Howard Hughes Corp
Form 10-Q
August 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2012

or

o **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 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-4673192**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

13355 Noel Road, 22nd Floor, Dallas, Texas 75240

(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant s telephone number, including area code)

N / A

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o 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). x Yes o 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

The number of shares of common stock, $0.01 par value, outstanding as of August 5, 2012 was 37,973,640.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

		June 30, 2012		December 31, 2011
		(In thousands, except share amounts)		
Assets:				
Investment in real estate:				
Master Planned Community assets	$	1,597,244	$	1,602,437
Land		253,024		236,363
Buildings and equipment		627,554		556,786
Less: accumulated depreciation		(101,169)		(92,494)
Developments in progress		204,450		195,034
Net property and equipment		2,581,103		2,498,126
Investment in Real Estate Affiliates		32,597		62,595
Net investment in real estate		2,613,700		2,560,721
Cash and cash equivalents		254,288		227,566
Accounts receivable, net		15,315		15,644
Municipal Utility District receivables, net		94,710		86,599
Notes receivable, net		30,182		35,354
Tax indemnity receivable, including interest		326,972		331,771
Deferred expenses, net		12,549		10,338
Prepaid expenses and other assets, net		119,987		127,156
Total assets	$	3,467,703	$	3,395,149
Liabilities:				
Mortgages, notes and loans payable	$	659,397	$	606,477
Deferred tax liabilities		76,876		75,966
Warrant liabilities		226,185		127,764
Uncertain tax position liability		133,404		129,939
Accounts payable and accrued expenses		119,435		125,404
Total liabilities		1,215,297		1,065,550
Commitments and Contingencies (see Note 13)				
Equity:				
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued				
Common stock: $.01 par value; 150,000,000 shares authorized, 37,973,640 shares issued and outstanding as of June 30, 2012 and 37,945,707 shares issued and outstanding as of December 31, 2011		379		379
Additional paid-in capital		2,713,178		2,711,109
Accumulated deficit		(459,275)		(381,325)
Accumulated other comprehensive loss		(8,308)		(5,578)
Total stockholders equity		2,245,974		2,324,585
Noncontrolling interests		6,432		5,014
Total equity		2,252,406		2,329,599

Total liabilities and equity	$	3,467,703	$	3,395,149

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	$ 43,928	$ 18,148	$ 80,017	$ 41,540
Builder price participation	1,528	597	2,341	1,118
Minimum rents	20,577	16,976	39,474	33,695
Tenant recoveries	6,003	4,615	11,867	9,139
Condominium unit sales	134	6,660	267	10,424
Resort and conference center revenues	11,970		21,626	
Other land revenues	3,531	2,257	7,048	3,556
Other rental and property revenues	6,268	1,568	11,062	4,451
Total revenues	93,939	50,821	173,702	103,923
Expenses:				
Master Planned Community cost of sales	22,978	9,438	41,657	24,874
Master Planned Community operations	9,979	4,941	21,026	11,027
Rental property real estate taxes	3,171	2,630	7,009	5,783
Rental property maintenance costs	2,086	1,563	4,041	3,123
Condominium unit cost of sales	36	5,273	96	8,252
Resort and conference center operations	7,371		14,785	
Other property operating costs	15,044	10,135	29,373	20,004
Provision for doubtful accounts	164	304	45	315
General and administrative	8,160	7,662	16,557	12,483
Depreciation and amortization	5,893	3,186	10,951	6,383
Total expenses	74,882	45,132	145,540	92,244
Operating income	19,057	5,689	28,162	11,679
Interest income	2,342	2,243	4,673	4,754
Interest expense	(200)		(201)	
Warrant liability gain (loss)	23,430	56,910	(98,421)	(69,135)
Loss on remeasurement of tax indemnity receivable	(8,782)		(8,782)	
Equity in earnings from Real Estate Affiliates	446	2,110	3,122	7,623
Income (loss) before taxes	36,293	66,952	(71,447)	(45,079)
Provision for income taxes	1,301	959	5,085	3,415
Net income (loss)	34,992	65,993	(76,532)	(48,494)
Net income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Net income (loss) attributable to common stockholders	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)
Basic Income (Loss) Per Share:	$ 0.91	$ 1.74	$ (2.06)	$ (1.28)

Diluted Income (Loss) Per Share:	$ 0.27	$ 0.22	$ (2.06)	$ (1.28)

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Comprehensive Income (Loss), Net of Tax:				
Net income (loss)	$ 34,992	$ 65,993	$ (76,532)	$ (48,494)
Other comprehensive income (loss):				
Interest rate swap	(2,263)	(748)	(2,161)	(748)
Capitalized swap interest	(159)		(569)	
Pension plan adjustment		(63)		(128)
Other comprehensive loss	(2,422)	(811)	(2,730)	(876)
Comprehensive income (loss)	32,570	65,182	(79,262)	(49,370)
Comprehensive income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Comprehensive income (loss) attributable to common stockholders	$ 31,888	$ 65,162	$ (80,680)	$ (49,418)

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED)

(In thousands, except shares)	Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests in Consolidated Ventures	Total Equity
Balance January 1, 2011	37,904,506	$ 379	$ 2,708,036	$ (528,505)	$ (1,627)	$ 824	$ 2,179,107
Net income (loss)				(48,542)		48	(48,494)
Distributions to noncontrolling interests						(63)	(63)
Other comprehensive loss					(876)		(876)
Stock plan activity	37,601		1,245				1,245
Balance, June 30, 2011	37,942,107	$ 379	$ 2,709,281	$ (577,047)	$ (2,503)	$ 809	$ 2,130,919
Balance January 1, 2012	37,945,707	$ 379	$ 2,711,109	$ (381,325)	$ (5,578)	$ 5,014	$ 2,329,599
Net income (loss)				(77,950)		1,418	(76,532)
Interest rate swaps, net of tax ($150)					(2,161)		(2,161)
Capitalized swap interest, net of tax $330					(569)		(569)
Stock plan activity	27,933		2,069				2,069
Balance, June 30, 2012	37,973,640	$ 379	$ 2,713,178	$ (459,275)	$ (8,308)	$ 6,432	$ 2,252,406

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30, 2012	2011
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	$ (76,532)	$ (48,494)
Adjustments to reconcile net loss to cash provided by operating activities:		
Loss on remeasurement of tax indemnity receivable	8,782	
Equity in earnings (loss) from Real Estate Affiliates, net of distributions	72	(3,547)
Provision for doubtful accounts	45	315
Depreciation	8,853	5,435
Amortization	2,098	948
Amortization of deferred financing costs and debt market rate adjustments, net	(155)	277
Amortization of intangibles other than in-place leases	(89)	45
Straight-line rent amortization	(482)	(758)
Deferred income taxes	4,612	3,302
Restricted stock and stock option amortization	2,069	876
Warrant liability loss	98,421	69,135
Master Planned Community and condominium development expenditures	(47,235)	(33,206)
Master Planned Community and condominium cost of sales	39,467	29,938
Net changes:		
Accounts and notes receivable	9,682	2,512
Prepaid expenses and other assets	2,191	(3,803)
Deferred expenses	(1,730)	(492)
Accounts payable and accrued expenses	(20,508)	(234)
Other, net	(10)	(5,256)
Cash provided by operating activities	29,551	16,993
Cash Flows from Investing Activities:		
Real estate and property expenditures	(20,036)	(18,565)
Consideration paid to acquire Millennium Waterway Apartments, net of cash acquired	(2,721)	
Distribution from Millennium Waterway Apartments	6,876	
Proceeds from sales of investment in Real Estate Affiliates	8,579	
Investments in Real Estate Affiliates	(1,450)	(42)
Decrease in restricted cash	7,703	
Cash used in investing activities	(1,049)	(18,607)
Cash Flows from Financing Activities:		
Proceeds from issuance of mortgages, notes and loans payable	35,827	29,000
Principal payments on mortgages, notes and loans payable	(36,308)	(38,049)
Deferred financing costs	(1,299)	
Proceeds from issuance of management warrants		2,000
Distributions to noncontrolling interests		(63)
Cash used in financing activities	(1,780)	(7,112)

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	Six Months Ended June 30, 2012	2011
	(In thousands)	
Net change in cash and cash equivalents	26,722	(8,726)
Cash and cash equivalents at beginning of period	227,566	284,682
Cash and cash equivalents at end of period	$ 254,288	$ 275,956
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 10,284	$ 7,410
Interest capitalized	13,253	8,707
Income taxes paid	824	
Non-Cash Transactions:		
Consolidation of partner s interest:		
Land	(15,917)	
Building and equipment	(56,002)	
Other Assets	(2,669)	
Mortgages, notes and loans payable	55,584	
Other liabilities	754	
Reduction in investments in Real Estate Affiliates due to the Millennium Waterway Apartments acquisition	22,405	
Special Improvement District bond transfers associated with land sales	(2,189)	(3,188)
Real estate and property expenditures	4,345	
Prepetition liabilities funded by GGP		2,714

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the SEC. Such condensed consolidated financial statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (Quarterly Report) should refer to The Howard Hughes Corporation s (HHC or the Company) audited Consolidated Financial Statements for the year ended December 31, 2011 which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2011. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods have been included. We have made certain reclassifications in 2011 to conform to the 2012 presentation. In 2011, we reclassified $3.3 million of deferred income taxes from accounts payable and accrued expenses on the Condensed Consolidated Statements of Cash Flows to conform to the 2012 presentation. During the second quarter of 2012, we reclassified certain salaries and overhead costs relating to land development activities for The Woodlands from general and administrative expenses to Master Planned Community operations. Reclassification of $1.4 million for the six months ended June 30, 2012 was related to the three months ended March 31, 2012, and reclassifications of $1.3 million and $2.5 million were related to the three and six months ended June 30, 2011, respectively. In addition, we reclassified operating costs related to the Columbia office properties from general and administrative expenses to other property costs. The amounts reclassified were $0.1 million and $0.3 million for the three months and six months ended June 30, 2011. The results for the interim period ended June 30, 2012 and 2011 are not necessarily indicative of the results to be expected for the full fiscal year.

As more fully described in Note 4, on July 1, 2011, we acquired our partner s 47.5% economic interest in The Woodlands not previously owned by us. As a result of the acquisition, beginning on July 1, 2011, we consolidated the financial results of The Woodlands which were previously accounted for under the equity method. Our financial statements as of and for the six months ended June 30, 2012 are not comparable to the same period in 2011 due to the consolidation of The Woodlands.

Management has evaluated all material events occurring subsequent to the date of the condensed consolidated financial statements up to the date and time this Quarterly Report is filed on Form 10-Q.

NOTE 2 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010 (the Effective Date), we issued warrants to purchase 8.0 million shares of our common stock to certain of the sponsors (the Sponsors Warrants) with an estimated initial value of approximately $69.5 million. The initial exercise price for the warrants of $50.00 per share is subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. Approximately 6.1 million warrants are immediately exercisable and approximately 1.9 million warrants are exercisable upon 90 days prior notice for the first 6.5 years after issuance and are subsequently exercisable without notice any time thereafter. The Sponsors Warrants expire on November 9, 2017.

In November 2010 and February 2011, we entered into certain warrant agreements (the Management Warrants) with David R. Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our Chief Financial Officer, in each case prior to his appointment to such position. The Management Warrants representing 2,862,687 underlying shares were issued pursuant to such agreements at fair value in exchange for a combined total of approximately $19.0 million in cash from such executives at the commencement of their respective employment. Mr. Weinreb and Mr. Herlitz s warrants have exercise prices of $42.23 per share and Mr. Richardson s warrant has an exercise price of $54.50 per share. Generally, the Management Warrants become exercisable in November 2016 and expire by February 2018.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The estimated $178.4 million fair value for the Sponsors Warrants and estimated $47.8 million fair value for the Management Warrants as of June 30, 2012, have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data. The estimated fair values for the Sponsor Warrants and Management Warrants were $102.6 million and $25.2 million, respectively, as of December 31, 2011. Changes in the fair value of the Sponsors Warrants and the Management Warrants are recognized in earnings, and accordingly, a warrant liability gain of $23.4 million and a warrant liability loss of $98.4 million were recognized for the three and six months ended June 30, 2012, respectively, compared to a warrant liability gain of $56.9 million and a warrant liability loss of $69.1 million for the three and six months ended June 30, 2011, respectively.

NOTE 3 EARNINGS PER SHARE

Basic earnings per share (EPS) is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding. Diluted EPS is computed after adjusting the numerator and denominator of the basic EPS computation for the effects of any potentially dilutive common shares. The dilutive effect of options and non-vested stock issued under stock-based compensation plans is computed using the treasury stock method. The dilutive effect of the Sponsors Warrants and Management Warrants is computed using the if-converted method. Gains, if any, associated with the Sponsors Warrants and Management Warrants are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti-dilutive.

Information related to our EPS calculations is summarized as follows:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except per share amounts)			
Basic EPS:				
Numerator:				
Net income (loss)	$ 34,992	$ 65,993	$ (76,532)	$ (48,494)
Net income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Net income (loss) attributable to common stockholders	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)
Denominator:				
Weighted average basic common shares outstanding	37,907	37,897	37,905	37,897
Diluted EPS:				
Numerator:				
	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)

Net income (loss) attributable to common stockholders				
Less: Warrant liability gain	(23,430)	(56,910)		
Adjusted net income (loss) available to common stockholders	$ 10,880	$ 9,063	$ (77,950)	$ (48,542)
Denominator:				
Weighted average basic common shares outstanding	37,907	37,897	37,905	37,897
Restricted stock and stock options	5	3		
Warrants	2,339	2,970		
Weighted average diluted common shares outstanding	40,251	40,870	37,905	37,897
Basic Earnings (Loss) Per Share:	$ 0.91	$ 1.74	$ (2.06)	$ (1.28)
Diluted Earnings (Loss) Per Share:	$ 0.27	$ 0.22	$ (2.06)	$ (1.28)

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The diluted EPS computation for the three months ended June 30, 2012 excludes 847,937 stock options and 14,900 shares of restricted stock because their inclusion would have been anti-dilutive. The diluted EPS computation for the six months ended June 30, 2012 excludes 847,937 stock options, 57,933 shares of restricted stock and 10,862,687 Sponsors and Management warrants because their inclusion would have been anti-dilutive.

NOTE 4 ACQUISITIONS AND DISPOSITIONS

On May 31, 2012, we acquired our partner s interest in the 393-unit Millennium Waterway Apartments for $6.9 million, following the funding of a $55.6 million ten-year non-recourse mortgage bearing a 3.75% interest rate. Total assets of $78.6 million and liabilities of $56.4 million, including the recently funded loan, were consolidated into our financial statements at fair value as of the acquisition date. Prior to the acquisition, we accounted for our investment in Millennium Waterway Apartments under the equity method. We now own 100% of this stabilized Class A multi-family property located in The Woodlands Town Center. This transaction did not represent a significant acquisition of assets under the SEC rules. Included in the consolidated statements of income (loss) since the acquisition date are revenues of $0.6 million and net income of $0.3 million for the three months ended June 30, 2012. In conjunction with this acquisition, we entered into a new joint venture with the partner to construct a 314-unit Class A multi-family property. Please refer to Note 7 Real Estate Affiliates for a description of the new joint venture.

As previously disclosed in our annual report, we are actively pursuing the sale of our 22-acre site in Pocatello, Idaho (Alameda Plaza). On July 6, 2012, we sold 11.5 acres consisting of 104,705 square feet of mostly vacant retail space for $4.6 million. We are continuing to explore the sale of the remaining 10.5 acres consisting of 85,636 square feet of mostly vacant retail space.

On July 1, 2011, we acquired our partner s 47.5% economic interest (represented by a 57.5% legal interest) in TWCPC Holdings, L.P., The Woodlands Operating Company, L.P. and TWLDC Holdings, L.P. (collectively referred to as The Woodlands) for $117.5 million. The Woodlands is located near Houston, Texas. We made the acquisition so that we can control attractive residential and commercial future development opportunities and assets as well as to internalize The Woodlands platform to benefit our Master Planned Community (MPC) business. As a result of the acquisition, we now consolidate The Woodlands operations and our condensed consolidated financial statements are therefore not comparable to prior periods. Please refer to Note 15 Segments for a presentation of the results as if we consolidated The Woodlands for all periods presented. Prior to such acquisition, we accounted for The Woodlands using the equity method.

Pro Forma Information

The following pro forma information for the three and six months ended June 30, 2011 was prepared as if The Woodlands acquisition had occurred as of the beginning of such period:

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
	(In thousands)	
Total revenues	$ 95,586	$ 185,847
Net income (loss) attributable to common shareholders	72,702	(37,888)

Pro forma adjustments were made for: (1) purchase accounting, including (a) depreciation for the step-up in basis for property, plant and equipment, (b) amortization of in-place and above/below market leases, (c) land cost of sales increase for step-up in land basis for finished lots acquired and sold and (d) amortization of deferred financing costs,

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

prepaid commissions and deferred profits which were eliminated and (2) adjustments for interest expense which is capitalizable in accordance with the Company s interest capitalization policy.

The pro forma information is not necessarily indicative of the results that would have occurred had the acquisition occurred as of the beginning of the period presented, nor is it necessarily indicative of future results.

NOTE 5 IMPAIRMENT

We review our real estate assets, including operating assets, land held for development and sale and developments in progress, for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Generally accepted accounting principles require that if impairment indicators exist and the undiscounted cash flows expected to be generated by an asset are less than its carrying amount, an impairment provision should be recorded to write down the carrying amount of such asset to its fair value. The impairment analysis does not consider the timing of future cash flows and whether the asset is expected to earn an above or below market rate of return.

Our investment in each of the Real Estate Affiliates is evaluated periodically and as deemed necessary for recoverability and valuation declines that are other-than-temporary. If the decrease in value of our investment in a Real Estate Affiliate is deemed to be other-than-temporary, our investment in such Real Estate Affiliate is reduced to its estimated fair value.

There were no impairment charges recorded during the three or six months ended June 30, 2012 and 2011.

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents, for each of the fair value hierarchy levels required under Accounting Standards Codification (ASC) 820, Fair Value Measurement, our assets and liabilities that are measured at fair value on a recurring basis.

	June 30, 2012	December 31, 2011

	Fair Value Measurements Using				Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)				(In thousands)			
Liabilities								
Warrants	$ 226,185	$	$	$ 226,185	$ 127,764	$	$	$ 127,764
Interest rate swaps	6,697		6,697		4,367		4,367	

The valuation of warrants is based on an option pricing valuation model. The inputs to the model include the fair value of the stock related to the warrants, exercise price of the warrants, term, expected volatility, risk-free interest rate and dividend yield.

The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts and includes consideration

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of counterparty credit risk. The variable cash receipts are based on an expectation of future interest rates derived from observable market interest rate curves.

The following table presents a reconciliation of the beginning and ending balances of the fair value measurements using significant unobservable inputs (Level 3):

	2012	2011
	(In thousands)	
Balance as of December 31,	$ 127,764	$ 227,348
Warrant liability loss	98,421	69,135
Purchases		2,000
Balance as of June 30,	$ 226,185	$ 298,483

The significant unobservable input used in the fair value measurement of our warrants designated as Level 3 is as follows:

	Fair Value (In thousands)	Valuation Technique	Unobservable Input	Range/ Average
Warrants	$ 226,185	Option Pricing Valuation Model	Expected Volatility (a)	27%-33% (29.6%)

(a) Based on the asset volatility of comparable companies.

The expected volatility in the table above is a significant unobservable input used to estimate the fair value of our warrant liabilities. An increase in expected volatility would increase the fair value of the liability, while a decrease in expected volatility would decrease the fair value of the liability.

The following table summarizes our assets and liabilities that were measured at fair value on a non-recurring basis as a result of the acquisition of our partner s interest in the Millennium Waterway Apartments.

Quoted Prices in	Significant	Total Loss (Gain)

	Total Fair Value Measurement		Active Markets for Identical Assets (Level 1)		Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Three and Six Months Ended June 30, 2012
					(In thousands)				
Investment in Real Estate Affiliates	$	22,405	$	22,405(a)	$		$		$

(a) We measured our equity interest in Millennium Waterway Apartments based on our purchase of our partners 23.5% economic interest in Millennium