

AMERICAN REALTY INVESTORS INC
Form 10-Q/A
May 17, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from _____ to _____

Commission File Number 001-15663

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

Nevada
(State or Other Jurisdiction of
Incorporation or Organization)

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

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

(469) 522-4200

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

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

Common Stock, \$.01 par value (Class)	11,525,389 (Outstanding at May 5, 2012)
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AMERICAN REALTY INVESTORS, INC.
FORM 10-Q
TABLE OF CONTENTS

	PAGE	
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Balance Sheets at March 31, 2012 (unaudited) and December 31, 2011	3
	Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011 (unaudited)	4
	Consolidated Statement of Shareholders' Equity for the three months ended March 31, 2012 (unaudited)	5
	Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2012 and 2011 (unaudited)	6
	Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011 (unaudited)	7
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	33
Item 4.	Controls and Procedures	33
PART II. OTHER INFORMATION		
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	34
Item 6.	Exhibits	34
SIGNATURES		35

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)

	March 31, 2012	December 31, 2011
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	\$ 1,081,349	\$ 1,120,122
Real estate held for sale at cost, net of depreciation (\$3,168 and \$1,752, for 2012 and 2011)	28,663	15,015
Real estate subject to sales contracts at cost, net of depreciation (\$10,000 and \$9,790 in 2012 and 2011)	45,956	49,982
Less accumulated depreciation	(160,628)	(158,489)
Total real estate	995,340	1,026,630
Notes and interest receivable		
Performing (including \$100,713 and \$104,969 in 2012 and 2011 from affiliates and related parties)	114,810	110,136
Non-performing (including \$3,279 and \$0 in 2012 and 2011 from affiliates and related parties)	9,160	4,787
Less allowance for estimated losses (including \$18,962 and \$8,962 in 2012 and 2011 from affiliates and related parties)	(23,383)	(13,383)
Total notes and interest receivable	100,587	101,540
Cash and cash equivalents	8,161	20,312
Investments in unconsolidated subsidiaries and investees	7,848	10,746
Other assets (including \$22 and \$11 in 2012 and 2011 from affiliates and related parties)	69,718	76,243
Total assets	\$ 1,181,654	\$ 1,235,471
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$ 833,969	\$ 855,619
Notes related to assets held-for-sale	20,089	13,830
Notes related to subject to sales contracts	40,615	44,516
Stock-secured notes payable and margin debt	26,486	26,898
Affiliate payables	638	10,294
Deferred gain (including \$77,227 and \$71,964 in 2012 and 2011 from sales to related parties)	79,072	78,750
Accounts payable and other liabilities (including \$1,861 and \$1,822 in 2012 and 2011 to affiliates and related parties)	94,663	110,307
	1,095,532	1,140,214
Shareholders' equity:		

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Preferred stock, \$2.00 par value, authorized 15,000,000 shares, issued and outstanding Series A, 3,353,954 shares in 2012 and 2011 (liquidation preference \$10 per share), including 900,000 shares in 2012 and 2011 held by subsidiaries	4,908	4,908
Common stock, \$.01 par value, authorized 100,000,000 shares; issued 11,941,174 shares and outstanding 11,525,389 shares in 2012 and in 2011	115	115
Treasury stock at cost; 415,785 shares in 2012 and 2011 and 234,314 and 236,587 shares held by TCI as of 2012 and 2011.	(6,395)	(6,395)
Paid-in capital	106,127	105,388
Retained earnings	(54,361)	(47,486)
Accumulated other comprehensive income	(786)	(786)
Total American Realty Investors, Inc. shareholders' equity	49,608	55,744
Non-controlling interest	36,514	39,513
Total equity	86,122	95,257
Total liabilities and equity	\$ 1,181,654	\$ 1,235,471

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

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

	For the Three Months Ended March 31,	
	2012	2011
	(dollars in thousands, except share and per share amounts)	
Revenues:		
Rental and other property revenues (including \$167 and \$0 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	\$30,318	\$27,918
Expenses:		
Property operating expenses(including \$307 and \$297 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	16,208	15,919
Depreciation and amortization	5,503	5,282
General and administrative(including \$922 and \$1,187 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	3,181	3,242
Provision on impairment of notes receivable and real estate assets	-	5,178
Advisory fee to affiliate	2,658	3,522
Total operating expenses	27,550	33,143
Operating income	2,768	(5,225)
Other income (expense):		
Interest income(including \$3,431 and \$466 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	3,340	668
Other income (including \$1,500 and \$0 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	1,628	1,214
Mortgage and loan interest (including \$922 and \$306 for the three months ended 2012 and 2011 respectively from affiliates and related parties)	(17,735)	(14,666)
Loss on sale of investments	(362)	-
Earnings from unconsolidated subsidiaries and investees	117	(95)
Total other expenses	(13,012)	(12,879)
Loss before gain on land sales, non-controlling interest, and taxes	(10,244)	(18,104)
Gain (loss) on land sales	(1,021)	5,344
Loss from continuing operations before tax	(11,265)	(12,760)
Income tax benefit	1,125	485
Net loss from continuing operations	(10,140)	(12,275)
Discontinued operations:		
Loss from discontinued operations	(375)	(2,750)
Gain on sale of real estate from discontinued operations	3,588	4,137
Income tax expense from discontinued operations	(1,125)	(485)
Net income from discontinued operations	2,088	902
Net loss	(8,052)	(11,373)
Net loss attributable to non-controlling interest	1,177	2,170
Net loss attributable to American Realty Investors, Inc.	(6,875)	(9,203)
Preferred dividend requirement	(613)	(617)

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Net loss applicable to common shares	\$ (7,488)	\$ (9,820)
Earnings per share - basic				
Loss from continuing operations	\$ (0.83)	\$ (0.93)
Income from discontinued operations	0.18		0.07	
Net loss applicable to common shares	\$ (0.65)	\$ (0.86)
Earnings per share - diluted				
Loss from continuing operations	\$ (0.83)	\$ (0.93)
Income from discontinued operations	0.18		0.07	
Net loss applicable to common shares	\$ (0.65)	\$ (0.86)
Weighted average common share used in computing earnings per share	11,525,389		11,493,115	
Weighted average common share used in computing diluted earnings per share	11,525,389		11,493,115	
Amounts attributable to American Realty Investors, Inc.				
Loss from continuing operations	\$ (8,963)	\$ (10,105)
Income from discontinued operations	2,088		902	
Net loss	\$ (6,875)	\$ (9,203)

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Three Months Ended March 31, 2012
(unaudited)
(dollars in thousands)

	Total Capital	Comprehensive Loss	Series A Preferred Stock	Common Stock Shares	Common Stock Amount	Treasury Stock	Paid-in Capital	Accumulated		
								Retained Earnings	Other Comprehensive Income (Loss)	Non-controlling Interest
Balance, December 31, 2011	\$95,257	\$(137,440)	\$4,908	11,941,174	\$115	\$(6,395)	\$105,388	\$(47,486)	\$(786)	\$39,513
Net loss	(8,052)	(8,052)	-	-	-	-	-	(6,875)	-	(1,177)
Sale of controlling interest	1,149	-	-	-	-	-	-	-	-	1,149
Acquisition of non-controlling interest	(69)	-	-	-	-	-	-	-	-	(69)
Sale of non-controlling interest	(1,468)	-	-	-	-	-	1,434	-	-	(2,902)
Distribution of non-controlling interest	(82)	-	-	-	-	-	(82)	-	-	-
Series A preferred stock cash dividend (\$1.00 per share)	(613)	-	-	-	-	-	(613)	-	-	-
Balance, March 31, 2012	\$86,122	\$(145,492)	\$4,908	11,941,174	\$115	\$(6,395)	\$106,127	\$(54,361)	\$(786)	\$36,514

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

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

	For the Three Months Ended March 31,	
	2012	2011
	(dollars in thousands)	
Net loss	\$(8,052)	\$(11,373)
Other comprehensive loss		
Unrealized loss on foreign currency translation	-	(786)
Unrealized gain (loss) on investment securities	-	-
Total other comprehensive loss	-	(786)
Comprehensive loss	(8,052)	(12,159)
Comprehensive loss attributable to non-controlling interest	1,177	2,170
Comprehensive loss attributable to American Realty Investors, Inc.	\$(6,875)	\$(9,989)

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

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

	For the Three Months Ended March 31,	
	2012	2011
	(dollars in thousands)	
Cash Flow From Operating Activities:		
Net loss	\$(8,052) \$(11,373)
Adjustments to reconcile net loss applicable to common shares to net cash used in operating activities:		
Gain on sale of land	1,021	(5,344)
Gain on sale of income producing properties	(3,588)	(4,137)
Depreciation and amortization	5,746	7,188
Provision for impairment of notes receivable and real estate assets	-	6,059
Amortization of deferred borrowing costs	917	1,108
Earnings from unconsolidated subsidiaries and investees	(117)	95
(Increase) decrease in assets:		
Accrued interest receivable	(2,544)	(740)
Other assets	-	827
Prepaid expense	68	919
Escrow	7,814	11,227
Rent receivables	(302)	(535)
Affiliate receivable	-	(4,048)
Increase (decrease) in liabilities:		
Accrued interest payable	(1,047)	5,677
Affiliate payables	(9,656)	(12,219)
Other liabilities	(13,106)	(11,007)
Net cash used in operating activities	(22,846)	(16,303)
Cash Flow From Investing Activities:		
Proceeds from notes receivables	12,776	9,391
Origination of notes receivable	(9,279)	-
Proceeds from sales of income producing properties	18,678	3,912
Proceeds from sale of land	10,897	46,657
Proceeds from sale of investment in unconsolidated real estate entities	-	897
Proceeds from sale of investments	114	-
Investment in unconsolidated real estate entities	2,898	(111)
Improvement of land held for development	(136)	(1,214)
Improvement of income producing properties	(394)	(386)
Acquisition of non-controlling interest	(138)	(23)
Sale of non-controlling interest	(1,468)	-
Sale of controlling interest	1,262	2,012
Construction and development of new properties	(3,189)	(14,087)
Net cash provided by investing activities	32,021	47,048
Cash Flow From Financing Activities:		
Proceeds from notes payable	60,915	30,812

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Recurring amortization of principal on notes payable	(6,027)	(3,294)
Debt assumption by buyer, part of seller proceeds	(17,073)	-
Payments on maturing notes payable	(56,474)	(64,409)
Stock-secured borrowings and margin debt	-	3,164
Deferred financing costs	(1,972)	(260)
Distributions to non-controlling interests	(82)	(366)
Preferred stock dividends - Series A	(613)	(617)
Repurchase of common stock/treasury stock	-	(62)
Conversion of preferred stock into common stock	-	31
Net cash used in financing activities	(21,326)	(35,001)
Net decrease in cash and cash equivalents	(12,151)	(4,256)
Cash and cash equivalents, beginning of period	20,312	12,649
Cash and cash equivalents, end of period	\$8,161	\$8,393
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$47,231	\$16,795
Schedule of noncash investing and financing activities:		
Notes receivable received from affiliate	\$6,000	\$-

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

As used herein, the terms “ARL”, “the Company”, “we”, “our” or “us” refer to American Realty Investors, Inc., a Nevada corporation, which was formed in November 1999. In August 2000, the Company acquired American Realty Trust, Inc. (“ART”), a Georgia corporation and National Realty, L.P. (“NRLP”), a Delaware partnership.

The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange (“NYSE”) under the symbol (“ARL”). Approximately 87.6% of ARL’s stock is owned by affiliated entities. ARL owns approximately 82.7% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc. (“TCI”), a Nevada corporation, which has its common stock listed and traded on the New York Stock Exchange (“NYSE”) under the symbol (“TCI”). ARL is a “C” corporation for U.S. federal income tax purposes and has consolidated TCI’s accounts and operations since March 2003.

TCI, a subsidiary of ARL, owns approximately 81.1% of the common stock of Income Opportunity Realty Investors, Inc. (“IOT”). Effective July 17, 2009, IOT’s financial results were consolidated with those of ARL and TCI and their subsidiaries. Shares of IOT are traded on the American Stock Exchange (“AMEX”) under the symbol (“IOT”).

ARL invests in real estate through direct ownership, leases and partnerships and also invests in mortgage loans on real estate. Prime Income Asset Management, LLC (“Prime”) served as the Company’s external Advisor and Cash Manager until April 30, 2011. Prime also served as an Advisor and Cash Manager to TCI and IOT. Effective April 30, 2011, Pillar Income Asset Management, Inc. (“Pillar”) became the Company’s external Advisor and Cash Manager under similar terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to TCI and IOT. Regis Realty Prime, LLC (“Regis”) manages our commercial and hotel properties, and provides brokerage services. ARL engages third-party companies to lease and manage its apartment properties. We have no employees.

Properties

We own or had interests in a total property portfolio of 67 income-producing properties as of March 31, 2012. The properties consisted of:

- 17 commercial properties consisting of 11 office buildings, one industrial warehouse, four retail properties and one parking garage, comprising in aggregate approximately 3.9 million rentable square feet;
 - One hotel comprising 161 rooms;
- 49 apartment communities totaling 9,097 units, excluding apartments being developed; and
 - 5,125 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We completed construction on five construction projects in 2011 and are in the predevelopment process on several residential apartment communities, scheduled for construction in 2012. At March 31, 2012, we had no 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.

A maritime harbor town is being constructed on the 420 acre site of the former naval base of Olpenitz between the mouth of the River Schlei and the Baltic Sea in the state of Schleswig-Holstein in North Germany. The project is located less than 30 miles from the Danish border. The town will comprise a marina offering several thousand moorings, premium vacation homes each with their own landing stage as well as exclusive hotels, restaurants, shops and a range of leisure activities from sailing to golfing to cross-country skiing. At the current time over 50 lots in Phase One, of an initial 180, have been sold and are in various stages of construction.

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, have been condensed or omitted in accordance with such rules and regulations, although management believes the disclosures are adequate to prevent the information presented from being misleading. In the opinion of management, all adjustments (consisting of normal recurring matters) considered necessary for a fair presentation have been included. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for other interim periods or for the full fiscal year.

The year-end consolidated balance sheet at December 31, 2011 was derived from the audited financial statements at that date, but does not include all of the information and disclosures required by GAAP for complete financial statements. For further information, refer to the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. Certain 2011 financial statement amounts have been reclassified to conform to the 2012 presentation, including adjustments for discontinued operations.

Principles of consolidation

The accompanying financial statements include the accounts of the Company, its subsidiaries, generally all of which are wholly-owned, and all entities in which we have a controlling interest. Arrangements that are not controlled through voting or similar rights are accounted for as a Variable Interest Entity ("VIE"), in accordance with the provisions and guidance of ASC Topic 810 "Consolidation", whereby we have determined that we are a primary beneficiary of the VIE and meet certain criteria of a sole general partner or managing member as identified in accordance with Emerging Issues Task Force ("EITF") Issue 04-5, Investor's Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Rights ("EITF 04-5"). VIE's 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 VIE's and general market conditions.

For entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary, the entities are accounted for using the equity method of accounting. Accordingly, our share of the net earnings or losses of these entities is included in consolidated net income. Our investment in Gruppa Florentina, LLC, is accounted for under the equity method. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when they were sold to a third party.

Real estate, depreciation, and impairment

Real estate assets are stated at the lower of depreciated cost or fair value, if deemed impaired. Major replacements and betterments are capitalized and depreciated over their estimated useful lives. Depreciation is computed on a straight-line basis over the useful lives of the properties (buildings and improvements – 10-40 years; furniture, fixtures and equipment – 5-10 years). The Company continually evaluates the recoverability of the carrying value of its real estate assets using the methodology prescribed in ASC Topic 360, “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.

Real estate held for sale

We periodically classify real estate assets as “held for sale”. An asset is classified as held for sale after the approval of our board of directors and after an active program to sell the asset has commenced. Upon the classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its estimated fair value, less costs to sell the asset. Subsequent to the classification of assets as held for sale, no further depreciation expense is recorded. Real estate assets held for sale are stated separately on the accompanying Consolidated Balance Sheets. Upon a decision to no longer market as an asset for sale, the asset is classified as an operating asset and depreciation expense is reinstated. The operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying statements of operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. This classification of operating results as discontinued operations applies retroactively for all periods presented. Additionally, gains and losses on assets designated as held for sale are classified as part of discontinued operations.

Cost capitalization

Costs related to planning, developing, leasing and constructing a property are capitalized and classified as Real Estate in the Consolidated Balance Sheets. We capitalize interest to qualifying assets under development based on average accumulated expenditures outstanding during the period. In capitalizing interest to qualifying assets, we first use the interest incurred on specific project debt, if any, and next use the weighted average interest rate of non-project specific debt. We capitalize interest, real estate taxes and certain operating expenses until building construction is substantially complete and the building is ready for its intended use, but no later than one year from the cessation of major construction activity.

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

Fair value measurement

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

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

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

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

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

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

Newly issued accounting standards

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our consolidated statements, including that which we have not yet adopted. We do not believe that any such guidance will have a material effect on our financial position or results of operations.

NOTE 2. REAL ESTATE ACTIVITY

The highlights of our significant real estate transactions for the three months ended March 31, 2012 are listed below:

On January 3, 2012, we recognized the March 23, 2011 sale of 82.2 acres of land known as Denton Coonrod land located in Denton County, Texas to Cross County National Associates, LP, a related party under common control, for a sales price of \$1.8 million. The existing mortgage of \$0.8 million, secured by the property, was paid in full when ownership transferred to the existing lender. We recorded a gain on sale of \$0.04 million on the land parcel.

On January 17, 2012, we sold 100% of our stock in American Realty Trust, Inc. to One Realco Corporation, a related party under common control, for a sales price of \$10.0 million. We provided \$10.0 million in seller-financing with a five-year note receivable. The note accrues interest at 3.00% and is payable at maturity on January 17, 2017. The note is fully reserved by the Company. Subsequent to the sale ART filed for Chapter Eleven bankruptcy protection.

On January 30, 2012, we refinanced the existing mortgage on Parc at Maumelle apartments, a 240-unit complex located in Little Rock, Arkansas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.1 million and \$0.7 million in closing costs. The note accrues interest at 3.00% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2052.

On February 2, 2012, TCI and its subsidiary, 1340 Poydras, LLC, executed a guarantor settlement and consent agreement with the lender for the Amoco building, Petra CRE CDO 2007-1, Ltd (“Petra”) to transfer ownership of the Amoco building to a new entity, 1340 Owner, LLC, which is affiliated with the existing lender, Petra. Regis will continue to manage the property while under Petra’s ownership and TCI will have an option to repurchase the property during the option term which shall end two years following the commencement of the agreement. We have deferred the recognition of the sale in accordance with ASC 360-20 due to our continuing involvement related to the obligations under the note and guaranty agreements and the repurchase option.

On February 7, 2012, we recognized the September 1, 2011 sale of 22.92 acres of land known as Andrew B land, Denton County, Texas to TCI Luna Ventures, LLC, a related party under common control, for a sales price of \$1.3 million. We received a credit of \$2.1 million to satisfy a portion of the multi-tract collateral debt when ownership transferred to the existing lender. We recorded a gain on sale of \$1.2 million on the land parcel.

On February 23, 2012, we sold a 220-unit apartment complex known as Wildflower Villas apartments located in Temple, Texas for a sales price of \$19.6 million. The buyer assumed the existing debt of \$13.7 million secured by the property. We recorded a gain on sale of \$3.6 million on the apartment sale.

On February 27, 2012, we re-purchased 100% interest in Cross County National Associates, LP from ABC Land Real Estate, LLC and ABC Land & Development, Inc., both related parties under common control, for a sales price of \$9.5 million. This entity owns a 307,266 square foot retail center known as Cross County Mall located in Mattoon, Illinois. We assumed the existing mortgage of \$9.2 million, secured by the property. On March 22, 2011, we sold our ownership in Cross County National Associates, LP to ABC Land Real Estate, LLC and ABC Land & Development, Inc., both related parties under common control, for an amount equal to the re-purchase price. We did not recognize the March 22, 2011 sale in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost. Upon re-purchasing the ownership interests in the current period, the seller financing note of \$0.3 million was cancelled. There is no change in the financial statements related to the March 22, 2011 sale or the subsequent re-purchase.

On February 29, 2012, we refinanced the existing mortgage on Huntington Ridge apartments, a 198-unit complex located in DeSoto, Texas, for a new mortgage of \$15.0 million. We paid off the existing mortgage of \$14.6 million and \$0.4 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Laguna Vista apartments, a 206-unit complex located in Dallas, Texas, for a new mortgage of \$17.7 million. We paid off the existing mortgage of \$17.0 million and \$0.3 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Savoy of Garland apartments, a 144-unit complex located in Garland, Texas, for a new mortgage of \$10.3 million. We paid off the existing mortgage of \$10.2 million and \$0.1 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On March 1, 2012, we sold 100% of our interests in LaDue, LLC to ABC Land & Development, Inc., a related party under common control, for a sales price of \$1.9 million. This entity owns 8.01 acres of land known as LaDue land located in Dallas County, Texas. We provided \$1.3 million in seller-financing with a five-year note receivable. The note accrues interest at 5% and is payable at maturity on March 1, 2017. The buyer assumed the existing mortgage of \$0.6 million, secured by the property. We have deferred the recognition of the sale in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost.

On March 5, 2012, we recognized the September 1, 2011 sale of 7.39 acres of land known as DeSoto Ranch land located in DeSoto, Texas to TCI Luna Ventures, LLC, a related party under common control, for a sales price of \$1.3 million. We received a credit of \$1.0 million to satisfy a portion of the multi-tract collateral debt when ownership transferred to the existing lender. We recorded a gain on sale of \$0.1 million on the land parcel.

On March 27, 2012, we sold 319.07 acres of land known as Waco Ritchie land located in Waco, Texas for a sales price of \$1.9 million. The existing mortgage of \$1.5 million, secured by the property, was paid in full. We recorded a loss on sale of \$0.8 million on the land parcel.

On March 28, 2012, we sold 29.59 acres of land known as Elm Fork land located in Carrollton, Texas for a sales price of \$1.9 million. The existing mortgage of \$1.8 million, secured by the property, was paid in full. We recorded a loss on sale of \$1.3 million on the land parcel.

In December 2010, there were various commercial and land holdings sold to FRE Real Estate, Inc., a related party under common control. During the first three months of 2011, many of these transactions were rescinded as of the original transaction date and were subsequently sold to related parties under the same ownership as FRE Real Estate, Inc. As of March 31, 2012, there is one commercial building, Thermalloy that remains in FRE Real Estate, Inc. We have deferred the recognition of the sales in accordance with ASC 360-20 due to our continuing involvement, inadequate initial investment and questionable recovery of investment cost.

We continue to invest in the development of apartments and various projects. During the three months ended March 31, 2012, we have expended \$3.1 million on construction and development and capitalized \$0.1 million of interest costs.

The properties that we have sold to a related party under common control and have deferred the recognition of the sale are treated as "subject to sales contract" on the Consolidated Balance Sheets. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and may or may not be transferred back to the seller upon resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. According to the loan documents, we are currently in default on these mortgages primarily due to lack of payment although we are actively involved in discussions with every lender in order to settle or cure the default situation. We have reviewed each asset and taken impairment to the extent we feel the value of the property was less than our current basis.

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. Our mortgage notes receivable consist of first, wraparound and junior mortgage loans (dollars in thousands):

Borrower	Date	Rate	Amount	Security
Performing loans:				
Miscellaneous non-related party notes	Various	Various	4,097	Various security interests
Miscellaneous related party notes (1)	Various	Various	2,321	Various security interests
Unified Housing Foundation, Inc. (Cliffs of El Dorado) (1)	12/27	5.25%	2,097	100% Interest in Unified Housing of McKinney, LLC
Unified Housing Foundation, Inc. (Echo Station) (1)	12/27	5.25%	1,481	100% Interest in Unified Housing of Temple, LLC
Unified Housing Foundation, Inc. (Inwood on the Park) (1)	12/27	5.25%	5,059	100% Interest in Unified Housing Inwood, LLC
Unified Housing Foundation, Inc. (Kensington Park) (1)	12/27	5.25%	3,936	100% Interest in Unified Housing Kensington, LLC
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/27	5.25%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/27	5.25%	9,096	Membership interest in Housing for Seniors of Humble, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	07/15	5.25%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/27	5.25%	4,663	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	07/15	5.25%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/27	5.25%	6,000	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing) (1)	12/27	5.25%	2,272	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	07/15	5.25%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC
	12/27	5.25%	4,812	

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Unified Housing Foundation, Inc. (Sendero Ridge) (1)				100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Timbers of Terrell) (1)	12/27	5.25%	1,323	100% Interest in Unified Housing of Terrell, LLC
Unified Housing Foundation, Inc. (Tivoli) (1)	12/27	5.25%	7,965	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. (Reserve at White Rock Phase I) (1)	12/27	5.25%	2,485	100% Interest in Unified Housing of Harvest Hill I, LLC
Unified Housing Foundation, Inc. (Reserve at White Rock Phase II) (1)	12/27	5.25%	2,555	100% Interest in Unified Housing of Harvest Hill, LLC
Unified Housing Foundation, Inc. (Trails at White Rock) (1)	12/27	5.25%	3,815	100% Interest in Unified Housing of Harvest Hill III, LLC
Unified Housing Foundation, Inc.(1)	12/12	5.00%	6,000	Unsecured
Realty Advisors Management, Inc. (1)	12/16	4.00%	20,387	Unsecured
One Realco Corporation - ART Sale (1)	01/17	3.00%	10,000	Unsecured
Accrued interest			1,965	
Total Performing			\$ 114,810	
Non-Performing loans:				
Ocean Beach Partners, L.P. (1)	12/11	7.00%	3,279	Folsom Land (36 acres in Farmers Branch, TX)
130 Windmill Farms, L.P.	10/11	7.00%	507	Unsecured
Dallas Fund XVII L.P. (2)	10/09	9.00%	1,432	Unsecured
Leman Development, Ltd.	07/11	7.00%	1,500	Unsecured
Tracy Suttles	12/11	0.00%	1,077	Unsecured
Miscellaneous non-related party notes	Various	Various	1,019	Various secured interest
Accrued interest			346	
Total Non-Performing			\$ 9,160	
Allowance for estimated losses			(23,383)	
Total			\$ 100,587	

(1) Related party notes

(2) Note matured and an allowance was taken for estimated losses at full value of note

NOTE 4. INVESTMENT IN UNCONSOLIDATED JOINT VENTURES AND INVESTEEES

Investments in unconsolidated joint ventures 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 in unconsolidated joint ventures and other investees consist of the following:

13

	Percentage ownership as of March 31,			
	2012		2011	
Garden Centura, L.P. (1)	0.00	%	5.00	%
Gruppa Fiorentina, LLC (1)	20.00	%	20.00	%
LK-Four Hickory, LLC (1)	0.00	%	28.57	%

(1) Other investees

Our partnership interest in Garden Centura, L.P. in the amount of 5% was accounted for under the equity method because we exercise significant influence over the operations and financial activities. We guaranteed the notes payable and controlled the day-to-day activities. Accordingly, the investment was carried at cost, adjusted for the companies' proportionate share of earnings or losses. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when the investments were sold to a third party.

The following is a summary of the financial position and results of operations from our investees:

	For the Three Months ended March 31,	
	2012	2011
Other Investees		
Real estate, net of accumulated depreciation	\$11,703	\$119,203
Notes receivable	5,789	5,118
Other assets	30,751	42,076
Notes payable	(13,670)	(87,381)
Other liabilities	(6,342)	(15,711)
Shareholders' equity/partners capital	(28,231)	(63,305)
Revenue	\$11,609	\$14,088
Depreciation	(334)	(1,640)
Operating expenses	(10,388)	(11,644)
Gain on land sales	-	-
Interest expense	(302)	(1,185)
Income from continuing operations	\$585	\$(381)
Income from discontinued operations	-	-
Net income	\$585	\$(381)
Company's proportionate share of earnings	\$117	24

NOTE 5. NOTES PAYABLE

In conjunction with the development of various apartment projects and other developments, we drew down \$0.9 million in construction loans during the three months ended March 31, 2012.

On January 30, 2012, we refinanced the existing mortgage on Parc at Maumelle apartments, a 240-unit complex located in Little Rock, Arkansas, for a new mortgage of \$16.8 million. We paid off the existing mortgage of \$16.1 million and \$0.7 million in closing costs. The note accrues interest at 3.00% and payments of interest and principal are

due monthly based upon a 40-year amortization schedule, maturing on February 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Huntington Ridge apartments, a 198-unit complex located in DeSoto, Texas, for a new mortgage of \$15.0 million. We paid off the existing mortgage of \$14.6 million and \$0.4 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Laguna Vista apartments, a 206-unit complex located in Dallas, Texas, for a new mortgage of \$17.7 million. We paid off the existing mortgage of \$17.0 million and \$0.3 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

On February 29, 2012, we refinanced the existing mortgage on Savoy of Garland apartments, a 144-unit complex located in Garland, Texas, for a new mortgage of \$10.3 million. We paid off the existing mortgage of \$10.2 million and \$0.1 million in closing costs. The note accrues interest at 3.03% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2052.

The properties that we have sold to a related party under common control and have deferred the recognition of the sale are treated as “subject to sales contract” on the Consolidated Balance Sheets. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and may or may not be transferred back to the seller upon resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. According to the loan documents, we are currently in default on these mortgages primarily due to lack of payment although we are actively involved in discussions with every lender in order to settle or cure the default situation. We have reviewed each asset and taken impairment in the prior year to the extent we feel the value of the property was less than our current basis

NOTE 6. STOCK-SECURED NOTES PAYABLE

The Company has margin arrangements with various financial institutions and brokerage firms, which provide for borrowings of up to 50.0% of the market value of marketable equity securities. We also have other notes payable secured by stock. The borrowings under such margin arrangements and notes are secured by the equity securities of IOT, TCI, and ARL’s trading portfolio securities, and bear interest rates ranging from 4.00% to 10.00% per annum. Stock-secured notes payable and margin borrowings were \$26.5 million at March 31, 2012.

NOTE 7. RELATED PARTY TRANSACTIONS

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to affiliates as of March 31, 2012 (dollars in thousands):

Balance, December 31, 2011	Pillar
	\$ (10,294)
Cash transfers	(1,835)
Advisory fees	(2,658)
Commissions to Pillar/Regis	(1,388)
Cost reimbursements	(835)
Interest to Advisor	(204)
POA fees	(52)
Net income fee	(42)
Expenses paid by Advisor	(1,037)
Financing (mortgage payments)	1,589
Note receivable with affiliate	6,874

Sales/Purchases transactions	(58)
Intercompany property transfers	9,302
Balance, March 31, 2012	\$ (638)

During the ordinary course of business, we have related party transactions that include, but are not limited to rent income, interest income, interest expense, general and administrative costs, commissions, management fees, and property expenses. In addition, we have assets and liabilities that include related party amounts. The affiliated amounts included in assets and liabilities, and the affiliated revenues and expenses received/paid are shown on the face of the financial statements.

NOTE 8. OPERATING SEGMENTS

Our segments are based on our method of internal reporting which classifies our operations by property type. Our property types are grouped into commercial, apartments, hotels, land and other operating segments. Significant differences among the accounting policies of the operating segments as compared to the consolidated financial statements principally involve the calculation and allocation of administrative and other expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their net operating income and cash flow.

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

Presented below is our reportable segments' operating income for the three months ended March 31, 2012 and 2011, including segment assets and expenditures (dollars in thousands):

Commercial						
For the Three Months Ended	Properties	Apartments	Hotels	Land	Other	Total
March 31, 2012						
Operating revenue	\$ 9,197	\$20,536	\$544	\$-	\$41	\$30,318
Operating expenses	5,273	9,715	553	279	388	16,208
Depreciation and amortization	1,671	3,886	15	-	(69)	5,503
Mortgage and loan interest	2,995	10,922	62	1,704	2,052	17,735
Interest income	-	-	-	-	3,340	3,340
Loss on land sales	-	-	-	(1,021)	-	(1,021)
Segment operating gain (loss)	\$(742)	\$(3,987)	\$(86)	\$(3,004)	\$1,010	\$(6,809)
Capital expenditures	447	198	-	5	-	650
Assets	172,663	564,401	192	229,421	-	966,677
Property Sales						
Sales price	\$-	\$21,146	\$-	\$11,543	\$-	\$32,689
Cost of sale	-	17,558	-	12,564	-	30,122
Deferred current gain	-	-	-	-	-	-
Recognized prior deferred gain	-	-	-	-	-	-
Gain (loss) on sale	\$-	\$3,588	\$-	\$(1,021)	\$-	\$2,567
Commercial						
For the Three Months Ended	Properties	Apartments	Hotels	Land	Other	Total
March 31, 2011						
Operating revenue	\$9,322	\$17,798	\$520	\$270	\$8	\$27,918
Operating expenses	5,868	8,973	452	577	49	15,919
Depreciation and amortization	1,978	3,376	16	-	(88)	5,282
Mortgage and loan interest	2,495	6,744	62	3,800	1,565	14,666
Interest income	-	-	-	-	668	668
Gain on land sales	-	-	-	5,344	-	5,344
Segment operating gain (loss)	\$(1,019)	\$(1,295)	\$(10)	\$1,237	\$(850)	\$(1,937)
Capital expenditures	61,254	10,920	2,792	8,924	16	83,906
Assets	182,828	541,572	252	389,805	(18,991)	1,095,466
Property Sales						
Sales price	\$5,168	\$-	\$-	\$50,532	\$-	\$55,700
Cost of sale	4,882	-	-	46,328	-	51,210
Deferred current gain	-	-	-	-	-	-
Recognized prior deferred gain	3,851	-	-	1,140	-	4,991
Gain on sale	\$4,137	\$-	\$-	\$5,344	\$-	\$9,481

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

For the Three Months Ended March 31, 2012	For Three Months Ended March 31,	
	2012	2011
Segment operating loss	\$ (6,809)	\$ (1,937)
Other non-segment items of income (expense)		
General and administrative	(3,181)	(3,242)
Advisory fees	(2,658)	(3,522)
Provision on impairment of notes receivable and real estate assets	-	(5,178)
Other income	1,628	1,214
Loss on sale of investments	(362)	-
Equity in earnings of investees	117	(95)
Income tax benefit	1,125	485
Loss from continuing operations	\$ (10,140)	\$ (12,275)

The table below reconciles the segment information to the corresponding amounts in the Consolidated Balance Sheets:

	For Three Months Ended March 31,	
	2012	2011
Segment assets	\$ 966,677	\$ 1,095,466
Investments in real estate partnerships	7,848	12,152
Other assets and receivables	178,466	188,530
Assets held for sale	28,663	199,485
Total assets	\$ 1,181,654	\$ 1,495,633

NOTE 9. DISCONTINUED OPERATIONS

We apply the provisions of ASC Topic 360, "Property, Plant and Equipment". ASC Topic 360 requires that long-lived assets that are to be disposed of by sale be measured at the lesser of (1) book value or (2) fair value less cost to sell. In addition, it requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions.

Discontinued operations relates to properties that were either sold or held for sale as of the period ended March 31, 2012. Included in discontinued operations are a total of three and 23 properties as of 2012 and 2011, respectively. Properties sold in 2012 have been reclassified to discontinued operations for current and prior year reporting periods. In 2012, we sold one apartment complex (Wildflower Villas), one apartment complex was held for sale (Portofino) and one commercial property was held for sale (Clarke Garage). In 2011, we sold two apartment complexes (Spyglass, Westwood), 12 commercial properties (Addison Hanger I, Addison Hanger II, Alpenloan, Cooley Building, Fenton Center, One Hickory, Parkway North, Signature, Teleport Blvd, Two Hickory, Westgrove Air Plaza, Willowbrook Village), four hotels (Piccadilly Airport, Piccadilly Chateau, Piccadilly Shaw, Piccadilly University), 13 acres of land with a storage warehouse (Eagle Crest), and one trade show and exhibit hall (Denver Merchandise Mart). The gain on sale of the properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for the properties sold and held for sale (dollars in thousands):

	For the Three Months Ended March 31,	
	2012	2011
Revenue		
Rental	\$1,359	\$11,176
Property operations	1,027	7,541
	\$332	\$3,635
Expenses		
Interest	(368)	(3,237)
General and administration	(97)	(361)
Depreciation	(242)	(1,906)
Provision on impairment of real estate assets	-	(881)
	\$(707)	\$(6,385)
Net loss from discontinued operations before gains on sale of real estate, taxes, and fees	(375)	(2,750)
Gain on sale of discontinued operations	3,588	4,137
Income from discontinued operations before tax	\$3,213	\$1,387
Income tax expense	(1,125)	(485)
Income from discontinued operations	\$2,088	\$902

Our application of ASC Topic 360 results in the presentation of the net operating results of these qualifying properties sold or held for sale during 2012 as income from discontinued operations. This does not have an impact on net income available to common shareholders and only impacts the presentation of these properties within the Consolidated Statements of Operations.

NOTE 10. COMMITMENTS AND CONTINGENCIES AND LIQUIDITY

In conjunction with its sale of Four Hickory in November 2007, the Company agreed to fund approximately \$1.0 million to satisfy its commitment to compensate LK-Four Hickory, LLC for move-in discounts and other concessions to existing tenants at the time of sale. The Company also has certain agreements with LK-Four Hickory, LLC to fund projection shortfalls, which, to date, we have not had to provide any additional funding. In addition, related parties of the Company have active lease agreements with LK-Four Hickory, LLC.

On December 17, 2007, both Limkwang Nevada, Inc., the majority owner of LK-Four Hickory, LLC, and ARL unconditionally guaranteed the punctual payment when due, whether at stated maturity, by acceleration or hereafter, including all fees and expenses incurred by the bank on collection of a \$28.0 million note payable for LK-Four Hickory, LLC.

Liquidity. Management believes that ARL will generate excess cash flow from property operations in 2012, such excess however, will not be sufficient to discharge all of ARL's obligations as they became due. Management intends to sell land and income producing real estate, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

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

Litigation. American Realty Trust, Inc (“ART”) and its subsidiary ART Midwest, Inc have been embroiled in a lawsuit with a Mr. David Clapper and companies related to Mr. Clapper (“The Clapper Entities”) since 1999. The origins of the matter began in 1998 in a transaction whereby ART Midwest was to acquire eight apartments from the Clapper Entities. Through the years there have been ruling both for and against ART in this matter however in October 2011 a final ruling was issued whereby the Clapper Entities were awarded approximately \$74 million including \$26 million in damages and \$48 million in interest. This ruling was against ART and its subsidiary ART Midwest and not the Company or any other subsidiary of the Company.

ART believes there were serious errors in the judge's ruling and has filed an appeal of the judge's ruling. ART further believes that should the Clapper Entities ultimately prevail that it has claims against a third party who was involved in this matter. These claims cannot be pursued until the main case with the Clapper Group is ultimately resolved.

Should the Clapper Group ultimately prevail the only defendants in this matter are ART and ART Midwest, Inc. whose total assets and net worth as of December 31, 2011 was approximately \$10 million. Neither the Company nor any of its subsidiaries other than ART have guaranteed or indemnified either ART or ART Midwest, Inc.

As of December 31, 2011 the Company reserved \$10 million which represents 100% of both the asset and book value of ART. In January 2012, the Company sold ART and its subsidiaries for a \$10 million note. The note is fully reserved by the Company. Subsequent to the sale ART filed for Chapter Eleven bankruptcy protection.

ARL, through a subsidiary, is developing a maritime harbor town on the 420 acre site of the former naval base of Olpenitz in Kappeln, Germany. At the current time over 50 lots in Phase One, of an initial 180, have been sold and are in various stages of construction. There have been disputes with our local partner related to his mismanagement of the project which resulted in our replacing him as the managing partner and led to filing for bankruptcy protection in Germany to completely remove him from the project. We believe that the value of the land and development in process will satisfy the existing creditors and return our investment. We are working on a plan for the bankruptcy court and expect to continue our involvement in the development of this project.

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

NOTE 11. EARNINGS PER SHARE

Earnings per share, "EPS", have been computed pursuant to the provisions of ASC Topic 260 "Earnings Per Share". The computation of basic EPS is calculated by dividing net income available to common shareholders from continuing operations, adjusted for preferred dividends, by the weighted-average number of common shares outstanding during the period. Shares issued during the period shall be weighted for the portion of the period that they were outstanding. As of March 31, 2012, we have 3,353,954 shares of Series A 10.0% Cumulative Convertible Preferred Stock, which are outstanding. These shares may be converted into common stock at 90.0% 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. As of March 31, 2012, we have 1,000 shares of stock options outstanding, which will expire January 1, 2015 if not exercised. The outstanding options are considered in the computation of diluted earnings per share if the effect of applying the "treasury stock" method is dilutive. As of March 31, 2012, the preferred stock and the stock options were anti-dilutive and thus not included in the EPS calculation.

NOTE 12. SUBSEQUENT EVENTS

On April 3, 2012, 5.2 acres of land known as Andrew C land, located in Denton, Texas, which was sold to a related party and treated as "subject to sales contract", was transferred to the lender for credit against the multi-tract loan balance. The sale that was deferred will be recognized in the second quarter of 2012 when ownership transferred to a third party.

On April 5, 2012, we sold a parking garage known as Clarke Garage located in New Orleans, Louisiana for a sales price of \$6.0 million.

On April 13, 2012, we recognized the August 20, 2010 sale of Comfort Inn, a 160-room hotel located in Denver, Colorado, which was sold to a related party and treated as “subject to sales contract”. The sale that was deferred will be recognized in the second quarter of 2012 when the property was sold to a third party.

On April 30, 2012, we refinanced the existing mortgage on Parc at Metro Center apartments, a 144-unit complex located in Nashville, Tennessee, for a new mortgage of \$11.0 million. We paid off the existing mortgage of \$10.5 million and \$0.5 million in closing costs. The note accrues interest at 2.95% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on May 1, 2052.

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

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

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

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

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

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

- costs of compliance with the Americans with Disabilities Act and other similar laws and regulations;
 - potential liability for uninsured losses and environmental contamination;
- risks associated with our dependence on key personnel whose continued service is not guaranteed; and
- the other risk factors identified in this Form 10-Q, including those described under the caption “Risk Factors.”

The risks included here are not exhaustive. Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements, include among others, the factors listed and described at Part I, Item 1A. “Risk Factors” in the Company’s Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company’s Form 10-K for the fiscal year ended December 31, 2011.

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

Overview

We are an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties, and land held for development. Our portfolio of income-producing properties includes residential apartment communities, office buildings, hotels, and other commercial properties. Our investment strategy includes acquiring existing income-producing properties as well as developing new properties on land already owned or acquired for a specific development project. We acquire land primarily in urban in-fill locations or high-growth suburban markets. We are an active buyer and seller of real estate and during the first three months of 2012 we sold \$24.0 million of land and income-producing properties. As of March 31, 2012, we owned 9,097 units in 49 residential apartment communities, 17 commercial properties comprising almost 3.9 million rentable square feet and one hotel containing a total of 161 rooms. In addition, we owned 5,125 acres of land held for development and a 420-acre holiday resort project in Germany currently in development.

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 certain of our wholly owned properties. When we sell assets, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. We generate operating revenues primarily by leasing apartment units to residents; leasing office, retail and industrial space to commercial tenants; and renting hotel rooms to guests.

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.

Prime Income Asset Management, LLC ("Prime") served as the Company's external Advisor and Cash Manager until April 30, 2011. Prime also served as an Advisor and Cash Manager to TCI and IOT. Effective April 30, 2011, Pillar Income Asset Management, Inc. ("Pillar") became the Company's external Advisor and Cash Manager under similar terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to TCI and IOT. Regis Realty Prime, LLC ("Regis") manages our commercial and hotel properties, and provides brokerage services. ARL engages third-party companies to lease and manage its apartment properties.

Critical Accounting Policies

We present our financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). In June 2009, the Financial Accounting Standards Board ("FASB") completed its accounting guidance codification project. The FASB Accounting Standards Codification ("ASC") became effective for our financial statements issued subsequent to June 30, 2009 and is the single source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. As of the effective date, we no longer refer to the authoritative guidance dictating our accounting methodologies under the previous accounting standards hierarchy. Instead, we refer to the ASC guidance as the sole source of authoritative literature.

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

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

For entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary, the entities are accounted for using the equity method of accounting. Accordingly, our share of the net earnings or losses of these entities are included in consolidated net income. Our investment in Gruppa Florentina, LLC is accounted for under the equity method. Our investments in Garden Centura, L.P. and LK-Four Hickory, LLC were accounted for under the equity method until December 28, 2011 and January 17, 2012, respectively, when they were sold to a third party

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 project costs incurred during the period of development.

Management reviews its long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates impairment in value. An impairment loss is recognized if the carrying amount of its assets is not recoverable and exceeds its fair value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The evaluation of anticipated cash flows is

highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods.

ASC Topic 360 “Property, Plant and Equipment” requires that qualifying assets and liabilities and the results of operations that have been sold, or otherwise qualify as held for sale, be presented as discontinued operations in all periods presented if the property operations are expected to be eliminated and we will not have significant continuing involvement following the sale. The components of the property’s net income that is reflected as discontinued operations include the net gain (or loss) upon the disposition of the property held for sale, operating results, depreciation and interest expense (if the property is subject to a secured loan). We generally consider assets to be held for sale when the transaction has been approved by our Board of Directors, or a committee thereof, and there are no known significant contingencies relating to the sale, such that the property sale within one year is considered probable. Following the classification of a property as held for sale, no further depreciation is recorded on the assets.

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

Investments in Unconsolidated Real Estate Ventures

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

Recognition of Rental Income

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. 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. For hotel properties, revenues for room sales and guest services are recognized as rooms are occupied and services are rendered. An allowance for doubtful accounts is recorded for all past due rents and operating expense reimbursements considered to be uncollectible.

Revenue Recognition on the Sale of Real Estate

Sales 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

For notes other than surplus cash notes, we record interest income as earned in accordance with the terms of the related loan agreements. Prior to January 1, 2012, on cash flow notes where payments are based upon surplus cash from operations, accrued but unpaid interest income was only recognized to the extent that cash was received. As of January 1, 2012, due to the consistency of cash received on the surplus cash notes, we will record interest as earned.

Allowance for Estimated Losses

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

Fair Value of Financial Instruments

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

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

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

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

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

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

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 been 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 and is held the entire period for both periods 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 following discussion is based on our Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011 as included in Part I, Item 1. "Financial Statements" of this report. 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 March 31, 2012 and 2011, we owned or had interests in a portfolio of 67 and 81 income producing properties, respectively. For discussion purposes, we broke this out between continuing operations and discontinued operations. The total property portfolio represents all income producing properties held as of March 31 for the period presented. Sales subsequent to quarter end represent properties that were held as of period end for the periods presented, but sold in the next quarter. Continuing operations represents all properties that have not been reclassified to discontinued operations as of March 31, 2012 for the periods presented. The table below shows the number of income

producing properties held at the quarter ended:

	March 31,	
	2012	2011
Continuing operations	62	55
Discontinued operations		