )
Net cash (used in) investing activities	(90,028 )	(61,100 )	(130,348 )

Cash Flow From Financing Activities:			
Proceeds from Series A bonds payable	115,337	—	—
Proceeds from notes payable	135,116	242,215	412,326
Recurring amortization of principal on notes payable	(86,091 )	(22,851 )	(26,668 )
Payments on maturing notes payable	—	(173,160)	(195,549)
Debt assumption by buyer	—	—	(16,688 )
Deferred financing costs	(3,599 )	841	(6,734 )
Distributions to non-controlling interests	—	—	11
Bond issuance costs	(6,887 )	—	—
Preferred stock dividends - Series A	(1,105 )	(1,101 )	(1,216 )
Conversion of preferred stock into common stock	—	—	2,308
Net cash provided by financing activities	152,771	45,944	167,790
Net increase (decrease) in cash and cash equivalents	25,398	2,290	2,933
Cash and cash equivalents, beginning of period	17,522	15,232	12,299
Cash and cash equivalents, end of period	\$42,920	\$17,522	\$15,232
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$55,976	\$50,945	\$44,672
Cash paid for taxes	\$—	\$—	\$—

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

**AMERICAN REALTY INVESTORS, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**For the Three Years Ended December 31,**

	2017	2016	2015
	(dollars in thousands)		
Net (loss)	\$(8,876)	\$(2,410)	\$(3,287)
Comprehensive income (loss) loss attributable to non-controlling interest	445	(322 )	1,327
Comprehensive (loss) attributable to American Realty Investors, Inc.	\$(8,431)	\$(2,732)	\$(1,960)

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



**AMERICAN REALTY INVESTORS, INC.**

**NOTES TO FINANCIAL STATEMENTS**

The accompanying Consolidated Financial Statements of American Realty Investors, Inc. "ARL" and consolidated entities have been prepared in conformity with accounting principles generally accepted in the United States of America, the most significant of which are described in Note 1. "Organization and Summary of Significant Accounting Policies." The Notes to Consolidated Financial Statements are an integral part of the Consolidated Financial Statements. The data presented in the Notes to Consolidated Financial Statements are as of December 31 of each year and for the year then ended, unless otherwise indicated. Dollar amounts in tables are in thousands, except per share amounts.

Certain balances for 2016 and 2015 have been reclassified to conform to the 2017 presentation.

**NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Organization and business.***

The Company, a Nevada corporation that was formed in 1999, is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange ("NYSE American") under the symbol "ARL". Over 80% of ARL's stock is owned by related party entities. ARL and a subsidiary own approximately 77.68% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc. "TCI", a Nevada corporation, whose common stock is traded on the NYSE American under the symbol "TCI".

TCI, a subsidiary of ARL, owns approximately 81.25% of the common stock of Income Opportunity Realty Investors, Inc. "IOR". Effective July 17, 2009, IOR's financial results were consolidated with those of ARL and TCI and their subsidiaries. IOR's common stock is traded on the New York Stock Exchange ("NYSE American") under the symbol "IOR".

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

and IOR. The officers of ARL also serve as officers of TCI, IOR and Pillar.

Since April 30, 2011, Pillar, the sole shareholder of which is Realty Advisors, LLC, a Nevada limited liability company, the sole member of which is Realty Advisors, Inc. “RAI”, a Nevada corporation, the sole shareholder of which is May Realty Holdings, Inc. (“MRHI”, formerly known as Realty Advisors Management, Inc. “RAMI”, effective August 7, 2014), a Nevada corporation, the sole shareholder of which is a trust known as the May Trust, became the Company’s external Advisor and Cash Manager. Pillar’s duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities. Pillar also arranges, for the Company’s benefit, debt and equity financing with third party lenders and investors. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. “Directors, Executive Officers and Corporate Governance – The Advisor”. ARL has no employees. Employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Regis Realty Prime, LLC, dba Regis Property Management, LLC (“Regis”), the sole member of which is Realty Advisors, LLC, manages our commercial and provides brokerage services. Regis receives property management fees and leasing commissions in accordance with the terms of its property-level management agreement. Regis is also entitled to receive real estate brokerage commissions in accordance with the terms of a non-exclusive brokerage agreement. See Part III, Item 10. “Directors, Executive Officers and Corporate Governance – Property Management and Real Estate Brokerage”. ARL engages third-party companies to lease and manage its apartment properties.

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

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

Our primary business is the acquisition, development and ownership of income-producing residential and commercial real estate properties. In addition, we opportunistically acquire land for future development in in-fill or high-growth suburban markets. From time to time and when we believe it appropriate to do so, we will also sell land and income-producing properties. We generate revenues by leasing apartment units to residents, and leasing office and retail space to various for-profit businesses as well as certain local, state and federal agencies. We also generate revenues from gains on sales of income-producing properties and land. At December 31, 2017, we owned fifty-one residential apartment communities comprising of 8,427 units, seven commercial properties comprising an aggregate of

approximately 1.7 million rentable square feet, and an investment in 3,666 acres of undeveloped and partially developed land, and a golf course comprising approximately 96.1 acres.

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

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

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

The Company in accordance with the VIE guidance in ASC 810 “Consolidations” consolidates fifty-one and fifty multifamily residential properties located throughout the United States at December 31, 2017 and 2016, respectively, with total units of 8,427 and 8,226, respectively. Assets totaling approximately \$483.7 million and approximately \$442 million at December 31, 2017 and 2016, respectively, were consolidated and included in “Real estate, at cost” on the balance sheet and are all collateral for their respective mortgage notes payable, none of which are recourse to the partnership in which they are in or to the Company.

**Real estate, depreciation, and impairment.** Real estate assets are stated at the lower of depreciated cost or fair value, if deemed impaired. Major replacements and betterments are capitalized and depreciated over their estimated useful lives. Depreciation is computed on a straight-line basis over the useful lives of the properties (buildings and improvements—10-40 years; furniture, fixtures and equipment—5-10 years). We continually evaluate the recoverability of

the carrying value of its real estate assets using the methodology prescribed in ASC Topic 360, "Property, Plant and Equipment." Factors considered by management in evaluating impairment of its existing real estate assets held for investment include significant declines in property operating profits, annually recurring property operating losses and other significant adverse changes in general market conditions that are considered permanent in nature. Under ASC Topic 360, a real estate asset held for investment is not considered impaired if the undiscounted, estimated future cash flows of an asset (both the annual estimated cash flow from future operations and the estimated cash flow from the theoretical sale of the asset) over its estimated holding period are in excess of the asset's net book value at the balance sheet date. If any real estate asset held for investment is considered impaired, a loss is provided to reduce the carrying value of the asset to its estimated fair value.

Any properties that are treated as "subject to sales contract" on the Consolidated Balance Sheets and are listed in detail in Schedule III, "Real Estate and Accumulated Depreciation" are those in which we have not recognized the legal sale according to the guidance in ASC 360-20 due to various factors, disclosed in each sale transaction under Item 1 Significant Real Estate Acquisitions/Dispositions and Financing. Any sale transaction where the guidance reflects that a sale had not occurred, the asset involved in the transaction, including the debt and property operations, remained on the books of the Company. We continue to charge depreciation to expense as a period costs for the property until such time as the property has been classified as held for sale in accordance with guidance reflected in ASC 360-10-45 "Impairment or Disposal of Long-Lived Assets".

***Real estate held for sale.*** We classify properties as held for sale when certain criteria are met in accordance with GAAP. At that time, we present the assets and obligations of the property held for sale separately in our consolidated balance sheet and we cease recording depreciation and amortization expense related to that property. Properties held for sale are reported at the lower of their carrying amount or their estimated fair value, less estimated costs to sell. We did not have any real estate assets classified as held for sale at December 31, 2017 or 2016.

Effective as of January 1, 2015, we adopted the revised guidance in Accounting Standards Update No. 2014-08 regarding discontinued operations. For sales of real estate or assets classified as held for sale after January 1, 2015, we will evaluate whether a disposal transaction meets the criteria of a strategic shift and will have a major effect on our operations and financial results to determine if the results of operations and gains on sale of real estate will be presented as part of our continuing operations or as discontinued operations in our consolidated statements of operations. If the disposal represents a strategic shift, it will be classified as discontinued operations for all periods presented; if not, it will be presented in continuing operations.

Any properties that are treated as “subject to sales contract” on the Consolidated Balance Sheets and are listed in detail in Schedule III, “Real Estate and Accumulated Depreciation” are those in which we have not recognized the legal sale according to the guidance in ASC 360-20 due to various factors, disclosed in Item 1 “Significant Real Estate Acquisitions/Dispositions and Financing.” Any sale transaction where the guidance reflects that a sale had not occurred, the asset involved in the transaction, including the debt, if appropriate, and property operations, remained on the books of the Company. We continue to charge depreciation to expense as a period costs for the property until such time as the property has been classified as held for sale in accordance with guidance reflected in ASC 360-10-45 “Impairment or Disposal of Long-Lived Assets.”

**Cost capitalization.** The cost of buildings and improvements includes the purchase price of property, legal fees and other acquisition costs. Costs directly related to planning, developing, initial leasing and constructing a property are capitalized and classified as Real Estate in the Consolidated Balance Sheets. Capitalized development costs include interest, property taxes, insurance, and other direct project costs incurred during the period of development.

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgment. Our capitalization policy on development properties is guided by ASC Topic 835-20 “Interest – Capitalization of Interest” and ASC Topic 970 “Real Estate - General”. The costs of land and buildings under development include specifically identifiable costs. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. We 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.

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

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

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

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

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

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

**Recognition of revenue.** Our revenues, which are composed largely of rental income, include rents reported on a straight-line basis over the lease term. In accordance with ASC 805 "Business Combinations", we recognize rental revenue of acquired in-place "above-" and "below-market" leases at their fair values over the terms of the respective leases.

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

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

**Foreign currency translation.** Foreign currency denominated assets and liabilities of subsidiaries with local functional currencies are translated to United States dollars at year-end exchange rates. The effects of translation are recorded in the cumulative translation component of shareholders’ equity. Subsidiaries with a United States dollar functional currency re-measure monetary assets and liabilities at year-end exchange rates and non-monetary assets and liabilities at historical exchange rates. The effects of re-measurement are included in income. Exchange gains and losses arising from transactions denominated in foreign currencies are translated at average exchange rates.

**Non-performing notes receivable.** ARL 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 in accordance with the terms of the agreement.

**Interest recognition on notes receivable.** We record interest income as earned in accordance with the terms of the related loan agreements.



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

**Cash equivalents.** For purposes of the Consolidated Statements of Cash Flows, all highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

**Restricted cash.** Restricted cash is comprised primarily of cash balances held in escrow by financial institutions under the terms of certain secured notes payable and certain unsecured bonds payable.

**Concentration of credit risk.** The Company maintains its cash balances at commercial banks and through investment companies, the deposits of which are insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2017 and 2016, the Company maintained balances in excess of the insured amount.

**Earnings per share.** Income (loss) per share is presented in accordance with ASC 620 "Earnings per Share". Income (loss) per share is computed based upon the weighted average number of shares of common stock outstanding during each year.

**Use of estimates.** In the preparation of Consolidated Financial Statements in conformity with GAAP, it is necessary for management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expense for the year ended. Actual results could differ from those estimates.

**Income taxes.** The Company is a "C" corporation for U.S. federal income tax purposes. For tax periods ending before August 31, 2012, the Company filed an annual consolidated income tax return with TCI and IOR and their subsidiaries. ARL was the common parent for the consolidated group. After that date, the Company and the rest of the ARL group joined the MRHI consolidated group for tax purposes. The income tax expense (benefit) for the 2012 tax period in the accompanying financial statement was calculated under a tax sharing and compensating agreement between ARL, TCI and IOR. That agreement continued until August 31, 2012, at which time a new tax sharing and compensating agreement was entered into by ARL, TCI, IOR and MRHI for the remainder of 2012 and subsequent years. The agreement specifies the manner in which the group will share the consolidated tax liability and also how certain tax attributes are to be treated among members of the group.



***Recent accounting pronouncements.***

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

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

**NOTE 2. REAL ESTATE**

A summary of our real estate owned as of the end of the year is listed below (dollars in thousands):

	2017	2016
Apartments	\$733,620	\$694,351
Apartments under construction	105,451	25,288
Commercial properties	200,797	218,857
Land held for development	77,560	79,188
Real estate held for sale	—	—
Real estate subject to sales contract	48,234	48,919
Total real estate, at cost, less impairment	1,165,663	1,066,603
Less accumulated depreciation	(177,546 )	(165,597 )
Total real estate, net of depreciation	\$988,117	\$901,006

Expenditures for repairs and maintenance are charged to operations as incurred. Significant betterments are capitalized. When assets are sold or retired, their costs and related accumulated depreciation are removed from the accounts with the resulting gains or losses reflected in net income or loss for the period.

Depreciation is computed on a straight line basis over the estimated useful lives of the assets as follows:

Land improvements	25 to 40 years
Buildings and improvements	10 to 40 years
Tenant improvements	Shorter of useful life or terms of related lease
Furniture, fixtures and equipment	3 to 7 years

### ***Fair Value Measurement***

The Company applies the guidance in ASC Topic 820, “Fair Value Measurements and Disclosures,” to the valuation of real estate assets. The Company is required to assess the fair value of its consolidated real estate assets with indicators of impairment. The value of impaired real estate assets is determined using widely accepted valuation techniques, including discounted cash flow analyses on the expected cash flow of each asset, as well as the income capitalization approach, which considers prevailing market capitalization rates, analyses of recent comparable sales transactions, information from actual sales negotiations and bona fide purchase offers received from third parties. The methods used to measure fair value may produce an amount that may not be indicative of net realizable value or reflective of future values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The fair value measurements used in these evaluations are considered to be Level 2 and 3 valuations within the fair value hierarchy in the accounting rules, as there are significant observable (Level 2) and unobservable inputs (Level 3). Examples of Level 2 inputs the Company utilizes in its fair value calculations are appraisals and bona fide purchase offers from third parties. Examples of Level 3 inputs the Company utilizes in its fair value calculations are discount rates, market capitalization rates, expected lease rental rates, timing of new leases, an estimate of future sales prices and comparable sales prices of similar assets, if available.

		Fair Value Measurements Using (dollars in thousands):		
December 31, 2015	Fair Value	Level 1	Level 2	Level 3
Commercial	\$3,000	\$—	\$—	\$3,000

The highlights of our significant real estate transactions for the year ended December 31, 2017, are discussed below.

### ***Purchases***

During the year ended December 31, 2017, the Company acquired one income-producing apartment properties from a third party in the state of North Carolina increasing the total number of units by 201, for a combined purchase price of \$79.7 million. In addition, we acquired one land parcel for future development for a total purchase price of \$5.4 million, adding 36.3 acres to the development portfolio.

### ***Sales***

As of December 31, 2017, subsidiaries hold approximately 91 acres of land, at various locations that were sold to related parties in multiple transactions. These transactions are treated as “subject to sales contract” on the Consolidated Balance Sheets. Due to the related party nature of the transactions, we deferred the recording of the sales in accordance with ASC 360-20.

We continue to invest in the development of apartment projects. During the year ended December 31, 2017, we have expended \$69.8 million related to the construction or predevelopment of various apartment complexes and capitalized \$2.4 million of interest costs.

**NOTE 3. NOTES AND INTEREST RECEIVABLE**

A portion of our assets are invested in mortgage notes receivable, principally secured by real estate. We may originate mortgage loans in conjunction with providing purchase money financing of property sales. Notes receivable are generally collateralized by real estate or interests in real estate and personal guarantees of the borrower and, unless noted otherwise, are so secured. Management intends to service and hold for investment the mortgage notes in our portfolio. A majority of the notes receivable provide for principal to be paid at maturity (dollars in thousands).

Borrower	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
H198, LLC (Las Vegas Land)	01 /20	12.00	% \$ 5,907	Secured
Leman Development, Ltd <sup>(2)</sup>	N/A	0.00	% 1,500	Unsecured
Oulan-Chikh Family Trust	03 /21	8.00	% 174	Secured
Unified Housing Foundation, Inc. (Cliffs of El Dorado) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Echo Station) <sup>(1)</sup>	12 /32	12.00	% 1,481	Secured
Unified Housing Foundation, Inc. (Inwood on the Park) <sup>(1)</sup>	12 /32	12.00	% 3,639	Secured
Unified Housing Foundation, Inc. (Kensington Park) <sup>(1)</sup>	12 /32	12.00	% 3,933	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) <sup>(1)</sup>	12 /32	12.00	% 2,000	Secured
Unified Housing Foundation, Inc. (Lakeshore Villas) <sup>(1)</sup>	12 /32	12.00	% 9,101	Secured
Unified Housing Foundation, Inc. (Limestone Canyon) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Limestone Canyon) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) <sup>(1)</sup>	12 /32	12.00	% 1,953	Secured
Unified Housing Foundation, Inc. (Limestone Ranch) <sup>(1)</sup>	12 /32	12.00	% 6,000	Secured
Unified Housing Foundation, Inc. (Parkside Crossing) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase I) <sup>(1)</sup>	12 /32	12.00	% 2,485	Secured
Unified Housing Foundation, Inc. (Reserve at White Rock Phase II) <sup>(1)</sup>	12 /32	12.00	% 2,555	Secured
Unified Housing Foundation, Inc. (Sendero Ridge) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Sendero Ridge) <sup>(1)</sup>	12 /32	12.00	% —	Secured
Unified Housing Foundation, Inc. (Timbers of Terrell) <sup>(1)</sup>	12 /32	12.00	% 1,323	Secured
Unified Housing Foundation, Inc. (Tivoli) <sup>(1)</sup>	12 /32	12.00	% 7,965	Secured
Unified Housing Foundation, Inc. (Trails at White Rock) <sup>(1)</sup>	12 /32	12.00	% 3,815	Secured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12 /17	12.00	% —	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12 /18	12.00	% 3,994	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12 /18	12.00	% 6,407	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	06 /20	12.00	% 5,760	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	12 /16	12.00	% —	Unsecured
Unified Housing Foundation, Inc. <sup>(1)</sup>	06 /19	12.00	% —	Unsecured
Other related party notes	Various	Various	1,349	Various secured interests

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

Other related party notes	Various	Various	465	Various unsecured interests
Other non-related party notes	Various	Various	3,466	Various secured interests
Other non-related party notes	Various	Various	15,252	Various unsecured interests
Accrued interest			7,249	
Total Performing			\$ 97,775	
Non- Performing				
One Realco Corporation <sup>(1,2)</sup>	01/17	3.00%	7,000	Unsecured
Realty Advisors Management, Inc. <sup>(1)</sup>	12/16	2.28%	20,387	Unsecured
Accrued Interest			2,703	
Total Non-Performing			\$30,090	Unsecured
Allowance for estimated losses			(15,770 )	
Total			\$ 112,095	

(1)Related party notes

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

46



As of December 31, 2017, the obligors on \$118.4 million or 88.2% of the mortgage notes receivable portfolio were due from related parties. The Company recognized \$12.4 million of interest income from these related party notes receivables.

As of December 31, 2017 none of the mortgage notes receivable portfolio were non-performing.

The Company has various notes receivable from Unified Housing Foundation, Inc. "UHF". UHF is determined to be a related party due to our significant investment in the performance of the collateral secured under the notes receivable. Payments are due from surplus cash flow from operations, sale or refinancing of the underlying properties. These notes are cross collateralized to the extent that any surplus cash available from any of the properties underlying these notes will be used to repay outstanding interest and principal for the remaining notes. Furthermore, any surplus cash available from any of the properties UHF owns, besides the properties underlying these notes, can be used to repay outstanding interest and principal for these notes. The allowance on the notes was a purchase allowance that was netted against the notes when acquired.

**NOTE 4. INVESTMENTS IN UNCONSOLIDATED SUBSIDIARIES AND INVESTEEES**

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

Investments accounted for via the equity method consists of the following:

	Percentage ownership as of December 31,		
	2017	2016	2015
Gruppa Fiorentina, LLC <sup>(1)</sup>	20.00 %	20.00 %	20.00 %
<sup>(1)</sup> Other investees.			

The market values, other than unconsolidated subsidiaries, as of the year ended December 31, 2017, 2016 and 2015 were not determinable as there were no readily traded markets for these entities. The following is a summary of the financial position and results of operations from our investees (dollars in thousands):

**For the Twelve Months Ended  
December 31,**

2017      2016      2015

Other Investees			
Real estate, net of accumulated depreciation	\$12,587	\$13,641	\$13,899
Notes receivable	2,724	9,561	8,457
Other assets	32,176	31,135	30,834
Notes payable	(17,845)	(9,834 )	(10,883)
Other liabilities	(5,991 )	(8,284 )	(7,967 )
Shareholders' equity/partners capital	(23,651)	(36,219)	(34,340)
Revenue	\$38,747	\$54,264	\$51,650
Depreciation	(1,279 )	(1,150 )	(1,150 )
Operating expenses	(35,410)	(49,856)	(47,143)
Interest expense	(1,065 )	(793 )	(805 )
Income (loss) from continuing operations	\$993	\$2,465	\$2,552
Income (loss) from discontinued operations	—	—	—
Net income (loss)	\$993	\$2,465	\$2,552
Company's proportionate share of earnings <sup>(1)</sup>	\$199	\$493	\$510

(1) Earnings represent continued and discontinued operations

**NOTE 5. NOTES AND INTEREST PAYABLE**

Below is a summary of our notes and interest payable as of December 31, 2017 (dollars in thousands):

	Notes Payable	Accrued Interest	Total Debt
Apartments	\$566,576	\$1,585	\$568,161
Apartments under Construction	\$78,683	\$113	\$78,796
Commercial	\$126,955	\$622	\$127,577
Land	\$22,888	\$203	\$23,091
Real estate subject to sales contract	\$1,449	\$508	\$1,957
Mezzanine financing	\$110,172	\$453	\$110,625
Other	\$10,013	\$101	\$10,114
Total	\$916,736	\$3,585	\$920,321
Unamortized deferred borrowing costs	(19,237 )	—	(19,237 )
	\$897,499	\$3,585	\$901,084

The following table summarizes our contractual obligations for principal payments as of December 31, 2017 (dollars in thousands):

Year	Amount
2018	\$86,323
2019	101,134
2020	64,255
2021	48,806
2022	11,204
Thereafter	605,013
Total	\$916,736

Interest payable at December 31, 2017, was \$2.6 million. Interest accrues at rates ranging from 2.5% to 12.0% per annum, and mature between 2018 and 2055. The mortgages were collateralized by deeds of trust on real estate having a net carrying value of \$901 million.

During the year, the Company refinanced or modified five loans with a total principal balance of \$78.9 million. The refinancing resulted in lower interest rates and the extension of the term of the loan. The modifications resulted in lower interest rates. The transactions provide for lower monthly payments over the term of the loans.

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

In conjunction with the development of various apartment projects and other developments, we drew down \$13 million in construction loans during the year ended December 31, 2017.

**NOTE 6. BONDS AND BONDS INTEREST PAYABLE**

In August 2016 Southern Properties Capital LTD (“Southern”), a British Virgin Islands corporation was incorporated for the purpose of raising funds by issuing Bonds to be traded on the Tel Aviv Stock Exchange (“TASE”). The Company transferred certain residential and commercial properties located in the United States to Southern, its wholly owned subsidiary. On February 13, 2017, Southern filed a final prospectus with the TASE for an offering and sale of nonconvertible Series A Bonds to be issued by Southern. The bonds are unsecured obligations of Southern. During 2017 on three separate occasions Southern issued nonconvertible Series A Bonds which in total amounted to approximately NIS400 million New Israeli Shekels (“NIS”) which converted to approximately \$115 million dollars. The Series A Bonds have a stated interest rate of 7.3%. At December 31, 2017 the effective interest rate is 9.17%. The bonds require semi-annual equal installments on January 31 and July 31 of each year from 2019 to 2023 (inclusive). The interest will be repaid on January 31 and July 31 of each of the years 2018 to 2023 (inclusive), first payment commenced on July 31, 2017.

a. Consisting of the following:

	December 31,	
	2017	2016
Bonds (Series A)	\$115,336	\$—
Less; deferred issuance expense, net	(5,916 )	—
Accrued Interest	3,629	—
	\$113,049	\$—

b. Aggregate maturities are as follows:

	December 31,	
	2017	2016
2018	\$—	—

2019	23,067	—
2020	23,067	—
2021	23,067	—
2022	23,067	—
Thereafter	23,067	—
	\$115,335	—

The funds were used principally for the acquisition and development of additional real estate operations in the United States. The funds were raised and will be repaid in NIS however the funds raised have been converted to US dollars. The Company records unrealized gains or losses each quarter based upon the relative exchange values of the US dollar and the NIS; however, no gain or loss will be realized until a conversion from US dollars to NIS actually occurs in the future. The recorded unrealized gain or loss is reflected as a separate line item to highlight the fact that it is a non-cash transaction until such time as actual payment of principal and interest on the bonds is made. For 2017 the Company reflected an unrealized foreign currency loss of \$4.5 million related to debenture transactions.

**NOTE 7.**            ***RELATED PARTY TRANSACTIONS  
AND FEES***

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

The Company has historically engaged in and may continue to engage in certain business transactions with related parties, including but not limited to asset acquisition and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm’s length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in our best interest.

Since April 30, 2011, Pillar, the sole shareholder of which is Realty Advisors, LLC, a Nevada limited liability company, the sole member of which is RAI, a Nevada corporation, the sole shareholder of which is MRHI, a Nevada corporation, the sole shareholder of which is a trust known as the May Trust, became the Company’s external Advisor and Cash Manager. Pillar’s duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities. Pillar also arranges, for the Company’s benefit, debt and equity financing with third party lenders and investors. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. “Directors, Executive Officers and Corporate Governance – The Advisor.” ARL has no employees. Employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Regis Realty Prime, LLC, dba Regis Property Management, LLC (“Regis”), the sole member of which is Realty Advisors, LLC, manages our commercial properties and provides brokerage services. Regis receives property management fees and leasing commissions in accordance with the terms of its property-level management agreement. Regis is also entitled to receive real estate brokerage commissions in accordance with the terms of a non-exclusive brokerage agreement. See Part III, Item 10. “Directors, Executive Officers and Corporate Governance – Property Management and Real Estate Brokerage.” ARL engages third-party companies to lease and manage its apartment properties.

Below is a description of the related party transactions and fees between Pillar and Regis:

Fees, expenses, and revenue paid to and/or received from our advisor:

	2017	2016	2015
	(dollars in thousands)		
<b>Fees:</b>			
Advisory	\$ 11,082	\$ 10,918	\$ 9,775
Mortgage brokerage and equity refinancing	1,712	775	1,612
Net income	250	257	492
Property acquisition and sales	—	—	921
	\$ 13,044	\$ 11,950	\$ 12,800
<b>Other Expense:</b>			
Cost reimbursements	\$ 3,240	\$ 3,826	\$ 3,675
Interest paid (received)	(1,195 )	(1,144 )	(1,234 )
	\$ 2,045	\$ 2,682	\$ 2,441
<b>Revenue:</b>			
Rental	\$ 783	\$ 708	\$ 726

Fees paid to Regis and related parties:

	2017	2016	2015
	(dollars in thousands)		
<b>Fees:</b>			
Property acquisition	\$ 9,128	\$ 10,775	\$ 1,932
Property management, construction management and leasing commissions	963	888	717
Real estate brokerage	1,369	787	1,105
	\$ 11,460	\$ 12,450	\$ 3,754

The Company received rental revenue of \$0.7 million in each of the three years ended December 31, 2017 from Pillar and its related parties for properties owned by the Company.

As of December 31, 2017, the Company had notes and interest receivables, net of allowances, of \$62.4 million and \$4.3 million, respectively, due from UHF, a related party. See Part 2, Item 8. Note 3. "Notes and Interest Receivable." During the current period, the Company recognized interest income of \$9.0 million, originated \$5.7 million, received principal payments of \$30.4 million and received interest payments of \$10.2 million from these related party notes receivables.

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





The Company is the primary guarantor, on a \$39.1 million mezzanine loan between UHF and a lender. In addition, ARL, and an officer of the Company are limited recourse guarantors of the loan. As of December 31, 2017, UHF was in compliance with the covenants to the loan agreement.

The Company is part of a tax sharing and compensating agreement with respect to federal income taxes between ARL, TCI and IOR and their subsidiaries that was entered into in July of 2009. The expense (benefit) in each year was calculated based on the amount of losses absorbed by taxable income multiplied by the maximum statutory tax rate of 35%.

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of December 31, 2017 (dollars in thousands):

	Pillar
Related party receivable, December 31, 2016	\$ 24,672
Cash transfers	56,635
Advisory fees	(11,082 )
Net income fee	(250 )
Cost reimbursements	(3,240 )
Interest income	1,196
Notes receivable purchased	(447 )
Fees and commissions	(3,082 )
Expenses paid by Advisor	(579 )
Financing (mortgage payments)	(17,313 )
Sales/purchases transactions	(9,818 )
Tax sharing	1,619
Related party receivable, December 31, 2017	\$ 38,311

As of December 31, 2017, subsidiaries hold approximately 66.7 acres of land, at various locations that were sold to related parties in multiple transactions. These transactions are treated as “subject to sales contract” on the Consolidated Balance Sheets. Due to the related party nature of the transactions TCI has deferred the recording of the sales in accordance with ASC 360-20.

**NOTE 8. DIVIDENDS**

ARL's Board of Directors established a policy that dividend declarations on common stock would be determined on an annual basis following the end of each year. In accordance with that policy, no dividends on ARL's common stock were declared for 2017, 2016, or 2015. Future distributions to common stockholders will be determined by the Board of Directors in light of conditions then existing, including the Company's financial condition and requirements, future prospects, restrictions in financing agreements, business conditions and other factors deemed relevant by the Board. On January 12, 2018 Realty Advisors converted 200,000 preferred shares plus accrued dividends into 482,716 shares of common stock.

**NOTE 9. INCOME TAXES**

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. We recognize deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If we determine that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, we would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes. We record uncertain tax positions in accordance with ASC 740 on the basis of a two-step process whereby (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

For financial reporting purposes, income before income taxes were:

	Years Ended December 31		
	2017	2016	2015
	(in thousands)		
TOTAL	(\$8,696)	(\$2,365)	(\$2,287)

The expense (benefit) for income taxes consists of:

	Years Ended December 31		
	2017	2016	2015
	(in thousands)		
Current:			
Federal	(\$3,044)	—	—
State	10	—	—
Deferred and other:			
Federal	3,044	(45)	(1,000)
State	170	—	—

Total Tax Expense \$180 (\$45) (\$1,000)

The reconciliation between the Company's effective tax rate on income from continuing operations and the statutory rate is as follows:

	Years Ended December 31		
	2017	2016	2015
	(in thousands)		
Income tax expense (benefit) at federal statutory rate	\$(3,044 )	\$(827 )	\$(1,283 )
State and local income taxes net of federal tax benefit	180	—	—
Repricing of deferred assets due to change in future rates	(28,663)	—	—
	—	—	
Change in valuation allowance	31,707	\$873	\$1,800
Reported income tax (benefit) expense	180	\$46	\$517
Effective Tax Rate	0.7 %	N/A	N/A

The company is subject to taxation in the United States and various states and foreign jurisdictions. As of December 31, 2017, the Company's tax years for 2016, 2015, and 2014 are subject to examination by the tax authorities. With few exceptions, as of December 31, 2017, the Company is no longer subject to U.S federal, state, local, or foreign examinations by tax authorities for the years before 2014.

The 2017 effective tax rate is driven primarily by the passing of the Tax Cuts and Jobs Act by congress. This act has reduced the statutory tax rate for corporations from 35% to 21% starting in 2018. As a result, the tax assets of ARI had to be re-priced to reflect the new rate for future years with the impact impacting the 2017 provision for income taxes.

**Components of the Net Deferred Tax Asset or Liability**

	Years Ended December 31	
	<b>2017</b>	<b>2016</b>
	(in thousands)	
Allowance for losses on notes	\$3,591	5,963
Installment note on land sale	2,875	4,793
Deferred gain	11,040	21,798
Net operating loss carryforward	50,931	73,021
Subtotal	68,437	105,575
Less: valuation allowance	(42,995)	(70,849)
Total net deferred tax assets	25,442	34,726
Basis differences for fixed assets	25,442	34,726
Total deferred tax liability	25,442	34,726
Net deferred tax asset	—	—
Current net deferred tax asset	25,442	34,726
Long-term net deferred tax liability	25,442	34,726
Net deferred tax asset	—	—

**Operating Loss and Tax Credit Carryforwards**

We have federal income tax NOL carryforwards related to our domestic operations of approximately \$209 million on a standalone basis, which have an indefinite life. We also have state NOLs in many of the various states in which we operate.

**Valuation Allowance Reversal**

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. At December 31, 2017, 2016 and 2015 ARL had a net deferred tax asset due to tax deductions available to it in future years. However, as management could not determine that it was more likely than not that ARL would realize the benefit of the deferred tax asset, a valuation allowance was established.

**NOTE 10. FUTURE MINIMUM RENTAL INCOME UNDER OPERATING LEASES**

ARL's operations include the leasing of commercial properties (office buildings, industrial warehouses and retail centers). The leases, thereon, expire at various dates through 2025. The following is a schedule of minimum future rents due to ARL under non-cancelable operating leases as of December 31, 2017 (dollars in thousands):

Year	Amount
2018	25,042
2019	19,828
2020	15,869
2021	13,643
2022	10,634
Thereafter	16,686
<b>Total</b>	<b>\$ 101,702</b>

**NOTE 11. OPERATING SEGMENTS**

Our segments are based on management's method of internal reporting which classifies its operations by property type. The segments are commercial, apartments, land and other. 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 operating income and cash flow.

Items of income that are not reflected in the segments are interest, other income, equity in partnerships and gains on sale of real estate. Expenses that are not reflected in the segments are provision for losses, advisory, net income and incentive fees, general and administrative, non-controlling interests and net loss from discontinued operations before gains on sale of real estate.

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

Presented below is the Company's reportable segments' operating income including segment assets and expenditures for the years 2017, 2016 and 2015 (dollars in thousands):

For the Twelve Months Ended December 31, 2017	<b>Commercial Properties</b>	<b>Apartments</b>	<b>Land</b>	<b>Other</b>	<b>Total</b>
Operating revenue	\$ 33,286	\$ 92,807	\$ 111	\$ 16	\$ 126,220
Operating expenses	(18,549 )	(43,677 )	(875 )	(987 )	(64,088 )
Depreciation and amortization	(9,358 )	(16,354 )	—	33	(25,679 )
Mortgage and loan interest	(7,527 )	(22,347 )	(1,945 )	(34,354 )	(66,173 )
Interest income	—	—	—	18,941	18,941
Gain on sale of income producing properties	2,391	12,760	1,547	—	16,698
Gain on land sales	—	—	4,884	—	4,884
Segment operating income (loss)	\$ 243	\$ 23,189	\$ 3,722	\$ (16,351 )	\$ 10,803
Capital expenditures	\$ (5,817 )	\$ 1,402	\$ 609	\$ —	\$ (3,806 )
Assets	\$ 137,157	\$ 727,508	\$ 127,554	\$ —	\$ 992,219
<b>Property Sales</b>					
Sales price	\$ 5,050	\$ —	\$ 29,969	\$ —	\$ 35,019
Cost of sale	(2,659 )	—	(23,538 )	—	(26,197 )
	—	12,760	—	—	12,760

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

Recognized prior deferred  
gain

Gain on sale	\$ 2,391	\$ 12,760	\$ 6,431	\$ —	\$ 21,582
--------------	----------	-----------	----------	------	-----------

For the Twelve Months Ended December 31, 2016	Commercial Properties	Apartments	Land	Other	Total
Operating revenue	\$ 33,026	\$ 86,603	\$ 30	\$ 4	\$ 119,663
Operating expenses	(20,398 )	(40,786 )	(1,745 )	(21 )	(62,950 )
Depreciation and amortization	(9,099 )	(14,759 )	—	73	(23,785 )
Mortgage and loan interest	(7,191 )	(25,381 )	(2,232 )	(24,558 )	(59,362 )
Interest income	—	—	—	20,453	20,453
Gain on sale of income producing properties	(238 )	16,445	—	—	16,207
Gain on land sales	—	—	3,121	—	3,121
Segment operating income (loss)	\$ (3,900 )	\$ 22,122	\$ (826 )	\$ (4,049 )	\$ 13,347
Capital expenditures	\$ 5,008	\$ 864	\$ 268	\$ —	\$ 6,140
Assets	\$ 150,838	\$ 622,061	\$ 128,107	\$ —	\$ 901,006
Property Sales					
Sales price	\$ 1,500	\$ 20,350	\$ 29,128	\$ —	\$ 50,978
Cost of sale	(1,738 )	(3,905 )	(26,007 )	—	(31,650 )
Gain on sale	\$ (238 )	\$ 16,445	\$ 3,121	\$ —	\$ 19,328



For the Twelve Months Ended December 31, 2015	Commercial Properties	Apartments	Land	Other	Total
Operating revenue	\$ 30,540	\$ 73,543	\$ —	\$ 105	\$ 104,188
Operating expenses	(17,761 )	(34,955 )	(1,029 )	(257 )	(54,002 )
Depreciation and amortization	(8,993 )	(12,498 )	—	73	(21,418 )
Mortgage and loan interest	(6,919 )	(23,699 )	(4,694 )	(17,165 )	(52,477 )
Interest income	—	—	—	16,674	16,674
Gain on land sales	—	—	21,648	—	21,648
Segment operating income (loss)	\$ (3,133 )	\$ 2,391	\$ 15,925	\$ (570 )	\$ 14,613
Capital expenditures	\$ 8,133	\$ 506	\$ 2,621	\$ —	\$ 11,260
Assets	\$ 155,147	\$ 551,415	\$ 146,945	\$ —	\$ 853,507
Property Sales					
Sales price	\$ —	\$ 11,129	\$ 107,298	\$ —	\$ 118,427
Cost of sale	—	(10,394 )	(88,387 )	—	(98,781 )
Recognized prior deferred gain	—	—	2,737	—	2,737
Gain on sale	\$ —	\$ 735	\$ 21,648	\$ —	\$ 22,383

The table below reflects the reconciliation of segment information to the corresponding amounts in the Consolidated Statements of Operations (dollars in thousands):

	For the Years Ended December 31,		
	2017	2016	2015
Segment operating income (loss)	\$ 10,803	\$ 13,347	\$ 14,613
Other non-segment items of income (expense)			
General and administrative	(7,691 )	(7,119 )	(6,893 )
Provision on impairment of notes receivable and real estate assets	—	—	(5,300 )
Net income fee to related party	(250 )	(257 )	(492 )
Advisory fee to related party	(11,082 )	(10,918 )	(9,775 )
Other income	(454 )	2,091	4,106
Loss on sale of investments	(331 )	—	(1 )
Earnings from unconsolidated joint ventures and investees	309	493	428
Litigation settlement	—	—	(352 )
Income tax benefit (expense)	(67 )	(46 )	(517 )
Gain (loss) from continuing operations	\$ (8,763 )	\$ (2,409 )	\$ (4,183 )

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

	For the Years Ended December 31,		
	2017	2016	2015
Segment assets	\$ 988,117	\$ 901,006	\$ 853,507

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

Investments in unconsolidated subsidiaries and investees	6,396	6,087	8,365
Notes and interest receivable	112,095	126,564	120,243
Other assets and receivables	190,112	141,252	135,253
Total assets	\$ 1,296,720	\$ 1,174,909	\$ 1,117,368

**NOTE 12. DISCONTINUED OPERATIONS**

Effective January 1, 2015, the Company adopted the provisions of ASU 2014-08, which changed the criteria of ASC 360 related to determining which disposals qualify to be accounted for as discontinued operations and modified related reporting and disclosure requirements. Disposals representing a strategic shift in operations that have a major effect on a company's operations and financial results will be presented as discontinued operations.

There were no sales of income-producing properties during 2017 or 2016 that met the criteria for discontinued operations. Amounts included in discontinued operations represent the residual amounts from sales classified as discontinued operations prior to January 1, 2015. The following table summarizes revenue and expense information for the properties sold that qualified as discontinued operations (dollars in thousands):

	For the Years Ended December 31,		
	2017	2016	2015
Revenues:			
Rental and other property revenues	\$—	\$—	\$355
	—	—	355
Expenses:			
Property operating expenses	—	2	(345)
Depreciation	—	—	—
General and administrative	—	—	99
Total operating expenses	—	2	(246)
Other income (expense):			
Other income (expense)	—	—	45
Mortgage and loan interest	—	—	(2 )
Loan charges and prepayment penalties	—	—	—
Litigation settlement	—	—	—
Total other expenses	—	—	43
Loss from discontinued operations before gain on sale of real estate and taxes	—	(2)	644
Gain on sale of real estate from discontinued operations	—	—	735
Income tax benefit (expense)	—	1	(483)
Income (loss) from discontinued operations	\$—	\$(1)	\$896

**NOTE 13. QUARTERLY RESULTS OF OPERATIONS**

The following is a tabulation of quarterly results of operations for the years 2017, 2016 and 2015. Quarterly results presented differ from those previously reported in ARL's Form 10-Q due to the reclassification of the operations of properties sold or held for sale to discontinued operations in accordance with ASC topic 360:

	Three Months Ended 2017			
	March 31,	June 30,	September 30,	December 31,
	(dollars in thousands, except share and per share amounts)			
<b>2017</b>				
Total operating revenues	\$31,822	\$31,587	\$31,807	\$31,005
Total operating expenses	27,345	26,759	26,397	28,292
Operating income	4,477	4,828	5,410	2,713
Other expense	(10,829 )	(15,676 )	(9,348 )	(11,853 )
Loss before gain on sales, non-controlling interest, and taxes	(6,352 )	(10,848 )	(3,938 )	(9,140 )
Gain (loss) on sale of income producing properties	—	—	12,760	3,938
Gain (loss) on land sales	445	(476 )	1,062	3,853
Income tax benefit (expense)	—	—	—	(180 )
Net income (loss) from continued operations	(5,907 )	(11,324 )	9,884	(1,529 )
Net loss from discontinued operations	—	—	—	—
Net income (loss)	(5,907 )	(11,324 )	9,884	(1,529 )
Less: net (income) loss attributable to non-controlling interest	193	435	(522 )	339
Preferred dividend requirement	(275 )	(275 )	(275 )	(280 )
Net income (loss) applicable to common shares	\$ (5,989 )	\$ (11,164 )	\$ 9,087	\$ (1,470 )
<b>PER SHARE DATA</b>				
Earnings per share - basic				
Loss from continued operations	\$ (0.39 )	\$ (0.72 )	\$ 0.59	\$ (0.09 )
Income from discontinued operations	—	—	—	—
Net income (loss) applicable to common shares	\$ (0.39 )	\$ (0.72 )	\$ 0.59	\$ (0.09 )
Weighted average common shares used in computing earnings per share	15,514,360	15,514,360	15,514,360	15,514,360
Earnings per share - diluted				
Loss from continued operations	\$ (0.39 )	\$ (0.72 )	\$ 0.59	\$ (0.09 )
Income from discontinued operations	—	—	—	—
Net income (loss) applicable to common shares	\$ (0.39 )	\$ (0.72 )	\$ 0.59	\$ (0.09 )
Weighted average common shares used in computing diluted earnings per share	15,514,360	15,514,360	15,514,360	15,514,360

Three Months Ended 2016

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

	March 31,	June 30,	September 30,	December 31,
	(dollars in thousands, except share and per share amounts)			
2016				
Total operating revenues	\$29,205	\$30,834	\$30,067	\$29,557
Total operating expenses	25,881	26,212	26,272	26,664
Operating income	3,324	4,622	3,795	2,893
Other expense	(8,470)	(8,156)	(9,252)	(10,447)
Loss before gain on sales, non-controlling interest, and taxes	(5,146)	(3,534)	(5,457)	(7,554)
Gain (loss) on sale of income producing properties	(244)	5,168	—	11,283
Gain (loss) on land sales	1,652	1,719	555	(805)
Income tax benefit (expense)	—	—	(46)	—
Net income (loss) from continued operations	(3,738)	3,353	(4,948)	2,924
Net loss from discontinued operations	2	—	—	(3)
Net income (loss)	(3,736)	3,353	(4,948)	2,921
Less: net (income) loss attributable to non-controlling interest	530	(864)	1,194	(1,182)
Preferred dividend requirement	(497)	(53)	(275)	(276)
Net income (loss) applicable to common shares	\$(3,703)	\$2,436	\$(4,029)	\$1,463
 PER SHARE DATA				
Earnings per share - basic				
Loss from continued operations	\$(0.24)	\$0.16	\$(0.26)	\$0.09
Income from discontinued operations	—	—	—	—
Net income (loss) applicable to common shares	\$(0.24)	\$0.16	\$(0.26)	\$0.09
Weighted average common shares used in computing earnings per share	15,514,360	15,514,360	15,514,360	15,514,360
 Earnings per share - diluted				
Loss from continued operations	\$(0.24)	\$0.16	\$(0.26)	\$0.09
Income from discontinued operations	—	—	—	—
Net income (loss) applicable to common shares	\$(0.24)	\$0.16	\$(0.26)	\$0.09
Weighted average common shares used in computing diluted earnings per share	15,514,360	15,514,360	15,514,360	15,514,360

	Three Months Ended 2015			
	March 31,	June 30,	September 30,	December 31,
	(dollars in thousands, except share and per share amounts)			
2015				
Total operating revenues	\$ 23,156	\$ 24,241	\$ 27,826	\$ 28,965
Total operating expenses	21,155	20,388	25,741	30,596
Operating income	2,001	3,853	2,085	(1,631 )
Other expense	(2,338 )	(5,139 )	(11,152 )	(12,993 )
Loss before gain on land sales, non-controlling interest, and taxes	(337 )	(1,286 )	(9,067 )	(14,624 )
Gain (loss) on land sales	2,876	3,027	1,958	13,787
Income tax benefit	103	(12 )	274	(882 )
Net income (loss) from continued operations	2,642	1,729	(6,835 )	(1,719 )
Net income from discontinued operations	190	(22 )	508	220
Net income (loss)	2,832	1,707	(6,327 )	(1,499 )
Less: net (income) loss attributable to non-controlling interest	508	(540 )	1,164	195
Preferred dividend requirement	(390 )	(275 )	(275 )	(276 )
Net income (loss) applicable to common shares	\$ 2,950	\$ 892	\$ (5,438 )	\$ (1,580 )
<b>PER SHARE DATA</b>				
Earnings per share - basic				
Loss from continued operations	\$ 0.20	\$ 0.06	\$ (0.38 )	\$ (0.24 )
Income from discontinued operations	0.01	—	0.03	0.01
Net income (loss) applicable to common shares	\$ 0.21	\$ 0.06	\$ (0.35 )	\$ (0.23 )
Weighted average common shares used in computing earnings per share	14,027,619	15,367,320	15,514,360	15,514,360
Earnings per share - diluted				
Loss from continued operations	\$ 0.16	\$ 0.05	\$ (0.38 )	\$ (0.24 )
Income from discontinued operations	0.01	—	0.03	0.01
Net income (loss) applicable to common shares	\$ 0.17	\$ 0.05	\$ (0.35 )	\$ (0.23 )
Weighted average common shares used in computing diluted earnings per share	17,426,707	17,844,339	15,514,360	15,514,360

**NOTE 14. COMMITMENTS, CONTINGENCIES, AND LIQUIDITY**

*Liquidity.* Management believes that ARL will generate excess cash flow from property operations in 2018. Such excess however, will not be sufficient to discharge all of ARL's obligations as they become due. Management intends to sell land and income-producing real estate, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

*Guarantees.* TCI is a primary guarantor, on a \$39.1 million mezzanine loan between UHF and a lender. In addition, ARL, and an officer of the Company are limited recourse guarantors of the loan. As of December 31, 2017 UHF was in compliance with the covenants to the loan agreement.

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

**ART and ART Midwest, Inc.**

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

The Clapper Parties subsequently filed a new lawsuit against ARI, its subsidiary EQK Holdings, Inc. "EQK", and ART. The Clapper Parties seek damages from ARL for payment by ART to ARL of ART's stock in EQK in exchange for a release of the Antecedent Debt owed by ART to ARI. In February 2018 the court determined that this legal matter

should not have been filed in federal court and therefore granted motions to dismiss on jurisdictional grounds. The company has no knowledge as to whether the plaintiffs will attempt to refile their lawsuit in a state court.

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



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

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

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

The Final Judgment entered against Dynex Commercial, Inc. on July 20, 2015 awarded Basic was \$0.256 million in damages, plus pre-judgment interest of \$0.192 million for a total amount of \$0.448 million. The Judgment awarded ART was \$14.2 million in damages, plus pre-judgment interest of \$10.6 million for a total amount of \$24.8 million. The Judgment awarded TCI was \$11.1 million, plus pre-judgment interest of \$8.4 million for a total amount of \$19.5 million. The Judgment also awarded Basic, ART, and TCI post-judgment interest at the rate of 5% per annum from April 25, 2014 until the date their respective damages were paid. Lastly, the Judgement awarded Basic, ART, and TCI was \$1.6 million collectively in attorneys’ fees from Dynex Commercial, Inc.

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

### **NOTE 15. EARNINGS PER SHARE**

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

As of December 31, 2017, we have 2,000,614 shares of Series A 10.0% cumulative convertible preferred stock, which are outstanding. These shares may be converted into common stock at 90% of the average daily closing price of the common stock for the prior 20 trading days. These are considered in the computation of diluted earnings per share if the effect of applying the if-converted method is dilutive. Of the outstanding 2,000,614 shares, 900,000 are held by ARL. Dividends are not paid on the shares owned by ARL.

Prior to July 17, 2014, RAI owned 2,451,435 shares of the outstanding Series A 10.0% convertible preferred stock and had accrued dividends unpaid of \$15.1 million. On July 17, 2014, RAI converted 890,797 shares, including \$6.3 million in accumulated dividends unpaid for these shares, into the requisite number of shares of common stock. This conversion resulted in the issuance of 2,502,230 new shares of ARL common stock. On April 9, 2015, RAI converted 460,638 shares including \$2.3 million in accumulated dividends unpaid for these shares, into the requisite number of shares of common stock. This conversion resulted in the issuance of 1,486,741 new shares of ARL common stock. As of December 31, 2017, RAI owns 1,100,000 shares of the outstanding Series A convertible preferred stock and has accrued dividends unpaid of \$9.7 million.

The Company had 135,000 shares of Series K convertible preferred stock, which were held by TCI and used as collateral on a note. The note has been paid in full and the Series K preferred stock was cancelled May 7, 2014.

Prior to January 1, 2015, the Company had 1,000 shares of stock options outstanding. These options expired unexercised January 1, 2015. The options are no longer included in the dilutive earnings per share calculation for the current period, but are considered in the computation for the prior periods if applying the “treasury stock” method is dilutive.

As of December 31, 2017, the Series A convertible preferred stock and the stock options were anti-dilutive and therefore not included in the EPS calculation.

**NOTE 16. SUBSEQUENT EVENTS**

The date to which events occurring after December 31, 2017, the date of the most recent balance sheet, have been evaluated for possible adjustments to the financial statements or disclosure is March 30, 2017, which is the date of which the financial statements were available to be issued. There are no subsequent events that would require an adjustment to the financial statements.

On February 15, 2018, Southern issued Series B bonds in the amount of NIS 137.7 million par value (approximately \$39.4 million as of February 15, 2018). The Series B bonds are registered on the TASE. The bonds are reported in NIS and bear stated annual interest rate of 6.8%. Interest shall be repaid January 31 and July 31 of each of the years 2019 to 2023 (inclusive), first payment commencing on July 31, 2018. The principal shall be repaid in ten equal installments on January 31 and July 31 of each of the years from 2015 to 2025 (inclusive). The total bond issuance cost incurred is 41.4 million.

In March 2018, the Company and a substantial financial institution (“Macquarie”) entered into an agreement to form a special purpose entity (“Joint Venture”) that would principally own and operate the existing TCI Class A multifamily residential portfolio that is currently owned 100% by Company’s subsidiaries. The Joint Venture would also actively participate in the development and/or acquisitions of additional Class A assets. It is anticipated that the Southern and Macquarie would each have a 49% ownership interest and a 50% voting interest in the Joint Venture. The remaining 2% ownership interest would be allotted to Daniel J. Moos, the current President and Chief Executive Officer of TCI and Abode Properties. The completion of agreement is subject to the approval of certain regulators.

**Schedule III****AMERICAN REALTY INVESTORS, INC.****REAL ESTATE AND ACCUMULATED DEPRECIATION****December 31, 2017**

Property/Location	Encumbrances	Initial Cost		Cost Capitalized Subsequent to Acquisition	Asset Impairment	Gross Amounts of Which Carried at End of Year		Total
		Land	Buildings			Land	Building & Improvements	
<b>(dollars in thousands)</b>								
Properties Held for Investment								
Apartments								
Anderson Estates, Oxford, MS	769	378	2,683	313	—	378	2,996	3,374
Blue Lake Villas I, Waxahachie, TX	10,448	438	10,252	19	—	438	10,271	10,709
Blue Lake Villas II, Waxahachie, TX	3,769	287	4,496	—	—	287	4,496	4,783
Breakwater Bay, Beaumont, TX	9,112	740	10,498	—	—	740	10,498	11,238
Bridgewood Ranch, Kaufman, TX	6,233	762	6,913	—	—	762	6,913	7,675
Capitol Hill, Little Rock, AR	8,740	1,860	8,002	—	—	1,860	8,002	9,862
Centennial, Oak Ridge, TN	20,518	2,570	22,589	—	—	2,570	22,589	25,159
Crossing at Opelika, Opelika, AL	1,399	1,606	14,451	—	—	1,606	14,451	16,056
Curtis Moore Estates,	14,498	186	5,976	702	—	186	6,678	6,860

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

Greenwood, MS Dakota Arms, Lubbock, TX	12,194	921	12,834	168	—	921	13,002	13,9
David Jordan Phase II, Greenwood, MS	551	51	1,591	225	—	51	1,816	1,86
David Jordan Phase III, Greenwood, MS	556	83	2,179	356	—	83	2,535	2,61
Desoto Ranch, DeSoto, TX	14,877	1,349	16,838	11	—	1,349	16,849	18,1
Falcon Lakes, Arlington, TX	13,352	1,318	14,461	27	—	1,318	14,488	15,8
Heather Creek, Mesquite, TX	10,976	1,326	12,157	18	—	1,326	12,175	13,5
Holland Lake, Weatherford, TX	11,510	1,450	14,955	—	—	1,450	14,955	16,4
Lake Forest, Houston, TX	11,808	335	14,221	—	—	335	14,221	14,5
Legacy at Pleasant Grove, Texarkana, TX	14,495	2,005	18,109	—	—	2,005	18,109	20,1
Lofts at Reynolds Village, Asheville, NC	28,230	3,704	33,340	—	—	3,704	33,340	37,0
Lodge at Pecan Creek, Denton, TX	15,959	1,349	16,180	—	—	1,349	16,180	17,5
Mansions of Mansfield, Mansfield, TX	15,084	977	17,843	31	—	977	17,874	18,8
Metropolitan Apartments, North Little Rock, AR	25,233	3,323	29,857	—	—	3,323	29,857	33,1
Mission Oaks, San Antonio, TX	14,433	1,266	16,717	122	—	1,266	16,839	18,1
Monticello Estate, Monticello, AR	431	36	1,493	264	—	36	1,757	1,79
Northside on Travis, Sherman, TX	12,873	1,300	14,586	—	—	1,300	14,586	15,8
Oak Hollow, Sequin, TX	11,680	1,435	12,403	—	—	1,435	12,403	13,8
Oceanaire Apartments, Biloxi, MS	10,791	1,384	12,575	—	—	1,384	12,575	13,9
Overlook at Allensville, Sevierville, TN	12,079	1,228	12,297	—	—	1,228	12,297	13,5
Parc at Clarksville, Clarksville, TN	12,441	571	14,360	59	—	571	14,419	14,9
	18,249	1,022	20,188	100	—	1,022	20,288	21,3

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

Parc at Denham Springs, Denham Springs, LA								
Parc at Maumelle, Little Rock, AR	15,438	1,048	18,464	—	—	1,048	18,464	19,5
Parc at Metro Center, Nashville, TN	10,148	947	12,601	182	—	947	12,783	13,7
Parc at Rogers, Rogers, AR	20,004	1,482	23,176	266	(3,180 )	1,482	20,262	21,7
Preserve at Pecan Creek, Denton, TX	14,006	885	16,668	17	—	885	16,685	17,5
Preserve at Prairie Pointe, Lubbock, TX	9,928	1,074	10,782	—	—	1,074	10,782	11,8
Riverwalk Phase I, Greenville, MS	272	23	1,543	175	—	23	1,718	1,74
Riverwalk Phase II, Greenville, MS	1,053	52	4,051	364	—	52	4,415	4,46
Sawgrass Creek, New Port Richey, FL	—	784	7,056	—	—	784	7,056	7,84
Sonoma Court, Rockwall, TX	10,456	941	11,136	—	—	941	11,136	12,0
Sugar Mill, Baton Rouge, LA	11,031	1,437	13,437	135	—	1,437	13,572	15,0
Tattersall Village, Hinesville, GA	20,025	2,670	23,767	—	—	2,670	23,767	26,4
Toulon, Gautier, MS	20,104	1,621	20,107	372	—	1,621	20,479	22,1
Tradewinds, Midland, TX	13,882	3,313	20,073	—	—	3,313	20,073	23,3
Villager, Ft. Walton, FL	713	141	1,267	—	—	141	1,267	1,40
Villas at Park West I, Pueblo, CO	10,250	1,171	10,453	—	—	1,171	10,453	11,6
Villas at Park West II, Pueblo, CO	9,278	1,463	13,060	—	—	1,463	13,060	14,5
Vista Ridge, Tupelo, MS	10,530	1,339	13,398	—	—	1,339	13,398	14,7
Vistas of Vance Jackson, San Antonio, TX	14,834	1,265	16,760	121	—	1,265	16,881	18,1
Waterford, Roseberg, TX	16,940	2,341	20,926	—	—	2,341	20,926	23,2
Westwood, Mary Ester, FL	3,938	693	6,650	—	—	693	6,650	7,34
Windsong, Fort Worth, TX	10,459	790	11,595	—	—	790	11,595	12,3

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

Total Apartments Held for Investment	\$ 566,577	\$ 60,740	\$ 672,014	\$ 4,047	\$ (3,180 )	\$ 60,740	\$ 672,881	\$ 733,
Apartment Under Construction								
Abode Red Rock	22,945	6,038	—	28,095	—	6,038	28,095	34,1
Apache Point	—	—	—	149	—	—	149	149
Eagle Crossing	—	—	—	81	—	—	81	81
Forest Pines	—	5,040	—	269	—	5,040	269	5,30
Lakeside Lofts, Farmers Branch, TX	1	—	—	5,079	—	—	5,079	5,07
McKinney Point	—	—	—	137	—	—	137	137
Parc at Bentonville	—	—	—	85	—	—	85	85
Parc at Garland	—	—	—	81	—	—	81	81
Parc at Wylie	—	—	—	195	—	—	195	195
Oak Hollow II	5,475	1,046	—	4,622	—	1,046	4,622	5,66
Overlook at Allensville Square II, Sevierville, TN	—	1,843	—	530	—	1,843	530	2,37
Sawgrass II	1,007	—	—	3,772	—	—	3,772	3,77
Sugar Mill II	—	—	—	4	—	—	4	4
Terra Lago, Rowlett, TX	39,042	5,588	—	42,137	—	5,588	42,137	47,7
Total Apartments Under Construction	\$ 68,470	\$ 19,555	\$ —	\$ 85,236	\$ —	\$ 19,555	\$ 85,236	\$ 104,

**AMERICAN REALTY INVESTORS, INC.**  
**REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**December 31, 2017**

**Schedule III**  
**Continued**

Property/Location	Initial Cost	Cost Capitalized Subsequent to Acquisition	Asset Impairment	Gross Amounts of Which Carried at End of Year		Total		
				Land	Building & Improvements			
Encumbrance	Land	Buildings	Improvements	Impairment	Land	Improvements	Total	
(dollars in thousands)								
Commercial								
600 Las Colinas, Las Colinas, TX	38,600	5,751	53,972	16,360	—	5,751	70,332	76,083
770 South Post Oak, Houston, TX	12,600	1,763	15,839	264	—	1,763	16,103	17,373
Bridgeview Plaza, LaCrosse, WI	4,906	—	658	476	—	—	1,134	1,134
Browning Place (Park West I), Farmers Branch, TX	42,473	5,096	47,711	13,728	—	5,096	61,439	66,537
Mahogany Run Golf Course, US Virgin Islands	—	418	6,037	147	(5,300 )	418	884	1,331
Fruitland Plaza, Fruitland Park, FL	—	17	16	67	—	17	83	100
Senlac VHP, Farmers Branch, TX	—	622	58	85	—	622	143	765
Stanford Center, Dallas, TX	28,000	3,878	35,476	7,257	(9,600 )	3,878	33,133	37,011
Total Commercial	\$ 126,579	\$ 17,545	\$ 159,767	\$ 38,384	\$ (14,900 )	\$ 17,545	\$ 183,251	\$ 200,751
Held for Investment								
Land								
Audubon, Adams County, MS	—	519	—	296	—	519	296	815
Bonneau Land, Farmers Branch,	—	1,309	—	—	—	1,309	—	1,309



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

TX								
Cooks Lane, Fort Worth, TX	157	1,094	—	—	—	1,094	—	1,094
Dedeaux, Gulfport, MS	—	1,612	—	46	(38 )	1,612	8	1,612
Denham Springs, Denham Springs, LA	61	714	—	—	—	714	—	714
Gautier Land, Gautier, MS	—	202	—	—	—	202	—	202
Lake Shore Villas, Humble, TX	—	81	—	3	—	81	3	84
Lubbock Land, Lubbock, TX	—	234	—	—	—	234	—	234
Nakash, Malden, MO	—	103	—	—	—	103	—	103
Nashville, Nashville, TN	—	278	—	59	—	278	59	337
Ocean Estates, Gulfport, MS	—	1,418	—	390	—	1,418	390	1,808
Texas Plaza Land, Irving, TX	—	1,738	—	—	(238 )	1,738	(238 )	1,500
Union Pacific Railroad Land, Dallas, TX	—	130	—	—	—	130	—	130
Willowick Land, Pensacola, FL	—	137	—	—	—	137	—	137
Windmill Farms Land, Kaufman County, TX	14,922	48,927	—	14,210	(20,376 )	48,927	(6,166 )	42,761
2427 Valley View Ln, Farmers Branch, TX	—	76	—	—	—	76	—	76
GNB Land ARI 8/06 L2870	—	1,010	—	—	—	1,010	—	1,010
GNB Land Edina 6/07 L2875	—	7,955	—	—	(6,023 )	7,955	(6,023 )	1,932
GNB Land Edina B1530	—	5,135	—	32	(3,692 )	5,135	(3,660 )	1,475
Hollywood Casino Land Tract II, Farmers Branch, TX	—	3,192	—	1,346	—	3,192	1,346	4,538
Lacy Longhorn Land, Farmers Branch, TX	—	1,169	—	—	(760 )	1,169	(760 )	409
Manhattan Land	—	(344 )	—	611	—	—	611	267
Mininvest Land, Dallas, TX	—	7	—	—	—	7	—	7
Mira Lago, Farmers	—	53	—	15	—	53	15	68

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

Branch, TX Nicholson Croslin, Dallas, TX	—	184	—	—	(118 )	184	(118 )	66
Nicholson Mendoza, Dallas, TX	—	80	—	—	(51 )	80	(51 )	29
Senlac Land Tract II, Farmers Branch, TX	—	656	—	—	—	656	—	65
Valley View 34 (Mercer Crossing), Farmers Branch, TX	—	1,173	—	—	(945 )	1,173	(945 )	22
Dominion Mercer, Farmers Branch, TX	11,125	4,040	—	2,998	—	4,040	2,998	7,0
Mandahl Bay Land	—	667	—	—	—	667	—	66
Meloy/Portage Land	—	5,119	—	—	(1,069 )	5,119	(1,069 )	4,0
McKinney 36, Collin County, TX	1,211	456	—	161	(19 )	456	142	59
Travis Ranch Land, Kaufman County, TX	307	80	—	—	—	80	—	80
Travis Ranch Retail, Kaufman City, TX	—	1,517	—	—	—	1,517	—	1,5
Total Land Held for Investment	\$ 27,783	\$ 90,721	\$ —	\$ 20,167	\$ (33,329 )	\$ 91,065	\$ (13,162 )	\$ 77

**AMERICAN REALTY INVESTORS, INC.**  
**REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**December 31, 2017**

**Schedule III**  
**Continued**

Property/Location	Initial Cost	Cost Capitalized Subsequent to Acquisition	Asset Impairment	Gross Amounts of		Carried at End of	
				Asset	Impairment		
	Encumbrance	Land	Buildings	Improvements	Impairment	Land	Buildings & Improvements
	(dollars in thousands)						
Corporate Departments/Investments/Misc.							
TCI - Corporate	119,786	—	660	—	—	—	6
Total Corporate Departments/Investments/Misc.	\$ 119,786	\$ —	\$ 660	\$ —	\$ —	\$ —	\$ 6
Total Properties Held for Investment	\$ 909,195	\$ 188,561	\$ 832,441	\$ 147,834	\$ (51,409 )	\$ 188,905	\$ 9
Properties Held for Sale							
Commercial							
Total Commercial Held for Sale	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Total Properties Held for Sale	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Properties Subject to Sales Contract							
Commercial							
Total Commercial Subject to Sales Contract	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

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

Land							
Dominion Tract, Dallas, TX	\$ 1,079	\$ 2,083	\$ —	\$ 53	(133 )	2,003	\$ —
Hollywood Casino Tract I, Farmers Branch, TX	420	1,608	—	125	(110 )	1,623	\$ —
LaDue Land, Farmers Branch, TX	—	1,845	—	—	—	1,845	\$ —
Three Hickory Land, Farmers Branch, TX	—	1,202	—	—	—	1,202	\$ —
Travelers Land, Farmers Branch, TX	—	21,511	—	4	—	21,515	\$ —
Travelers Land, Farmers Branch, TX	—	6,891	—	—	(4,978 )	1,913	\$ —
Valwood Land	—	3,332	—	—	—	3,332	\$ —
Walker Land, Dallas County, TX	—	19,167	—	70	(6,062 )	13,175	\$ —
Whorton Land, Bentonville, AR	—	3,510	—	568	(2,451 )	1,627	\$ —
Total Land Subject to Sales Contract	\$ 1,499	\$ 61,149	\$ —	\$ 820	\$ (13,734 )	\$ 48,235	\$ —
Total Properties Subject to Sales Contract	\$ 1,499	\$ 61,149	\$ —	\$ 820	\$ (13,734 )	\$ 48,235	\$ —
Land Sold							
	\$ —	\$ —	\$ —	\$ —	—	\$ —	\$ —
Total Land Sold	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
TOTAL: Real Estate	\$ 910,694	\$ 249,710	\$ 832,441	\$ 148,654	\$ (65,143 )	\$ 237,140	\$ 9

**SCHEDULE III****(Continued)****AMERICAN REALTY INVESTORS, INC.****REAL ESTATE AND ACCUMULATED DEPRECIATION****As of December 31, 2017**

	2017	2016	2015
	(dollars in thousands)		
<b>Reconciliation of Real Estate</b>			
Balance at January 1,	\$1,066,603	\$1,003,545	\$831,540
<b>Additions</b>			
Acquisitions, improvements and construction	129,483	112,762	216,090
<b>Deductions</b>			
Sale of real estate	(30,424 )	(49,704 )	(38,785 )
Asset impairments	—	—	(5,300 )
Balance at December 31,	\$1,165,662	\$1,066,603	\$1,003,545
<b>Reconciliation of Accumulated Depreciation</b>			
Balance at January 1,	\$165,597	\$150,038	\$131,777
<b>Additions</b>			
Depreciation	24,417	23,277	20,386
<b>Deductions</b>			
Sale of real estate	(12,468 )	(7,718 )	(2,125 )
Balance at December 31,	\$177,546	\$165,597	\$150,038

## SCHEDULE IV

**AMERICAN REALTY INVESTORS, INC.**  
**MORTGAGE LOANS**  
**December 31, 2017**

Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgage	Carrying Amount of Mortgage	Principal or Loans Subject to Delinquent Principal or Interest
(dollars in thousands)							
<b>Christine Tunney</b>	10.00%	09/17	Interest only paid quarterly.	—	49	48	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Compton Partners</b>	10.00%	09/17	Interest only paid quarterly.	—	289	289	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>David Monier</b>	10.00%	09/17	Interest only paid quarterly.	—	97	97	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Earl Samson III</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Edward Samson III</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—

Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>H198, LLC</b>	12.00%	01/20		—	5,907	5,907	—
Las Vegas Land							
<b>Hammon Operating Corporation</b>	10.00%	09/17	Interest only paid quarterly.	—	193	193	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Harold Wolfe</b>	10.00%	09/17	Interest only paid quarterly.	—	193	193	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Herrick Partners</b>	10.00%	09/17	Interest only paid quarterly.	—	91	91	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Mary Anna MacLean</b>	10.00%	09/17	Interest only paid quarterly.	—	193	193	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Michael Monier</b>	10.00%	09/17	Interest only paid quarterly.	—	304	304	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Michale Witte</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P.							
<b>Palmer Brown Madden</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—

Class A limited  
partnership interests  
in Edina Park Plaza  
Associates, L.P.

<b>Richard Schmaltz</b>	10.00%	09/17	Interest only paid quarterly.	—	203	203	—
-------------------------	--------	-------	-------------------------------------	---	-----	-----	---

Class A limited  
partnership interests  
in Edina Park Plaza  
Associates, L.P.

<b>Robert Baylis</b>	10.00%	09/17	Interest only paid quarterly.	—	193	193	—
----------------------	--------	-------	-------------------------------------	---	-----	-----	---

Class A limited  
partnership interests  
in Edina Park Plaza  
Associates, L.P.

<b>Sherman Bull</b>	10.00%	09/17	Interest only paid quarterly.	—	193	193	—
---------------------	--------	-------	-------------------------------------	---	-----	-----	---

Class A limited  
partnership interests  
in Edina Park Plaza  
Associates, L.P.

<b>Unified Housing Foundation, Inc. (Echo Station)</b> 100% Interest in UH of Temple, LLC	12.00%	12/32	Excess cash flow	9,719	1,809	1,481	—
--	--------	-------	---------------------	-------	-------	-------	---



## SCHEDULE IV

(Continued)

**AMERICAN REALTY INVESTORS, INC.**  
**MORTGAGE LOANS**  
**December 31, 2017**

Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgage	Carrying Amount of Mortgage	Principal or Loans Subject to Delinquent Principal or Interest
(dollars in thousands)							
<b>Unified Housing Foundation, Inc. (Inwood on the Park/UH of Inwood, LLC)</b> 100% Interest in UH of Inwood, LLC	12.00%	12/32	Excess cash flow	22,227	5,462	3,639	—
<b>Unified Housing Foundation, Inc. (Kensington Park/UH of Kensington, LLC)</b> 100% Interest in UH of Kensington, LLC	12.00%	12/32	Excess cash flow	18,723	4,310	3,933	—
<b>Unified Housing Foundation, Inc. (Lakeshore Villas/HFS of Humble, LLC) (31.5% of cash flow)</b> Interest in Unified Housing Foundation Inc.	12.00%	12/32	Excess cash flow	15,756	8,836	6,369	—
<b>Unified Housing Foundation, Inc. (Lakeshore Villas/HFS of Humble, LLC)</b>	12.00%	12/32	Excess cash flow	15,965	2,959	2,732	—

100% Interest in HFS of Humble, LLC <b>Unified Housing Foundation, Inc. (Limestone Ranch)</b>	12.00%	12/32	Excess cash flow	18,641	12,335	7,953	—
100% Interest in UH of Vista Ridge, LLC <b>Unified Housing Foundation, Inc. (Reserve at White Rock I)</b>	12.00%	12/32	Excess cash flow	15,640	2,794	2,485	—
100% Interest in UH of Harvest Hill I, LLC <b>Unified Housing Foundation, Inc. (Reserve at White Rock II)</b>	12.00%	12/32	Excess cash flow	14,026	2,843	2,555	—
100% Interest in UH of Harvest Hill, LLC <b>Unified Housing Foundation, Inc. (Timbers of Terrell)</b>	12.00%	12/32	Excess cash flow	7,294	1,702	1,323	—
100% Interest in UH of Terrell, LLC <b>Unified Housing Foundation, Inc. (Tivoli)</b>	12.00%	12/32	Excess cash flow	10,398	12,761	7,966	—
100% Interest in UH of Tivoli, LLC <b>Unified Housing Foundation, Inc. (Trails at White Rock)</b>	12.00%	12/32	Excess cash flow	21,712	4,245	3,815	—
100% Interest in UH of Harvest Hill III, LLC <b>William H. Ingram</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P. <b>William S. Urkiel</b>	10.00%	09/17	Interest only paid quarterly.	—	97	97	—
Class A limited partnership interests in Edina Park Plaza Associates, L.P. <b>Willingham Revocable Trust</b>	10.00%	09/17	Interest only paid quarterly.	—	96	96	—

Class A limited  
 partnership interests in  
 Edina Park Plaza  
 Associates, L.P.

<b>Various related party notes</b>	various	various	Excess cash flow	—	1,349	1,349	—
<b>Various non-related party notes</b>	various	various		—	496	796	—

67

## SCHEDULE IV

(Continued)

**AMERICAN REALTY INVESTORS, INC.**  
**MORTGAGE LOANS**  
**December 31, 2017**

Description	Interest Rate	Final Maturity Date	Periodic Payment Terms	Prior Liens	Face Amount of Mortgage	Carrying Amount of Mortgage	Principal or Loans Subject to Delinquent Principal or Interest
(dollars in thousands)							
Leman Development, Ltd. <sup>(1)</sup>	0.00%	N/A		—	1,500	1,500	—
One Realco Corporation <sup>(1)</sup>	3.00%	01/17	Interest and principal due at maturity.	—	10,000	7,000	—
Oulan-Chikh Family Trust	8.00%	03/21		—	174	174	—
Realty Advisors Management, Inc.	2.28%	12/16	Interest only paid quarterly.	—	20,387	20,387	—
Unified Housing Foundation, Inc. (Lakeshore Villas/HFS of Humble, LLC) (68.5% of cash flow)	12.00%	12/32	Excess cash flow	15,965	2,189	2,000	—
Unified Housing Foundation, Inc.	12.00%	12/18	Excess cash flow	—	3,994	3,994	—
Unified Housing Foundation, Inc.	12.00%	12/18	Excess cash flow	—	6,407	6,407	—
Unified Housing Foundation, Inc.	12.00%	06/20	Excess cash flow	—	5,760	5,760	—
Various related party notes	various	various	Excess cash flow	—	1,814	465	—
Various non-related party notes	various	various		—	16,048	15,252	—
						\$ 117,913	
			Accrued interest			9,952	
			Allowance for estimated losses			(15,770 )	
						<b>\$ 112,095</b>	

(1) Fully reserved

68

**SCHEDULE IV****AMERICAN REALTY INVESTORS, INC.****MORTGAGE LOANS****As of December 31,**

	2017	2016	2015
		(dollars in thousands)	
Balance at January 1,	\$143,601	\$137,280	\$152,645
Additions			
New mortgage loans	15,741	11,703	18,055
Increase (decrease) of interest receivable on mortgage loans	581	13,835	11,130
Deductions			
Amounts received	(32,058 )	(19,217 )	(16,486 )
Non-cash reductions	—	—	(28,064 )
Balance at December 31,	\$127,865	\$143,601	\$137,280

69

**ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

None.

**ITEM 9A.**

***CONTROLS AND PROCEDURES***

**Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our Principal Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e)) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Principal Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our Principal Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

**Management’s Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention or overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

Management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2017. In making this assessment, management used the criteria set forth in *Internal Control—Integrated Framework*

issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on management's assessments and those criteria, management has concluded that Company's internal control over financial reporting was effective as of December 31, 2017.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial report. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

### **Changes in Internal Control over Financial Reporting**

In preparation for management's report on internal control over financial reporting, we documented and tested the design and operating effectiveness of our internal control over financial reporting. There were no changes in our internal controls over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f)) that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. *OTHER INFORMATION***

**Not applicable.**



## **PART III**

### **ITEM 10. *DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE***

#### **Directors**

The affairs of ARL are managed by a Board of Directors. The Directors are elected at the annual meeting of stockholders or are appointed by the incumbent Board and serve until the next annual meeting of stockholders or until a successor has been elected or appointed.

It is the Board's objective that a majority of the Board consists of independent directors. For a Director to be considered independent, the Board must determine that the Director does not have any direct or indirect material relationship with ARL. The Board has established guidelines to assist it in determining director independence which conform to, or are more exacting than, the independence requirements in the New York Stock Exchange listing rules. The independence guidelines are set forth in ARL's "Corporate Governance Guidelines". The text of this document has been posted on ARL's Internet website at ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)) and is available in print to any shareholder who requests it. In addition to applying these guidelines, the Board will consider all relevant facts and circumstances in making an independence determination.

ARL has adopted a code of conduct that applies to all Directors, officers and employees, including our principal executive officer, principal financial officer, and principal accounting officer. Stockholders may find our code of conduct on our website by going to our website address at ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)). We will post any amendments to the code of conduct, as well as any waivers that are required to be disclosed by the rules of the SEC or the New York Stock Exchange, on our website.

Our Board of Directors has adopted charters for our Audit, Compensation, and Governance and Nominating Committees of the Board of Directors. Stockholders may find these documents on our website by going to the website address at ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)). You may also obtain a printed copy of the materials referred to by contacting us at the following address:

American Realty Investors, Inc.

Attn: Investor Relations

1603 LBJ Freeway, Suite 800

Dallas, Texas 75234

Telephone: 469-522-4200

All members of the Audit Committee and the Governance and Nominating Committee must be independent directors. Members of the Audit Committee must also satisfy additional independence requirements, which provide (i) that they may not accept, directly or indirectly, any consulting, advisory, or compensatory fee from ARL or any of its subsidiaries other than their Director's compensation (other than in their capacity as a member of the Audit Committee, the Board of Directors, or any other committee of the Board), and (ii) no member of the Audit Committee may be an "affiliated person" of ARL or any of its subsidiaries, as defined by the Securities and Exchange Commission.

The current Directors of ARL are listed below, together with their ages, terms of service, all positions and offices with ARL and its advisor Pillar, their principal occupations, business experience, and directorships with other companies during the last five years or more. The designation "affiliated", when used below with respect to a Director, means that the Director is an officer, director, or employee of Pillar, an officer of the Company, or an officer or director of a related party of the Company. The designation "independent," when used below with respect to a Director, means that the Director is neither an officer of the Company nor a director, officer, or employee of Pillar (but may be a director of the Company), although the Company may have certain business or professional relationships with such Director as discussed in Part III, Item 13. "Certain Relationships and Related Transactions and Director Independence".

**HENRY A. BUTLER**, age 67, Director, Affiliated, since February 2011 and Chairman of the Board since May 2011

Mr. Butler has served as Vice President Land Sales for Pillar Income Asset Management, LLC since April 2011, and its predecessor, Prime Income Asset Management, LLC from July 2003 to April 2011. Mr. Butler has been a Director of the Company since February 2011 and Chairman of the Board since May 2011. He has also served as Chairman of the Board since May 2009 and as a Director since July 2003 of IOR and Chairman of the Board since May 2009 and a Director since December 2001 of TCI.

**ROBERT A. JAKUSZEWSKI**, age 55, Director, Independent, since March 2004.

Mr. Jakuszewski is currently has served as a Territory Manager for Artesa Labs since April 2015. He was a Medical Specialist from January 2014 to April 2015 for VAYA Pharma, Inc., Senior Medical Liaison from January 2013 to July 2013 for Vein Clinics of America, and the Vice President of Sales and Marketing from September 1998 to December 2012 for New Horizons Communications, Inc. Mr. Jakuszewski has been a Director of the Company since March 2004. He has also been a Director of IOR since November 2005 and a Director of TCI since November 2005.



**TED R. MUNSELLE**, age 62, Director, Independent, since May 2009

Mr. Munselle has been Vice President and Chief Financial Officer of Landmark Nurseries, Inc. since October 1998. On February 17, 2012, he was appointed as a member of the Board of Directors for Spindletop Oil & Gas Company and as Chairman of their Audit Committee. Spindletop's stock is traded on the Over-the-Counter (OTC) market. Mr. Munselle has been a Director of the Company since May 2009. He has also served as Director of IOR since February 2004 and Director of TCI since February 2004. Mr. Munselle is qualified as an Audit Committee financial expert within the meaning of SEC regulations and the Board of Directors of IOR has determined that he has accounting and related financial management expertise within the meaning of the listing standards of the NYSE American. Mr. Munselle is a Certified Public Accountant.

**RAYMOND D. ROBERTS, SR.**, age 86, Director, Independent, since June 2016

Mr. Roberts is currently retired. Mr. Roberts has served as Director of the Company since June 2, 2016. He has also served as Director of ARL and TCI since June 2, 2016. For more than five years prior to December 31, 2014, he was Director of Aviation of Steller Aviation, Inc., a privately held corporation engaged in the business of aircraft (Boeing 737) and logistical management.

### **Board Meetings and Committees**

The Board of Directors held eight meetings during 2017. For such year, no incumbent Director attended fewer than 75% of the aggregate of (1) the total number of meetings held by the Board during the period for which he/she had been a Director and (2) the total number of meetings held by all committees of the Board on which he/she served during the periods that he/she served. Under ARL's Corporate Governance Guidelines, each Director is expected to dedicate sufficient time, energy and attention to ensure the diligent performance of his or her duties, including by attending meetings of the stockholders of the Company, the Board and Committees of which he is a member. The Board of Directors has standing Audit, Compensation, and Governance and Nominating Committees.

*Audit Committee.* The current Audit Committee was formed on February 19, 2004, and its function is to review ARL's operating and accounting procedures. The charter of the Audit Committee has also been adopted by the Board. The charter of the Audit Committee was adopted on February 19, 2004 and is available on the company's investor relations website ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)). The Audit Committee is an "audit committee" for purposes of Section 3(a) (58) of the Securities Exchange Act of 1934. The current members of the Audit Committee, all of whom are independent within the meaning of the SEC Regulations, the listing standards of the New York Stock Exchange, Inc., and ARL's Corporate Governance Guidelines, are Messrs. Jakuszewski, Munselle (Chairman) and Roberts.

Mr. Ted R. Munselle, a member of the Committee, is qualified as an Audit Committee financial expert within the meaning of SEC Regulations, and the Board has determined that he has accounting and related financial management expertise within the meaning of the listing standards of the New York Stock Exchange, Inc. All of the members of the Audit Committee meet the experience requirements of the listing standards of the listing standards of the New York Stock Exchange. The Audit Committee met five times during 2017.

*Governance and Nominating Committee.* The Governance and Nominating Committee is responsible for developing and implementing policies and practices relating to corporate governance, including reviewing and monitoring implementation of ARL's Corporate Governance Guidelines. In addition, the Committee develops and reviews background information on candidates for the Board and makes recommendations to the Board regarding such candidates. The Committee also prepares and supervises the Board's annual review of director independence and the Board's performance self-evaluation. The Charter of the Governance and Nominating Committee was adopted on March 22, 2004. The current members of the Committee are Messrs. Jakuszewski (Chairman), Roberts and Munselle. The Governance and Nominating Committee met two times during 2017.

*Compensation Committee.* The Compensation Committee is responsible for overseeing the policies of the Company relating to compensation to be paid by the Company to the Company's principal executive officer and any other officers designated by the Board and make recommendations to the Board with respect to such policies, produce necessary reports and executive compensation for inclusion in the Company's Proxy Statement in accordance with applicable rules and regulations and to monitor the development and implementation of succession plans for the principal executive officers and other key executives and make recommendations to the Board with respect to such plans. The charter of the Compensation Committee was adopted on March 22, 2004, and is available on the Company's Investor Relations website ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)). The current members of the Compensation Committee are Messrs. Roberts (Chairman), Jakuszewski and Munselle. All of the members of the Compensation Committee are independent within the meaning of the listing standards of the NYSE American and the Company's Corporate Governance Guidelines. The Compensation Committee is to be comprised of at least two directors who are independent of Management and the Company. The Compensation Committee met two times during 2017.

The members of the Board of Directors on the date of this Report and the Committees of the Board on which they serve are identified below:

	Audit Committee	Governance and Nominating Committee	Compensation Committee
Robert A. Jakuszewski	X	Chair	X
Ted R. Munselle	Chair	X	X
Raymond D. Roberts Sr.	X	X	Chair
Henry A. Butler			

### **Presiding Director**

In March 2004, the Board created a new position of presiding director, whose primary responsibility is to preside over periodic executive sessions of the Board in which Management directors and other members of Management do not participate. The presiding director also advises the Chairman of the Board and, as appropriate, Committee Chairs with respect to agendas and information needs relating to Board and Committee meetings, provides advice with respect to the selection of Committee Chairs and performs other duties that the Board may from time to time delegate to assist the Board in fulfillment of its responsibilities.

The day following the annual meeting of stockholders held December 13, 2017 representing all stockholders of record dated November 2, 2017, the full Board met and re-appointed Ted R. Munselle as Presiding Director, to serve in such position until the Company's next annual meeting of stockholders to be held subsequently in 2018.

### **Determination of Director's Independence**

In February 2004, the Board adopted its Corporate Governance Guidelines. The Guidelines adopted by the Board meet or exceed the new listing standards adopted during that year by the New York Stock Exchange. The full text of the Guidelines can be found on the Company's Investor Relations website ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)).

Pursuant to the Guidelines, the Board undertook its annual review of director independence in March 8, 2016, and during this review, the Board considered transactions and relationships between each director or any member of his or her immediate family and ARL and its subsidiaries and related parties, including those reported under Certain Relationships and Related Transactions below. The Board also examined transactions and relationships between directors or their related parties and members of ARL's senior management or their related parties. As provided in the Guidelines, the purpose of such review was to determine whether such relationships or transactions were inconsistent

with the determination that the director is independent.

As a result of this review, the Board affirmatively determined of the then directors, Messrs. Munselle, Jakuszewski and Roberts are each independent of the Company and its Management under the standards set forth in the Corporate Governance Guidelines.

## **Executive Officers**

Executive officers of the Company are listed below, all except one of whom are employed by Pillar. Mr. Bertcher is employed by New Concept Energy, Inc (“NCE”). None of the executive officers receive any direct remuneration from the Company nor do any hold any options granted by the Company. Their positions with the Company are not subject to a vote of stockholders. In addition to the following executive officers, the Company has several vice presidents and assistant secretaries who are not listed herein. The ages, terms of service and all positions and offices with the Company, Pillar, other related entities, other principal occupations, business experience and directorships with other publicly held companies during the last five years or more are set forth below. No family relationships exist among any of the executive officers or directors of the Company.

### **DANIEL J. MOOS, 67**

Mr. Moos has served as President since April 2007 and Chief Executive Officer since March 2010 of IOR, ARL and TCI. Mr. Moos has also served as Prime’s President since April 2007, Secretary since June 2011 and Treasurer since October 2013. He has also served as a Director since December 2016, President since December 2010, Chief Executive Officer since March 2011 and Treasurer since October 2013 of Pillar.

### **GENE S. BERTCHER, 69**

Mr. Bertcher has served as Executive Vice President since February 2008, Chief Financial Officer since May 2008 and Treasurer since October 2013 of IOR, ARL and TCI. Mr. Bertcher has also served in the following capacities for NCE, a Nevada corporation which has its common stock listed on the NYSE American: Director since June 1999, Chairman of the Board since December 2006, Chief Executive Officer since December 2006, President since November 2004, Chief Financial Officer since November 1989, Treasurer since November 1989 and Secretary since October 2012. Mr. Bertcher has been employed by NCE since November 1989. He is a Certified Public Accountant.

**LOUIS J. CORNA, 70**

Mr. Corna has served as Executive Vice President, General Counsel/Tax Counsel and Secretary since February 2004 of IOR, ARL and TCI. He has also been Executive Vice President-Tax since April 2011 and Secretary since December 2010 of Pillar. Mr. Corna was also a Director and Vice President from June 2004 to December 2010 and Secretary from January 2005 to December 2010 of First Equity Properties, Inc., a Nevada corporation with securities registered under Section 12(g) of the Exchange Act.

**Code of Ethics**

ARL has adopted a code of ethics entitled “Code of Business Conduct and Ethics” that applies to all directors, officers, and employees (including those of the contractual Advisor to ARL). In addition, ARL has adopted a code of ethics entitled “Code of Ethics for Senior Financial Officers” that applies to the principal executive officer, president, principal financial officer, chief financial officer, principal accounting officer, and controller. The text of these documents has been posted on ARL’s internet website at ([www.americanrealtyinvest.com](http://www.americanrealtyinvest.com)) and are available in print to any stockholder who requests them.

**Compliance with Section 16(a) of the Securities Exchange Act of 1934**

Under the securities laws of the United States, ARL’s Directors, executive officers, and any persons holding more than 10% of ARL’s shares of common stock are required to report their ownership and any changes in that ownership to the Securities and Exchange Commission (the “Commission”). Specific due dates for these reports have been established and ARL is required to report any failure to file by these dates. All of these filing requirements were satisfied by ARL’s directors and executive officers and 10% holders during the fiscal year ended December 31, 2014. In making these statements, ARL has relied on the written representations of its incumbent Directors and executive officers and its 10% holders and copies of the reports that they have filed with the Commission.

**The Advisor**

Pillar has been ARL’s Advisor and Cash Manager since April 30, 2011. Although the Board of Directors is directly responsible for managing the affairs of ARL, and for setting the policies which guide it, the day-to-day operations of ARL are performed by Pillar, as the contractual advisor, under the supervision of the Board. Pillar’s duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities



and arranging debt and equity financing for the Company with third party lenders and investors. Additionally, Pillar serves as a consultant to the Board with regard to their decisions in connection with ARL's business plan and investment policy. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. "Directors, Executive Officers and Corporate Governance – The Advisor". ARL has no employees and as such, employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Pillar is a Nevada corporation, the sole shareholder of which is Realty Advisors, LLC, a Nevada limited liability company, the sole member of which is RAI, a Nevada corporation, the sole shareholder of which is MRHI, a Nevada corporation, the sole shareholder of which is a trust known as the May Trust.

The May Trust is a Trust, the beneficiaries of which are the children of Gene E. Phillips. Mr. Phillips is not an officer, manager or Director of Pillar, Realty Advisors, LLC, RAI, MRHI or ARL, nor is he a Trustee of the May Trust.

Under the Advisory Agreement, Pillar is required to annually formulate and submit, for Board approval, a budget and business plan containing a twelve-month forecast of operations and cash flow, a general plan for asset sales and purchases, lending, foreclosure and borrowing activity, and other investments. Pillar is required to report quarterly to the Board on ARL's performance against the business plan. In addition, all transactions require prior Board approval, unless they are explicitly provided for in the approved business plan or are made pursuant to authority expressly delegated to Pillar by the Board.

The Advisory Agreement also requires prior Board approval for the retention of all consultants and third party professionals, other than legal counsel. The Advisory Agreement provides that Pillar shall be deemed to be in a fiduciary relationship to the ARL stockholders; contains a broad standard governing Pillar's liability for losses incurred by ARL; and contains guidelines for Pillar's allocation of investment opportunities as among itself, ARL and other entities it advises. Pillar is a company of which Messrs. Moos, Bertcher and Corna serve as executive officers.

The Advisory Agreement with Pillar provides for Pillar to be responsible for the day-to-day operations of ARL and for Pillar to receive, as compensation for basic management and advisory services, a gross asset fee of 0.0625% per month (0.75% per annum) of the average of the gross asset value (total assets less allowance for amortization, depreciation or depletion and valuation reserves).

In addition to base compensation, Pillar receives the following forms of additional compensation:

(1) an annual net income fee equal to 7.5% of ARL's net income as an incentive for successful investment and management of the Company's assets;

(2) an annual incentive sales fee to encourage periodic sales of appreciated real property at optimum value equal to 10.0% of the amount, if any, by which the aggregate sales consideration for all real estate sold by ARL during such fiscal year exceeds the sum of:

(a) the cost of each such property as originally recorded in ARL's books for tax purposes (without deduction for depreciation, amortization or reserve for losses);

(b) capital improvements made to such assets during the period owned; and

(c) all closing costs (including real estate commissions) incurred in the sale of such real estate; provided however, no incentive fee shall be paid unless (a) such real estate sold in such fiscal year, in the aggregate, has produced an 8.0% simple annual return on the net investment including capital improvements, calculated over the holding period before depreciation and inclusive of operating income and sales consideration, and (b) the aggregate net operating income from all real estate owned for each of the prior and current fiscal years shall be at least 5.0% higher in the current fiscal year than in the prior fiscal year;

(3) an acquisition commission, from an unaffiliated party of any existing mortgage or loan, for supervising the acquisition, purchase or long-term lease of real estate equal to the lesser of:

(a) up to 1.0% of the cost of acquisition, inclusive of commissions, if any, paid to non-affiliated brokers; or

(b) the compensation customarily charged in arm's-length transactions by others rendering similar property acquisition services as an ongoing public activity in the same geographical location and for comparable property, provided that the aggregate purchase price of each property (including acquisition fees and real estate brokerage commissions) may not exceed such property's appraised value at acquisition;

- a construction fee equal to 6.0% of the so-called "hard costs" only of any costs of construction on a completed basis, based upon amounts set forth as approved on any architect's certificate issued in connection with such construction, which fee is payable at such time as the applicable architect certifies other costs for payment to third parties. The
- (4) phrase "hard costs" means all actual costs of construction paid to contractors, subcontractors and third parties for materials or labor performed as part of the construction but does not include items generally regarded as "soft costs," which are consulting fees, attorneys' fees, architectural fees, permit fees and fees of other professionals; and
- (5) reimbursement of certain expenses incurred by the advisor in the performance of advisory services.

The Advisory Agreement also provides that Pillar receive the following forms of compensation:

- (1) a mortgage or loan acquisition fee with respect to the acquisition or purchase from an unaffiliated party of any existing mortgage loan by ARL equal to the lesser of:
- (a) 1.0% of the amount of the mortgage or loan purchased; or
- (b) a brokerage or commitment fee which is reasonable and fair under the circumstances. Such fee will not be paid in connection with the origination or funding of any mortgage loan by ARL; and
- (2) a mortgage brokerage and equity refinancing fee for obtaining loans or refinancing on properties equal to the lesser of:
- (a) 1.0% of the amount of the loan or the amount refinanced; or
- (b) a brokerage or refinancing fee which is reasonable and fair under the circumstances; provided, however, that no such fee shall be paid on loans from Pillar without the approval of ARL's Board of Directors. No fee shall be paid on loan extensions.

Under the ARL Advisory Agreement, all or a portion of the annual advisory fee must be refunded by the Advisor if the operating expenses of ARL (as defined in the Advisory Agreement) exceed certain limits specified in the Advisory Agreement based on the book value, net asset value, and net income of ARL during the fiscal year.

The ARL Advisory Agreement requires Pillar to pay to ARL one-half of any compensation received from third parties with respect to the origination, placement or brokerage of any loan made by ARL; provided, however, that the compensation retained by Pillar shall not exceed the lesser of (1) 2.0% of the amount of the loan commitment or (2) a loan brokerage and commitment fee which is reasonable and fair under the circumstances.

The ARL Advisory Agreement further provides that Pillar shall bear the cost of certain expenses of its employees, excluding fees paid to ARL's Directors; rent and other office expenses of both Pillar and ARL (unless ARL maintains office space separate from that of Pillar); costs not directly identifiable to ARL's assets, liabilities, operations, business or financial affairs; and miscellaneous administrative expenses relating to the performance by Pillar of its duties under the Advisory Agreement.

If and to the extent that ARL shall request Pillar, or any director, officer, partner, or employee of Pillar, to render services for ARL other than those required to be rendered by the Advisory Agreement, Pillar separately would be compensated for such additional services on terms to be agreed upon between such party and ARL from time to time. As discussed below, under "Property Management and Real Estate Brokerage," effective January 1, 2011, Regis Realty Prime, LLC, dba Regis Property Management, LLC ("Regis"), the sole member of which is Realty Advisors, LLC, manages our commercial properties and provides brokerage services under similar terms as the previous agreements with Triad and Regis Realty I.

ARL entered into a Cash Management Agreement with Pillar on April 30, 2011, to further define the administration of the Company's day-to-day investment operations, relationship contacts, flow of funds and deposit and borrowing of funds. Under the Cash Management Agreement, all funds of the Company are delivered to Pillar which has a deposit liability to the Company and is responsible for payment of all payables and investment of all excess funds which earn interest at the Wall Street Journal prime rate plus 1.0% per annum, as set quarterly on the first day of each calendar quarter. Borrowings for the benefit of the Company bear the same interest rate. The term of the Cash Management Agreement is coterminous with the Advisory Agreement, and is automatically renewed each year unless terminated with the Advisory Agreement. ARL's management believes that the terms of the Advisory Agreement are at least as fair as could be obtained from unaffiliated third parties.

Situations may develop in which the interests of ARL are in conflict with those of one or more directors or officers in their individual capacities, or of Pillar, or of their respective related parties. In addition to services performed for ARL, as described above, Pillar actively provides similar services as agent for, and advisor to, other real estate enterprises, including persons and entities involved in real estate development and financing, including TCI and IOR. The Advisory Agreement provides that Pillar may also serve as advisor to other entities.

As Advisor, Pillar is a fiduciary of ARL's public investors. In determining to which entity a particular investment opportunity will be allocated, Pillar will consider the respective investment objectives of each entity and the

appropriateness of a particular investment in light of each such entity's existing mortgage note and real estate portfolios and business plan. To the extent any particular investment opportunity is appropriate to more than one such entity, such investment opportunity will be allocated to the entity that has had funds available for investment for the longest period of time, or, if appropriate, the investment may be shared among various entities. See Part III, Item 13 "Certain Relationships and Related Transactions, and Director Independence."

The terms of TCI's Advisory and Cash Management Agreements with Pillar are substantially the same as those of ARL's Advisory and Cash Management Agreements.

Pillar may assign the Advisory Agreement only with the prior consent of ARL.

The principal executive officers and directors of Pillar are set forth below:

Name	Directors/Officer(s)
Daniel J. Moos	President, Chief Executive Officer, Treasurer, Director
Gene S. Bertcher	Executive Vice President, Chief Accounting Officer
Louis J. Corna	Executive Vice President, Secretary, Tax Counsel, General Legal Counsel

### **Property Management**

Regis Realty Prime, LLC, dba Regis Property Management, LLC ("Regis"), the sole member of which is Realty Advisors, LLC, manages our commercial properties for a fee of 3.0% or less of the monthly gross rents collected on the commercial properties it manages, and leasing commissions of 6.0% or less in accordance with the terms of its property-level management agreement.

ARL engages third-party companies to lease and manage our apartment properties for a fee of 6.0% or less of the monthly gross rents collected on the residential properties under their management.

## Real Estate Brokerage

Regis provides real estate brokerage services to ARL and receives brokerage commissions of 3% or less of transaction amounts.

Regis also provides real estate brokerage services to TCI under terms which differ from ARL. TCI's brokerage agreement is computed on a sliding scale as listed below:

- (1) maximum fee of 4.5% on the first \$2.0 million of any purchase or sale transaction of which no more than 3.5% is to be paid to Regis;
- (2) maximum fee of 3.5% on transaction amounts between \$2.0 million-\$5.0 million of which no more than 3.0% is to be paid to Regis;
- (3) maximum fee of 2.5% on transaction amounts between \$5.0 million-\$10.0 million of which no more than 2.0% is to be paid to Regis; and
- (4) a maximum fee of 2.0% on transaction amounts in excess of \$10.0 million of which no more than 1.5% is to be paid to Regis.

## ITEM 11. EXECUTIVE COMPENSATION

ARL has no employees, payroll, or benefit plans, and pays no compensation to its executive officers. The Directors and executive officers of ARL, who are also officers or employees of Pillar, ARL's advisor, are compensated by Pillar. Such affiliated Directors and executive officers perform a variety of services for Pillar and the amount of their compensation is determined solely by Pillar. Pillar does not allocate the cash compensation of its officers among the various entities for which it serves as advisor. See Part III, Item 10. "Directors, Executive Officers and Corporate Governance" for a more detailed discussion of compensation payable to Pillar by ARL.

The only remuneration paid by ARL is to those directors who are not officers or employees of Pillar or its related companies. The Independent Directors (1) review the business plan of ARL to determine that it is in the best interest of ARL's stockholders, (2) review the advisory contract, (3) supervise the performance of the advisor and review the reasonableness of the compensation paid to the advisor in terms of the nature and quality of services performed,

(4) review the reasonableness of the total fees and expenses of ARL and (5) select, when necessary, a qualified independent real estate appraiser to appraise properties acquired

Effective February 2011 each non-affiliated Director is entitled to receive an annual retainer of \$20,000, with the Chairman of the Audit Committee to receive a one-time annual fee of \$500. Directors who are also employees of the Company or its advisor receive no additional compensation for service as a Director.

During 2017, \$60,500 was paid to non-employee Directors in total Directors' fees. The fees paid to the directors are as follows: Robert A. Jakuszewski \$20,000; Ted R. Munselle \$20,500; and Raymond D. Roberts, Sr. \$20,000.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT****Securities Authorized for Issuance Under Equity Compensation Plans**

The following table provides information as of December 31, 2017 regarding compensation plans under which equity securities of ARL are authorized for issuance.

**Security Ownership of Certain Beneficial Owners**

The following table sets forth the ownership of ARL's common stock both beneficially and of record, both individually and in the aggregate, for those persons or entities known by ARL to be the owner of more than 5.0% of the shares of ARL's common stock as of the close of business on March 30, 2018.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership*		Approximate Percent of Class**	
Prime Stock Holdings, Inc. 1603 LBJ Freeway, Suite 800 Dallas, Texas 75234	1,459,828	(1)	9.41	%
Realty Advisors, Inc. 1603 LBJ Freeway, Suite 800 Dallas, Texas 75234	13,292,037	(1)(2)(3)	85.68	%
Realty Advisors LLC 1603 LBJ Freeway, Suite 800 Dallas, Texas 75234	9,303,066	(1)(2)	59.96	%

\* "Beneficial Ownership" means the sole or shared power to vote, or to direct the voting of, a security or investment power with respect to a security, or any combination thereof.

\*\* Percentages are based upon 15,514,360 shares outstanding as of March 30, 2018.

(1) Includes 1,459,828 shares owned by RA Stock Holdings, Inc. ("RASH"), formerly One Realco Stock Holdings, a wholly-owned subsidiary of Realty Advisors, LLC ("RALLC"), over which each of the directors of RASH, Mickey Ned Phillips, may be deemed to be the beneficial owners by virtue of their positions as directors of RASH. The directors of RASH disclaim beneficial ownership of such.



Includes 7,843,238 shares owned directly by RALLC (“RALLC”), over which each of the managers, Gene S. (2) Bertcher and Daniel J. Moos, may be deemed to be beneficial owners by virtue of their positions as managers of RALLC. The managers of RALLC disclaim beneficial ownership of such shares.

78

(3) Includes 3,988,971 shares owned directly by Realty Advisors, Inc. "RAI" over which each of the directors and officers of RAI may be deemed beneficial owners, all of which disclaim beneficial ownership.

79

*Security Ownership of Management.* The following table sets forth the ownership of shares of ARL's common stock, both beneficially and of record, both individually in the aggregate, for the Directors and executive officers of ARL, as of the close of business on March 30, 2018.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership*	Approximate Percent of Class **
Gene S. Bertcher	13,521,251 (1)(2)(3)(4)	87.15 %
Henry A. Butler	229,214 (3)	1.48 %
Louis J. Corna	13,521,251 (1)(2)(3)(4)	87.15 %
Robert A. Jakuszewski	229,214 (3)	1.48 %
Daniel J. Moos	13,526,251 (1)(2)(3)(4)(5)	87.19 %
Ted R. Munselle	229,214 (3)	1.48 %
Raymond D. Roberts, Sr.	229,214 (3)	1.48 %
All Directors and Executive Officers as a group (7 persons)	13,526,251 (1)(2)(3)(4)(5)	87.19 %

\* "Beneficial Ownership" means the sole or shared power to vote, or to direct the voting of, a security or investment power with respect to a security, or any combination thereof.

\*\* Percentages are based upon 15,514,360 shares outstanding as of March 30, 2018.

Includes 7,843,238 shares owned direct by RALLC, over which the managers and executive offices of RALLC may be deemed to be the beneficial owners by virtue of their positions as managers and executive officers of RALLC; the managers and executive officers of RALLC disclaim beneficial ownership of such shares. Also (1) includes 3,988,971 shares owned direct by RAI, over which the executive officers of RAI may be deemed to be the beneficial owners by virtue of their positions; the executive officers of RAI disclaim beneficial ownership of such shares.

Includes 1,459,828 shares owned by (RASH), over which the executive officers of RASH may be deemed the (2) beneficial owners by virtue of their positions as executive officers of RASH; the executive officers of RASH disclaim beneficial ownership of such shares.

Includes 229,214 shares owned by Transcontinental Realty Investors, Inc. "TCI", over which the directors and (3) executive officers of TCI may be deemed to be the beneficial owners by virtue of their positions as directors and executive officers of TCI; the directors and executive officers of TCI disclaim beneficial ownership of such shares.

Includes 3,988,971 shares owned by RAI, over which the executive officers of RAI may be deemed to be the (4) beneficial owners by virtue of their positions as executive of RAI; the executive officers of RAI disclaim beneficial ownership of such shares.

(5) Daniel J. Moos owns directly 5,000 shares.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

### **Policies with Respect to Certain Activities**

Article 11 of ARL's Articles of Incorporation provides that ARL shall not, directly or indirectly, contract or engage in any transaction with (1) any director, officer or employee of ARL, (2) any director, officer or employee of the advisor, (3) the advisor, or (4) any affiliate or associate (as such terms are defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended) of any of the aforementioned persons, unless (a) the material facts as to the relationship among or financial interest of the relevant individuals or persons and as to the contract or transaction are disclosed to or are known by ARL's Board of Directors or the appropriate committee thereof and (b) ARL's Board of Directors or committee thereof determines that such contract or transaction is fair to ARL and simultaneously authorizes or ratifies such contract or transaction by the affirmative vote of a majority of independent directors of ARL entitled to vote thereon.

Article 11 defines an "Independent Director" (for purposes of that Article) as one who is neither an officer or employee of ARL, nor a director, officer or employee of ARL's advisor. This definition predates ARL's director independence guidelines adopted in February 2004.

ARL's policy is to have such contracts or transactions approved or ratified by a majority of the disinterested Directors with full knowledge of the character of such transactions, as being fair and reasonable to the stockholders at the time of such approval or ratification under the circumstances then prevailing. Such Directors also consider the fairness of such transactions to ARL. Management believes that, to date, such transactions have represented the best investments available at the time and they were at least as advantageous to ARL as other investments that could have been obtained.

ARL may enter into future transactions with entities, the officers, directors, or stockholders of which are also officers, directors, or stockholders of ARL, if such transactions would be beneficial to the operations of ARL and consistent with ARL's then-current investment objectives and policies, subject to approval by a majority of disinterested Directors as discussed above.

ARL does not prohibit its officers, directors, stockholders, or related parties from engaging in business activities of the types conducted by ARL.

### **Certain Business Relationships**

Pillar has been ARL's Advisor and Cash Manager since April 30, 2011. Although the Board of Directors is directly responsible for managing the affairs of ARL, and for setting the policies which guide it, the day-to-day operations of ARL are performed by Pillar, as the contractual advisor, under the supervision of the Board. Pillar's duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities and arranging debt and equity financing for the Company with third party lenders and investors. Additionally, Pillar serves as a consultant to the Board with regard to their decisions in connection with ARL's business plan and investment policy. Pillar also serves as an Advisor and Cash Manager to TCI and IOR. As the contractual advisor, Pillar is compensated by ARL under an Advisory Agreement that is more fully described in Part III, Item 10. "Directors, Executive Officers and Corporate Governance – The Advisor". ARL has no employees and as such, employees of Pillar render services to ARL in accordance with the terms of the Advisory Agreement.

Pillar is a Nevada corporation, the sole shareholder of which is Realty Advisors, LLC, a Nevada limited liability company, the sole member of which is RAI, a Nevada corporation, the sole shareholder of which is MRHI, a Nevada corporation, the sole shareholder of which is a trust known as the May Trust.

All of ARL's directors also serve as Directors of TCI and IOR. The executive officers of ARL also serve as executive officers of TCI and IOR. As such, they owe fiduciary duties to that entity as well as to Pillar under applicable law. TCI has the same relationship with Pillar, as does ARL. Mr. Bertcher is an officer, director and employee of NCE and as such also owes fiduciary duties to NCE as well as ARL, TCI and IOR under applicable law.

Regis Realty Prime, LLC, dba Regis Property Management, LLC ("Regis"), the sole member of which is Realty Advisors, LLC, manages our commercial properties for a fee of 3.0% or less of the monthly gross rents collected on the commercial properties it manages, and leasing commissions of 6.0% or less in accordance with the terms of its property-level management agreement.

ARL engages third-party companies to lease and manage our apartment properties for a fee of 6.0% or less of the monthly gross rents collected on the residential properties under their management.

At December 31, 2017, ARL owned approximately 77.68% of TCI's outstanding common stock and through its interest in TCI approximately 81.25% of IOR's outstanding common stock.

The Company is part of a tax sharing and compensating agreement with respect to federal income taxes between ARL, TCI and IOR and their subsidiaries. The expense (benefit) in each year was calculated based on the amount of losses absorbed by taxable income multiplied by the maximum statutory tax rate of 35%.

The Company's subsidiary, TCI, has a development agreement with Unified Housing Foundation, Inc. "UHF" a non-profit corporation that provides management services for the development of residential apartment projects in the future. The Company has also invested in surplus cash notes receivables from UHF and has sold several residential apartment properties to UHF in prior years. Due to this ongoing relationship and the significant investment in the performance of the collateral secured under the notes receivable, UHF has been determined to be a related party.

TCI is the primary guarantor, on a \$39.1 million mezzanine loan between UHF and a lender. In addition, ARL, and an officer of the Company are limited recourse guarantors of the loan. As of December 31, 2017 UHF was in compliance with the covenants to the loan agreement.

### **Related Party Transactions**

The Company has historically engaged in and may continue to engage in certain business transactions with related parties, including but not limited to asset acquisition and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in the best interest of our company.

In 2017, the Company paid advisory fees of \$10.9 million, net income fees of \$0.3 million, mortgage brokerage and equity refinancing fees of \$0.8 million, cost reimbursements of \$3.8 million and received interest of \$1.1 million from Pillar.

The Company paid property management fees, construction management fees and leasing commissions of \$0.9 million to Regis in 2017.

As of December 31, 2017, the Company had notes and interest receivables, net of allowances, of \$102.9 million and \$7.8 million, respectively, due from UHF, a related party. See Part 2, Item 8. Note 3. "Notes and Interest Receivable". During the current period, the Company recognized interest income of \$12.4 million, originated \$4.7 million, received principal payments of \$4.9 million and received interest payments of \$10.8 million from these related party notes receivables.



As of December 31, 2017, subsidiaries hold approximately 91 acres of land, at various locations that were sold to related parties in multiple transactions. These transactions are treated as “subject to sales contract” on the Consolidated Balance Sheets. Due to the related party nature of the transactions TCI has deferred the recording of the sales in accordance with ASC 360-20.

## Operating Relationships

The Company received rental revenue of \$0.7 million in each of the three years ended December 31, 2017 from Pillar and its related parties for properties owned by the Company.

## Advances and Loans

From time to time, ARL and its related parties have made advances to each other, which generally have not had specific repayment terms, did not bear interest, are unsecured, and have been reflected in ARL’s financial statements as other assets or other liabilities. ARL and the advisor charge interest on the outstanding balance of funds advanced to or from ARL. The interest rate, set at the beginning of each quarter, is the prime rate plus 1% on the average daily cash balances advanced. At December 31, 2017, Pillar owes ARL \$38.3 million.

### ITEM 14.

### *PRINCIPAL ACCOUNTING FEES AND SERVICES*

The following table sets forth the aggregate fees for professional services rendered to ARL for the years 2017 and 2016 by ARL’s principal accounting firms, Farmer, Fuqua and Huff, L.P., BDO Seidman, LLP and Swalm & Associates, PC:

<u>Type of Fee</u>	2017		2016	
	Farmer, Fuqua & Huff	Swalm & Associates	Farmer, Fuqua & Huff	Swalm & Associates
Audit Fees	\$881,183 <sup>(1)</sup>	\$ 72,136 <sup>(3)</sup>	\$881,576 <sup>(4)</sup>	\$ 60,551 <sup>(3)</sup>
Tax Fees	39,760 <sup>(2)</sup>	—	44,483 <sup>(5)</sup>	—
Total	\$920,943	\$ 72,136	\$926,059	\$ 60,551



- (1) Includes \$597,447 TCI
- (2) Includes \$39,760 TCI
- (3) All IOT
- (4) Includes \$575,563 TCI
- (5) Includes \$36,725 TCI

The audit fees for 2017 and 2016 were for professional services rendered for the audits and reviews of the consolidated financial statements of ARL and its subsidiaries. Tax fees for 2017 and 2016 were for services related to federal and state tax compliance and advice.

All services rendered by the principal auditors are permissible under applicable laws and regulations and were pre-approved by either the Board of Directors or the Audit Committee, as required by law. The fees paid to the principal auditors for the services described in the above table fall under the categories listed below:

*Audit Fees.* These are fees for professional services performed by the principal auditor for the audit of the Company's annual financial statements and review of financial statements included in the Company's 10-Q filings and services that are normally provided in connection with statutory and regulatory filing or engagements.

*Audit-Related Fees.* These are fees for assurance and related services performed by the principal auditor that are reasonably related to the performance of the audit or review of the Company's financial statements. These services include attestations by the principal auditor that are not required by statute or regulation and consulting on financial accounting/reporting standards. As of December 31, 2017 the company incurred \$0.3 million of audit related fees in connection to assurance and related services of a subsidiary.

*Tax Fees.* These are fees for professional services performed by the principal auditor with respect to tax compliance, tax planning, tax consultation, returns preparation, and review of returns. The review of tax returns includes the Company and its consolidated subsidiaries.

*All other Fees.* These are fees for other permissible work performed by the principal auditor that do not meet the above category descriptions

These services are actively monitored (as to both spending level and work content) by the Audit Committee to maintain the appropriate objectivity and independence in the principal auditor's core work, which is the audit of the Company's consolidated financial statements.

The Audit Committee has established policies and procedures for the approval and pre-approval of audit services and permitted non-audit services. The Audit Committee has the responsibility to engage and terminate ARL's independent auditors, to pre-approve their performance of audit services and permitted non-audit services, to approve all audit and non-audit fees, and to set guidelines for permitted non-audit services and fees. All the fees for 2017 and 2016 were pre-approved by the Audit Committee or were within the pre-approved guidelines for permitted non-audit services and fees established by the Audit Committee, and there were no instances of waiver of approved requirements or guidelines during the same periods.

Under the Sarbanes-Oxley Act of 2002 (the “SOX Act”) and the rules of the Securities and Exchange Commission (the “SEC”), the Audit Committee of the Board of Directors is responsible for the appointment, compensation, and oversight of the work of the independent auditor. The purpose of the provisions of the SOX Act and the SEC rules for the Audit Committee role in retaining the independent auditor is two-fold. First, the authority and responsibility for the appointment, compensation, and oversight of the auditors should be with directors who are independent of management. Second, any non-audit work performed by the auditors should be reviewed and approved by these same independent directors to ensure that any non-audit services performed by the auditor do not impair the independence of the independent auditor. To implement the provisions of the SOX Act, the SEC issued rules specifying the types of services that an independent may not provide to its audit client, and governing the Audit Committee’s administration of the engagement of the independent auditor. As part of this responsibility, the Audit Committee is required to pre-approve the audit and non-audit services performed by the independent auditor in order to assure that they do not impair the auditor’s independence. Accordingly, the Audit Committee has adopted a pre-approval policy of audit and non-audit services (the “Policy”), which sets forth the procedures and conditions pursuant to which services to be performed by the independent auditor are to be pre-approved. Consistent with the SEC rules establishing two different approaches to pre-approving non-prohibited services, the Policy of the Audit Committee covers pre-approval of audit services, audit-related services, international administration tax services, non-U.S. income tax compliance services, pension and benefit plan consulting and compliance services, and U.S. tax compliance and planning. At the beginning of each fiscal year, the Audit Committee will evaluate other known potential engagements of the independent auditor, including the scope of work proposed to be performed and the proposed fees, and approve or reject each service, taking into account whether services are permissible under applicable law and the possible impact of each non-audit service on the independent auditor’s independence from management. Typically, in addition to the generally pre-approved services, other services would include due diligence for an acquisition that may or may not have been known at the beginning of the year. The Audit Committee has also delegated to any member of the Audit Committee designated by the Board or the financial expert member of the Audit Committee responsibilities to pre-approve services to be performed by the independent auditor not exceeding \$25,000 in value or cost per engagement of audit and non-audit services, and such authority may only be exercised when the Audit Committee is not in session.



Schedule IV—Mortgage Loan Receivables on Real Estate

All other schedules are omitted because they are not applicable or because the required information is shown in the financial statements or the notes thereto.

**3. Incorporated Financial Statements**

Consolidated Financial Statements of Income Opportunity Realty Investors, Inc. (Incorporated by reference to Item 8. of Income Opportunity Realty Investors, Inc.’s Annual Report on Form 10-K for the year ended December 31, 2017).

Consolidated Financial Statements of Transcontinental Realty Investors, Inc. (Incorporated by reference to Item 8. of Transcontinental Realty Investors, Inc.’s Annual Report on Form 10-K for the year ended December 31, 2017).

(b) Exhibits.

The following documents are filed as Exhibits to this Report:

<b>Exhibit Number</b>	<b>Description</b>
3.1	Certificate of Restated 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).
3.2	Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc., dated August 29, 2000 (incorporate by reference to Exhibit 3.1 to the Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
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 B Cumulative Convertible Preferred Stock dated August 26, 2003 (incorporated by reference to Exhibit 3.3 to the Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
3.4	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 the Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).

Exhibit Number	Description
3.5	By-laws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4, filed on 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 Pillar Income Asset Management, LLC, dated April 30, 2011 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, dated April 30, 2011).
10.2	Second Amendment to Modification of Stipulation of Settlement dated October 17, 2001 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4, dated February 24, 2002).
14.0	Code of Ethics for Senior Financial Officers (incorporated by reference to Exhibit 14.0 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
21.1 *	Subsidiaries of the Registrant.
31.1 *	Rule 13a-14(a) Certification by Principal Executive Officer.
31.2 *	Rule 13a-14(a) Certification by Principal Financial Officer.
32.1 *	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith.



**SIGNATURES**

**Pursuant to the requirements of Section 13 or 15(d) 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.**

Dated: March 30, 2018

American Realty Investors, Inc.

By: /s/ Gene S. Bertcher  
**Executive Vice President and**

**Chief Financial Officer**

**(Principal Financial and Accounting Officer)**

**Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.**

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Henry A. Butler <b>Henry A. Butler</b>	Chairman of the Board and Director	March 30, 2018
/s/ Robert A. Jakuszewski <b>Robert A. Jakuszewski</b>	Director	March 30, 2018
/s/ Raymond D. Roberts, Sr. <b>Raymond D. Roberts, Sr.</b>	Director	March 30, 2018
/s/ Ted R. Munselle <b>Ted R. Munselle</b>	Director	March 30, 2018
/s/ Daniel J. Moos <b>Daniel J. Moos</b>	President and Chief Executive Officer (Principal Executive Officer)	March 30, 2018
/s/ Gene S. Bertcher <b>Gene S. Bertcher</b>	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2018



## ANNUAL REPORT ON FORM 10-K

### EXHIBIT INDEX

#### For the Year Ended December 31, 2017

- 3.1 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).
- 3.2 Certificate of Correction of Restated Articles of Incorporation of American Realty Investors, Inc., dated August 29, 2000 (incorporate by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
- 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 B Cumulative Convertible Preferred Stock dated August 26, 2003 (incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
- 3.4 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 the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
- 3.5 By-laws of American Realty Investors, Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-4, filed on 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).

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

- 10.1 Advisory Agreement between American Realty Investors, Inc. and Pillar Income Asset Management, LLC, dated April 30, 2011 (incorporated by reference to Exhibit 10.0 to the Registrant's Current Report on Form 8-K, dated April 30, 2011).
- 10.2 Second Amendment to Modification of Stipulation of Settlement dated October 17, 2001 (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-4, dated February 24, 2002).
- 14.0 Code of Ethics for Senior Financial Officers (incorporated by reference to Exhibit 14.0 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
- 21.1 \* Subsidiaries of the Registrant.
- 31.1 \* Rule 13a-14(a) Certification by Principal Executive Officer.
- 31.2 \* Rule 13a-14(a) Certification by Principal Financial Officer.
- 32.1 \* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.