

TRANSCONTINENTAL REALTY INVESTORS INC
Form 10-Q
November 14, 2013

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 September 30, 2013

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 001-09240

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

Nevada
(State or Other Jurisdiction of
Incorporation or Organization)

94-6565852
(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 required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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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 the definitions 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)

8,413,469
(Outstanding at November 5, 2013)

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2013	December 31, 2012
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate, at cost	\$942,013	\$978,781
Real estate held for sale at cost, net of depreciation (\$151 for 2013 and \$4,658 for 2012)	-	18,077
Real estate subject to sales contracts at cost, net of depreciation (\$1,861 for 2013 and \$16,412 for 2012)	41,549	45,706
Less accumulated depreciation	(149,085)	(145,614)
Total real estate	834,477	896,950
Notes and interest receivable:		
Performing (including \$59,444 in 2013 and \$58,008 in 2012 from related parties)	62,522	60,637
Non-performing	685	723
Less allowance for doubtful accounts (including \$2,097 in 2013 and 2012 from related parties)	(2,395)	(2,262)
Total notes and interest receivable	60,812	59,098
Cash and cash equivalents	9,076	16,620
Related party receivables	3,856	-
Investments in unconsolidated joint ventures and investees	5,508	5,439
Other assets	57,517	67,237
Total assets	\$971,246	\$1,045,344
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$712,745	\$730,931
Notes related to real estate held for sale	2,466	18,915
Notes related to real estate subject to sales contracts	28,068	55,976
Stock-secured notes payable	2,195	2,221
Related party payables	-	10,057
Deferred gain (from sales to related parties)	53,096	53,096
Accounts payable and other liabilities (including \$4,783 in 2013 and \$4,282 in 2012 to related parties)	37,047	41,019
Total liabilities	835,617	912,215
Shareholders' equity:		
Preferred stock, Series C: \$0.01 par value, authorized 10,000,000 shares, issued and outstanding 30,000	1	1

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shares in 2013 and 2012 (liquidation preference \$100 per share). Series D: \$0.01 par value, authorized, issued and outstanding 100,000 shares in 2013 and 2012 (liquidation preference \$100 per share)

Common stock, \$0.01 par value, authorized 10,000,000 shares, issued 8,413,669 shares in 2013 and 2012

and outstanding 8,413,469 shares in 2013 and 2012

Treasury stock at cost, 200 shares in 2013 and 2012

Paid-in capital

Retained earnings

Total Transcontinental Realty Investors, Inc. shareholders' equity

Non-controlling interest

Total shareholders' equity

Total liabilities and shareholders' equity

84		84
(2	)	(2)
271,998		272,774
(153,592	)	(156,559)
118,489		116,298
17,140		16,831
135,629		133,129
\$971,246		\$1,045,344

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

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
	(dollars in thousands, except per share amounts)			
Revenues:				
Rental and other property revenues (including \$165 and \$164 for the three months and \$497 and \$499 for the nine months ended 2013 and 2012, respectively, from related parties)	\$26,616	\$26,915	\$78,901	\$79,136
Expenses:				
Property operating expenses (including \$196 and \$225 for the three months and \$602 and \$735 for the nine months ended 2013 and 2012, respectively, from related parties)	13,198	13,343	37,535	38,254
Depreciation and amortization	5,275	4,965	15,525	14,871
General and administrative (including \$721 and \$547 for the three months and \$2,264 and \$1,796 for the nine months ended 2013 and 2012, respectively, from related parties)	1,545	968	4,990	4,176
Provision on impairment of notes receivable and real estate assets	214	-	214	-
Advisory fee to related party	2,168	2,198	6,377	6,719
Total operating expenses	22,400	21,474	64,641	64,020
Net operating income	4,216	5,441	14,260	15,116
Other income (expenses):				
Interest income (including \$2,168 and \$1,092 for the three months and \$6,456 and \$8,107 for the nine months ended 2013 and 2012, respectively, from related parties)	2,131	1,031	6,427	8,129
Other income and expenses (including \$0 and \$1,500 for the three months and \$0 and \$4,500 for the nine months ended 2013 and 2012, respectively, from related parties)	77	1,218	257	4,529
Mortgage and loan interest (including \$397 and \$714 for the three months and \$1,323 and \$2,193 for the nine months ended 2013 and 2012, respectively, from related parties)	(8,873)	(10,198)	(28,110)	(32,586)
Deferred borrowing costs amortization	(90)	552	(3,468)	(2,299)
Loan charges and prepayment penalties	-	(35)	(7,208)	(6,197)
Loss on the sale of investments	(275)	-	(283)	(118)
Earnings (losses) from unconsolidated joint ventures and investees	(30)	5	(28)	(58)

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Litigation settlement	(2,739)	(130)	(2,727)	(135)
Total other expenses	(9,799)	(7,557)	(35,140)	(28,735)
Net loss before gain on land sales, non-controlling interest, and taxes	(5,583	)	(2,116	)	(20,880	)	(13,619)
Gain (loss) on land sales	-		2,913		(48	)	8,074	
Net income (loss) from continuing operations before taxes	(5,583	)	797		(20,928	)	(5,545)
Income tax benefit (expense)	(95	)	(356	)	8,476		1,279	
Net income (loss) from continuing operations	(5,678	)	441		(12,452	)	(4,266)
Discontinued operations:								
Net loss from discontinued operations	(398	)	(1,098	)	(174	)	(1,518)
Gain on sale of real estate from discontinued operations	127		82		24,392		5,173	
Income tax benefit (expense) from discontinued operations	95		356		(8,476	)	(1,279)
Net income (loss) from discontinued operations	(176	)	(660	)	15,742		2,376	
Net income (loss)	(5,854	)	(219	)	3,290		(1,890)
Net income attributable to non-controlling interest	(97	)	(43	)	(323	)	(297)
Net income (loss) attributable to Transcontinental Realty Investors, Inc.	(5,951	)	(262	)	2,967		(2,187)
Preferred dividend requirement	(279	)	(277	)	(830	)	(831)
Net income (loss) applicable to common shares	\$(6,230	)	\$(539	)	\$2,137		\$(3,018)
Earnings per share - basic								
Net income (loss) from continuing operations	\$(0.72	)	\$0.01		\$(1.62	)	\$(0.64)
Net income (loss) from discontinued operations	(0.02	)	(0.08	)	1.87		0.28	
Net income (loss) applicable to common shares	\$(0.74	)	\$(0.07	)	\$0.25		\$(0.36)
Earnings per share - diluted								
Net income (loss) from continuing operations	\$(0.72	)	\$0.01		\$(1.62	)	\$(0.64)
Net income (loss) from discontinued operations	(0.02	)	(0.08	)	1.87		0.28	
Net income (loss) applicable to common shares	\$(0.74	)	\$(0.07	)	\$0.25		\$(0.36)
Weighted average common shares used in computing earnings per share	8,413,469		8,413,469		8,413,469		8,413,469	
Weighted average common shares used in computing diluted earnings per share	8,413,469		8,413,469		8,413,469		8,413,469	
Amounts attributable to Transcontinental Realty Investors, Inc.								
Net income (loss) from continuing operations	\$(5,775	)	\$398		\$(12,775	)	\$(4,563)
Net income (loss) from discontinued operations	(176	)	(660	)	15,742		2,376	
Net income (loss)	\$(5,951	)	\$(262	)	\$2,967		\$(2,187)

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

TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2013
(unaudited, dollars in thousands)

	Total Equity	Comprehensive Income (Loss)	Preferred Stock	Common Shares	Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest
Balance, December 31, 2012	\$ 133,129	\$ (159,156)	\$ 1	8,413,669	\$ 84	\$ (2)	\$ 272,774	\$ (156,559)	\$ -	\$ 16,831
Series C preferred stock dividends (7.0% per year)	(157)	-	-	-	-	-	(157)	-	-	-
Series D preferred stock dividends (9.0% per year)	(673)	-	-	-	-	-	(673)	-	-	-
Net income	3,290	3,290	-	-	-	-	-	2,967	-	323
Sale of controlling interest	54	-	-	-	-	-	54	-	-	-
Distributions to non-controlling interests	(14)	-	-	-	-	-	-	-	-	(14)
Balance, September 30, 2013	\$ 135,629	\$ (155,866)	\$ 1	8,413,669	\$ 84	\$ (2)	\$ 271,998	\$ (153,592)	\$ -	\$ 17,140

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

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

	For the Nine Months Ended September 30,	
	2013	2012
	(dollars in thousands)	
Net income (loss)	\$3,290	\$(1,890)
Other comprehensive income (loss)	-	-
Total comprehensive income (loss)	3,290	(1,890)
Comprehensive income attributable to non-controlling interest	(323)	(297)
Comprehensive income (loss) attributable to Transcontinental Realty Investors, Inc.	\$2,967	\$(2,187)

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

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

	For the Nine Months Ended September 30, 2013 2012 (dollars in thousands)	
Cash Flow From Operating Activities:		
Net income (loss)	\$3,290	\$(1,890)
Adjustments to reconcile net income (loss) applicable to common shares to net cash flows from operating activities:		
Loss (gain) on sale of land	48	(8,074)
Gain on sale of income-producing properties	(24,392)	(5,173)
Depreciation and amortization	16,036	16,663
Provision on impairment of notes receivable and real estate assets	214	-
Amortization of deferred borrowing costs	3,473	2,316
Earnings from unconsolidated joint ventures and investees	8	3
Decrease (increase) in assets:		
Accrued interest receivable	(1,440)	(2,791)
Other assets	138	(1,680)
Prepaid expense	(1,932)	2
Escrow	6,007	1,794
Earnest money	1,170	235
Rent receivables	2,786	(262)
Related party receivables	(3,856)	-
Decrease in liabilities:		
Accrued interest payable	(2,828)	(6,063)
Related party payables	(10,057)	(17,218)
Other liabilities	(5,141)	(18,896)
Net cash used in operating activities	(16,476)	(41,034)
Cash Flow From Investing Activities:		
Proceeds from notes receivable	-	11,993
Originations or advances on notes receivable	(488)	13,400
Acquisition of land held for development	(7)	(18,948)
Proceeds from sale of income-producing properties	76,001	39,999
Proceeds from sale of land	2,537	36,523
Proceeds from sale of investments	-	132
Investment in unconsolidated real estate entities	(77)	1,234
Improvement of land held for development	(373)	(190)
Improvement of income-producing properties	(6,396)	(2,204)
Acquisition of non-controlling interest	-	(69)
Sale of controlling interest	54	113
Construction and development of new properties	(326)	(4,664)
Net cash provided by investing activities	70,925	77,319
Cash Flow From Financing Activities:		

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Proceeds from notes payable	141,452	138,714
Recurring amortization of principal on notes payable	(11,356)	(17,741)
Payments on maturing notes payable	(189,837)	(166,887)
Deferred financing costs	(1,408)	(3,201)
Distributions to non-controlling interests	(14)	(8)
Preferred stock dividends - Series C	(157)	(159)
Preferred stock dividends - Series D	(673)	(672)
Net cash used in financing activities	(61,993)	(49,954)
Net decrease in cash and cash equivalents	(7,544)	(13,669)
Cash and cash equivalents, beginning of period	16,620	19,991
Cash and cash equivalents, end of period	\$9,076	\$6,322
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$18,322	\$29,965
Schedule of noncash investing and financing activities:		
Notes receivable received from related party	\$-	\$6,000
Related party payable/receivable for ARL cost basis sales adjustment	\$-	\$10,445
Acquisition of land for ARL cost basis sales adjustment	\$-	\$(10,445)

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 “TCI”, “the Company”, “we”, “our” or “us” refer to Transcontinental Realty Investors, Inc., a Nevada corporation. TCI is the successor to a California business trust which was organized on September 6, 1983, and commenced operations on January 31, 1984. Effective March 31, 2003, TCI’s financial results were consolidated in American Realty Investors, Inc. (“ARL”) Form 10-K and related consolidated financial statements.

The Company is headquartered in Dallas, Texas and its common stock trades on the New York Stock Exchange (“NYSE”) under the symbol (“TCI”). Subsidiaries of ARL own approximately 83.8% of the Company’s common stock. ARL’s common stock trades on the New York Stock Exchange under the symbol (“ARL”). We have no employees.

TCI is a “C” corporation for U.S. federal income tax purposes and files an annual consolidated tax return with ARL and its ultimate parent, Realty Advisors Management, Inc.

TCI 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 New York Stock Exchange Euronext (“NYSE MKT”) under the symbol (“IOT”).

TCI invests in real estate through direct ownership, leases and partnerships and also invests in mortgage loans on real estate. Pillar Income Asset Management, Inc. (“Pillar”) is the Company’s external Advisor and Cash Manager. Although the Board of Directors is directly responsible for managing the affairs of TCI, and for setting the policies which guide it, the day-to-day operations of TCI are performed by Pillar, as the contractual Advisor, under the supervision of the Board. Pillar’s duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities and arranging debt and equity financing for the Company with third party lenders and investors. Additionally, Pillar serves as a consultant to the Board with regard to their decisions in connection with TCI’s business plan and investment policy. Pillar also serves as an Advisor and Cash Manager to ARL and IOT.

Regis Realty Prime, LLC (“Regis”) manages our commercial properties and provides brokerage services for our real estate portfolio. TCI engages third-party companies to lease and manage its apartment properties. TCI also has a development agreement with Unified Housing Foundation, Inc. (“UHF”), a non-profit corporation that provides management services for the development of residential apartment projects in the future.

Properties

We own or had interests in a total property portfolio of 55 income-producing properties as of September 30, 2013. The properties consisted of:

- 10 commercial buildings consisting of seven office buildings, one industrial warehouse and two retail centers comprising in aggregate approximately 2.3 million rentable square feet;
- 45 apartment communities totaling 8,033 units; excluding apartments being developed; and
 - 4,105 acres of developed and undeveloped land.

We join with various third-party development companies to construct residential apartment communities. We are in the predevelopment process on several residential apartment communities but have not yet begun construction. At September 30, 2013, we had no apartment projects in development. The third-party developer typically holds a general partner, as well as a majority limited partner interest in a limited partnership formed for the purpose of building a single property while we generally take a minority 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.

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 and nine months ended September 30, 2013, 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, 2012, 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, 2012. Certain 2012 financial statement amounts have been reclassified to conform to the 2013 presentation, including adjustments for discontinued operations.

Principles of Consolidation

The accompanying Consolidated 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"). 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 is included in consolidated net income. Our investment in ARL is accounted for under the equity method.

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, after an active program to sell the asset has commenced and if the sale is probable. One of the deciding factors in determining whether a sale is probable is whether the firm purchase commitment is obtained and whether the sale is probable within the year. 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 that the sale is no longer probable, 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 Consolidated 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:

- Unadjusted quoted prices for identical and unrestricted assets or liabilities in Level 1 – 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.

Related Parties

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

Newly Issued Accounting Pronouncements

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our Consolidated Financial 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

Below is a summary of the real estate owned as of September 30, 2013 (dollars in thousands):

Apartments	\$588,035
Commercial properties	212,286
Land held for development	141,692
Real estate held for sale	151
Real estate subject to sales contract	43,410
Total real estate	985,574
Less accumulated depreciation	(151,097)
Total real estate, net of depreciation	\$834,477

The highlights of our significant real estate transactions for the nine months ended September 30, 2013, are listed below:

On January 8, 2013, the Company sold 14.52 acres of land known as Southwood located in Tallahassee, Florida, at a foreclosure auction to an independent third party for \$0.5 million. This land parcel was previously sold on December 31, 2012, to One Realco Corporation, a related party, for a sales price of \$0.6 million. The Company did not recognize or record the sale in accordance with ASC 360-20 due to TCI's continuing involvement, which included the potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer's inadequate initial investment and the Company's questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20. A sale to an independent third party, that met the requirements of ASC 360-20, took place on January 8, 2013, when the property was sold to a third party and sales proceeds were credited against the outstanding debt. There was no gain or loss on the land parcel sale.

On January 28, 2013, the Company sold a 314-unit apartment complex known as Verandas at City View located in Fort Worth, Texas, for a sales price of \$25.3 million to an independent third party. The buyer assumed the existing debt of \$18.2 million secured by the property. We recorded a gain of \$6.2 million on the sale.

On March 14, 2013, the Company sold 13.90 acres of land known as Sheffield located in Grand Prairie, Texas, to an independent third party for a sales price of \$2.3 million. The proceeds from the sale were used to pay off the multi-tract collateral debt, secured by the property. We recorded a nominal loss on the sale of the property.

On April 8, 2013, the Company recorded the transfer of ownership of Eton Square, a 225,566 square foot commercial building, located in Tulsa, Oklahoma, to the existing lender for satisfaction of the current mortgage note. There was a negotiated deficiency between the value of the property and the outstanding mortgage, resulting in a promissory note for \$2.0 million provided by the seller. The promissory note is reduced by \$1.0 million if timely payments are made in accordance with the note. The investment in the entity that owns this commercial building was previously sold on May 18, 2010, to TX Highland RS Corp, a related party, for a sales price of \$13.7 million. The Company did not recognize or record the sale in accordance with ASC 360-20 due to TCI's continuing involvement, which included the

potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer's inadequate initial investment and the Company's questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20. A sale to an independent third party, that met the requirements of ASC 360-20, took place on April 8, 2013, when the property was transferred to the existing lender and sales proceeds were credited against the outstanding debt. We recorded a nominal gain on the sale.

On April 12, 2013, the Company was granted full title to 0.2341 acres of land known as Mininvest, located in Dallas, Texas, by an order of judgment. We paid real estate taxes and have been maintaining the property for the years 1993-2007.

On February 2, 2012, the Company 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. Petra and its affiliate are independent third parties. TCI deferred the recognition of the sale in accordance with ASC 360-20 due to TCI’s continuing involvement related to the obligations under the note and guaranty agreements and the re-acquisition option. As of May 7, 2013, TCI and Petra settled the obligations set forth under the note and guaranty and terminated the re-acquisition option. TCI recorded the sale to the independent third party and recognized a gain of \$11.9 million. In connection with the settlement of certain litigation which had been pending in the U. S. District Court, Eastern District of Louisiana, among Petra, TCI, and a subsidiary, on May 7, 2013, TCI issued a \$5.0 million promissory note payable to the lender which is secured by an unrecorded confession of judgment and a collateral pledge to such lender of 135,000 shares of Series K convertible preferred stock of ARL issued on the same date to TCI. Such promissory note requires regular monthly payments, is pre-payable, and matures on March 5, 2015. The issuance of the \$5.0 million promissory note and collateral to the lender resolved all claims of the lender against TCI including deficiency claims under a mortgage covering certain real property located in New Orleans, Louisiana. The note has prepayment provisions whereby if it is paid off by March 1, 2014, the balance of \$3.5 million is forgiven and if paid off after March 1, 2014 but before March 1, 2015, \$2.5 million will be forgiven and collateral returned to the Company and the judgment released.

On May 9, 2013, the Company sold 225 Baronne, a 422,037 square foot building, located in New Orleans, Louisiana, for a sales price of \$1.5 million to an independent third party. Proceeds of sale were used to pay down a related party payable. We recorded a nominal gain on the sale.

On June 7, 2013, the Company sold a 206-unit apartment complex known as Laguna Vista, located in Farmers Branch, Texas, for a sale price of \$24.8 million to an independent third party. We recorded a gain on sale of \$6.1 million.

As of July 22, 2013, several subsidiaries of the Company entered into a Twenty-Second Amendment to the Agreement for Purchase and Sale for the sale of nine residential apartment complexes. According to the terms of the Agreement, the purchaser will assume the existing loans, secured by the property and the purchaser is in the process of obtaining approval from HUD for this transfer. According to this Amendment, the deposits received by the Company and the title company are now only refundable if HUD does not approve the transfer of assets. The original contract was dated December 5, 2012, and due to the restrictions on the consummation of the sale, the Company has decided that the purchase commitment is not firm and has not met the requirements to be considered held for sale. Upon the approval from HUD, we will reclassify the assets as held for sale. The properties included in this proposed transaction are Dorado Ranch, Huntington Ridge, Legends of El Paso, Mariposa Villas, Paramount Terrace, River Oaks, Savoy of Garland, Stonebridge at City Park, and Vistas at Pinnacle Park.

In December 2010, various commercial and land holdings were sold to FRE Real Estate, Inc., a related party. 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 September 30, 2013, one commercial building, Thermalloy, remains in FRE Real Estate, Inc. The Company did not recognize or record the sale in accordance with ASC 360-20 due to TCI’s continuing involvement, which included the potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer’s inadequate initial investment and the Company’s questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20.

The properties that we have sold to a related party 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, the maker is currently in default on these mortgages primarily due to lack of payment and is 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.

As of September 30, 2013, there remains one apartment complex, one commercial building and 212 acres of land that we have sold to a related party and have deferred the recognition of the sale. These 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, the maker is currently in default on these mortgages primarily due to lack of payment and is 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. The Company did not recognize or record the sale in accordance with ASC 360-20 due to our continuing involvement, which included the potential payment of cash shortfalls, future obligations under the existing mortgage and guaranty, the buyer’s inadequate initial investment and the Company’s questionable recovery of investment cost. The Company determined that no sale had occurred for financial reporting purposes and therefore the asset remained on the books and continued to record operating expenses and depreciation as a period cost until a sale occurred that met the requirements of ASC 360-20. The buyers received no compensation for the facilitation of the bankruptcy or debt restructuring process.

We continue to invest in the development of apartment projects. During the nine months ended September 30, 2013, we have expended \$0.3 million related to the construction or predevelopment of various apartment complexes.

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	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
Miscellaneous related party notes (1)	Various	Various	\$ 664	Various secured interests
S Breeze I-V, LLC	06/14	5.00%	3,078	6% Class A and 25% Class B Limited Partner Interests
Unified Housing Foundation, Inc. (Echo Station) (1)	12/32	12.00%	1,481	100% Interest in Unified Housing of Temple, LLC
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas) (1)	12/32	12.00%	6,363	Membership interest in Housing for Seniors of Humble, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00%	4,663	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Canyon) (1)	12/32	12.00%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch) (1)	12/32	12.00%	6,000	100% Interest in Unified Housing of Vista Ridge, LLC
	12/32	12.00%	2,250	

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Unified Housing Foundation, Inc. (Limestone Ranch) (1)				100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing) (1)	12/32	12.00%	1,936	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00%	4,812	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Sendero Ridge) (1)	12/32	12.00%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC
Unified Housing Foundation, Inc. (Timbers of Terrell) (1)	12/32	12.00%	1,323	100% Interest in Unified Housing of Terrell, LLC
Unified Housing Foundation, Inc. (Tivoli) (1)	12/32	12.00%	6,140	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. (Tivoli) (1)	12/32	12.00%	1,826	100% Interest in Unified Housing of Tivoli, LLC
Unified Housing Foundation, Inc. (1)	12/13	5.00%	6,000	Unsecured
Accrued interest			5,755	
Total Performing			\$ 62,522	
Non-Performing loans:				
Miscellaneous non-related party notes	Various	Various	640	Various secured and unsecured interests
Accrued interest			45	
Total Non-Performing			\$ 685	
Allowance for doubtful accounts			(2,395)	
Total			\$ 60,812	

(1) Related party notes

The Company has various notes receivable from Unified Housing Foundation, Inc. ("UHF"). UHF is determined to be a related party to the company due to our significant investment in the performance of the collateral secured under the notes receivable and its consulting agreement with TCI.

Payments are due from surplus cash flow of operations. Sale or refinance of any of the properties underlying these notes will be used to repay outstanding interest and principal for the remaining notes. These notes are cross-collateralized but to the extent cash is received from a specific UHF property, it is applied against any outstanding interest for the related-property note. The allowance on the UHF notes was a purchase allowance that was netted against the notes when acquired.

As of January 1, 2013, the Company agreed to extend the maturity on the surplus cash flow notes receivable from UHF for an additional term of five years in exchange for the early termination of the preferred interest rate. The original notes gave a five-year period of preferred interest at a rate of 5.25%, before returning to the original note rate of 12.0%.

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 and adjusted for the Company's proportionate share of their undistributed earnings or losses under the equity method of accounting. ARL is our parent company and is considered as an unconsolidated joint venture.

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

	Percentage ownership as of	
	September 30, 2013	September 30, 2012
American Realty Investors, Inc.(1)	1.99 %	1.99 %

(1) Unconsolidated investment in parent company

Our interest in the common stock of ARL in the amount of 1.99% is accounted for under the equity method because we exercise significant influence over the operations and financial activities. Accordingly, the investments are carried at cost, adjusted for the Company's proportionate share of earnings or losses.

On May 6, 2013, TCI acquired 135,000 shares of ARL Series K preferred stock for \$270,000. It was pledged to Petra CRE CDO and used as collateral on a \$5.0 million promissory note relating to the Amoco building settlement agreement. The par value per share is \$2 and the liquidation preference is \$22 per share. It is convertible to common stock at a rate of 5 to 1.

The following is a summary of the financial position and results of operations from our unconsolidated parent (dollars in thousands):

As of September 30,	2013	2012
Real estate, net of accumulated depreciation	\$44,306	\$45,901
Notes receivable	44,328	43,870
Other assets	135,883	130,418
Notes payable	(60,237)	(60,508)
Other liabilities	(93,483)	(84,628)
Shareholders' equity	(70,797)	(75,053)
For the Nine Months Ended September 30,	2013	2012
Revenue	\$9,450	\$5,786
Depreciation	(220)	(194)
Operating expenses	(6,420)	(3,264)
Gain (loss) on land sales	611	(1,507)
Loss on sale of investment	-	(361)
Interest expense	(4,773)	(3,245)
Loss from continuing operations	(1,352)	(2,785)
Income (loss) from discontinued operations	(15)	2,708
Net Loss	\$(1,367)	\$(77)
Company's proportionate share of earnings	\$(27)	\$(2)

NOTE 5. NOTES PAYABLE

Below is a summary of our notes and interest payable as of September 30, 2013 (dollars in thousands):

	Notes Payable	Stock Loans	Accrued Interest	Total Debt
Apartments	\$492,679	\$-	\$1,545	\$494,224
Commercial	105,557	-	258	105,815
Land	95,215	-	2,090	97,305
Real estate held for sale	2,457	-	9	2,466
Real estate subject to sales contract	26,616	-	1,452	28,068
Other	15,120	2,195	281	17,596
Total	\$737,644	\$2,195	\$5,635	\$745,474

On January 24, 2013, the Company refinanced the existing mortgage on Breakwater Bay apartments, a 176-unit complex located in Beaumont, Texas, for a new mortgage of \$9.8 million. We paid off the existing mortgage of \$9.1 million and \$0.3 million in closing costs and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2053.

On January 25, 2013, the Company refinanced the existing mortgage on Northside on Travis apartments, a 200-unit complex located in Sherman, Texas, for a new mortgage of \$13.9 million. We paid off the existing mortgage of \$13.5 million and \$1.3 million in closing costs and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2053.

On January 28, 2013, the Company refinanced the existing mortgage on Capitol Hill apartments, a 156-unit complex located in Little Rock, Arkansas, for a new mortgage of \$9.4 million. We paid off the existing mortgage of \$8.8 million and \$0.3 million in closing costs and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on February 1, 2053.

On February 12, 2013, the construction loan in the amount of \$17.0 million that was taken out on May 13, 2010 to fund the development of Toulon apartments, a 240-unit complex located in Gautier, Mississippi, closed into permanent financing. The note accrues interest at 5.37% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on December 1, 2051.

On February 25, 2013, the Company refinanced the existing mortgage on Mansions of Mansfield apartments, a 208-unit complex located in Mansfield, Texas, for a new mortgage of \$16.3 million. We paid off the existing mortgage of \$15.8 million and \$1.2 million in closing costs and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2053.

On February 25, 2013, the Company refinanced the existing mortgage on Preserve at Pecan Creek apartments, a 192-unit complex located in Denton, Texas, for a new mortgage of \$15.1 million. We paid off the existing mortgage of \$14.6 million and \$1.1 million in closing costs and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based upon a 40-year amortization schedule, maturing on March 1, 2053.

On March 25, 2013, the Company refinanced the existing mortgage on Parc at Clarksville apartments, a 168-unit complex, located in Clarksville, Tennessee, for a new mortgage of \$13.4 million. We paid off the existing mortgage of \$13.0 million and \$0.7 million in closing costs and escrows. The note accrues interest at 2.50% and payments of

interest and principal are due monthly based upon a 40-year amortization schedule, maturing on April 1, 2053.

On May 6, 2013, the Company signed a \$5.0 million promissory note to Petra CRE CDO relating to the Amoco building settlement agreement. The promissory note is collateralized with the ARL Series K preferred stock acquired by the Company.

On June 7, 2013, a wholly-owned subsidiary of IOT entered into a Settlement and Release Agreement and a Loan Purchase Agreement in order to purchase the Mercer/Travelers land mortgage note due to BDF TCI Mercer III, LLC (“BDF”), the existing lender, at a discount. Under the agreement, IOT is required to make monthly deposits of \$250,000 through August 6, 2013 or, if an extension option is exercised, September 5, 2013, with a final lump sum payment of \$28,663,277 due October 4, 2013. Under these agreements, IOT also agreed to purchase an obligation known as the Lamar land loan, due by the Company, from BDF. The Lamar land loan is to be purchased for \$1,836,723, requiring a cash payment of \$336,723 due September 5, 2013 or, if the extension option is exercised, October 4, 2013, and two promissory notes of \$750,000 each. The promissory notes will accrue interest at 5.0% and are due in full on the maturity dates, which will be six and twelve months from the closing date of September 5, 2013 or, if the extension option is exercised, October 4, 2013. During this time, IOT is still obligated to make monthly mortgage interest payments of \$150,000 per month according to the Fourth Modification to the Forbearance Agreement. On October 5, 2013, the Loan Purchase Agreement was modified. IOT was required to pay an extension fee of \$300,000 and the close was extended to November 5, 2013. IOT has the option to pay a second extension fee of \$400,000 and extend the close to December 5, 2013.

On June 26, 2013, the Company refinanced the existing mortgage on Dorado Ranch apartments, a 224-unit complex located in Dallas, Texas, for a new mortgage of \$16.6 million. We paid off the existing mortgage of \$16.2 million and \$1.4 million in closing cost and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based on a 40-year amortization schedule, maturing on July 1, 2053.

On June 26, 2013, the Company refinanced the existing mortgage on Legends of El Paso apartments, a 240-unit complex located in El Paso, Texas, for a new mortgage of \$16.0 million. We paid off the existing mortgage of \$15.2 million and \$1.2 million in closing cost and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based on a 40-year amortization schedule, maturing on July 1, 2053.

On June 26, 2013, the Company refinanced the existing mortgage on Vistas of Pinnacle Park apartments, a 332-unit complex located in Dallas, Texas, for a new mortgage of \$19.0 million. We paid off the existing mortgage of \$18.6 million and \$2 million in closing cost and escrows. The note accrues interest at 2.50% and payments of interest and principal are due monthly based on a 40-year amortization schedule, maturing on June 26, 2053.

On August 30, 2013, the Company obtained a loan of \$1.9 million, secured by 4.02 acres of land known as Denham Springs, located in Denham Springs, Louisiana, 2.90 acres of land known as Sugar Mill, located in Baton Rouge, Louisiana, and 23.24 acres of land known as Cooks Lane, located in Fort Worth, Texas. The existing loan on Denham Springs land for \$0.1 million was paid with the proceeds from the loan.

In conjunction with the development of various apartment projects and other developments, we drew down \$0.3 million in construction loans during the nine months ended September 30, 2013. This was related to the permanent closing of the construction loan for Toulon apartments.

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

The properties that we have sold to a related party 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, the maker is currently in default on these mortgages primarily due to lack of payment and is 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 6. RELATED PARTY TRANSACTIONS

The following table reconciles the beginning and ending balances of accounts receivable from and (accounts payable) to related parties as of September 30, 2013 (dollars in thousands):

	Pillar	ARL	Total
Related party payable, December 31, 2012	\$-	\$(10,057)	\$(10,057)
Cash transfers	14,748	-	14,748
Advisory fees	(6,377)	-	(6,377)
Net income fee	(159)	-	(159)
Fees and commissions	(2,567)	-	(2,567)
Cost reimbursements	(1,984)	-	(1,984)
Interest expense	-	(137)	(137)
Expenses paid by advisor	(824)	-	(824)
Financing (mortgage payments)	22	-	22
Sales/purchases transactions	9,081	-	9,081
Series K preferred stock acquisition	-	(270)	(270)
Purchase of obligations	(11,940)	14,320	2,380
Related party receivable, September 30, 2013	\$-	\$3,856	\$3,856

During the ordinary course of business, we have related party transactions that include, but are not limited to, rental 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 related party amounts included in assets and liabilities, and the related party revenues and expenses received/paid are shown on the face of the financial statements.

NOTE 7. 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, land and other operating segments. Significant differences between and 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 fees, net income and incentive fees, general and administrative, non-controlling interests and net loss from discontinued operations before gains on sale of real estate.

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

Presented below is our reportable segments’ operating income for the three and nine months ended September 30, 2013 and 2012, including segment assets and expenditures (dollars in thousands):

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For the Three Months Ended September 30, 2013	Commercial				Total
	Properties	Apartments	Land	Other	
Rental and other property revenues	\$5,786	\$20,734	\$2	\$94	\$26,616
Property operating expenses	3,673	9,245	261	19	13,198
Depreciation and amortization	1,681	3,594	-	-	5,275
Mortgage and loan interest	1,394	5,301	1,525	653	8,873
Deferred borrowing costs	15	5	31	39	90
Loan charges and prepayment penalties	-	-	-	-	-
Interest income	-	-	-	2,131	2,131
Gain on land sales	-	-	-	-	-
Segment operating income (loss)	\$(977)	\$2,589	\$(1,815)	\$1,514	\$1,311
Capital expenditures	2,998	37	83	-	3,118
Real estate assets	151,783	511,543	171,151	-	834,477
Property Sales					
Sales price	\$-	\$-	\$-	\$-	\$-
Cost of sale	-	(127)	-	-	(127)
Gain on sale	\$-	\$127	\$-	\$-	\$127

For the Three Months Ended September 30, 2012	Commercial				Total
	Properties	Apartments	Land	Other	
Rental and other property revenues	\$7,100	\$19,810	\$-	\$5	\$26,915
Property operating expenses	3,999	9,206	135	3	13,343
Depreciation and amortization	1,418	3,547	-	-	4,965
Mortgage and loan interest	1,521	6,221	1,502	954	10,198
Deferred borrowing costs	22	(632)	58	-	(552)
Loan charges and prepayment penalties	-	-	35	-	35
Interest income	-	-	-	1,031	1,031
Gain on land sales	-	-	2,913	-	2,913
Segment operating income	\$140	\$1,468	\$1,183	\$79	\$2,870
Capital expenditures	1,265	269	-	-	1,534
Real estate assets	169,652	561,375	178,098	-	909,125
Property Sales					
Sales price	\$3,000	\$-	\$17,410	\$-	\$20,410
Cost of sale	2,834	84	15,112	-	18,030
Deferred current gain	-	-	615	-	615
Gain (loss) on sale	\$166	\$(84)	\$2,913	\$-	\$2,995

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

	For the Three Months Ended September 30,	
	2013	2012
Segment operating income	\$ 1,311	\$ 2,870

Other non-segment items of income (expense)			
General and administrative	(1,545)	(968)	
Provision on impairment of notes receivable and real estate assets	(214)	-	
Advisory fee to related party	(2,168)	(2,198)	
Other income	77	1,218	
Loss on sale of investment	(275)	-	
Earnings (loss) from unconsolidated joint ventures and investees	(30)	5	
Litigation settlement	(2,739)	(130)	
Income tax expense	(95)	(356)	
Net income (loss) from continuing operations	\$ (5,678)	\$ 441	

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

	September 30,	
	2013	2012
Segment assets	\$ 834,477	\$ 909,125
Investments in real estate partnerships	5,508	4,992
Notes and interest receivable	60,812	56,449
Other assets	70,449	73,699
Total assets	\$ 971,246	\$ 1,044,265

For the Nine Months Ended September 30, 2013	Commercial				
	Properties	Apartments	Land	Other	Total
Rental and other property revenues	\$ 17,619	\$ 61,148	\$ 36	\$ 98	\$ 78,901
Property operating expenses	10,398	26,327	781	29	37,535
Depreciation and amortization	4,776	10,749	-	-	15,525
Mortgage and loan interest	4,519	17,231	4,304	2,056	28,110
Deferred borrowing costs	55	3,253	118	42	3,468
Loan charges and prepayment penalties	-	7,182	-	26	7,208
Interest income	-	-	-	6,427	6,427
Loss on land sales	-	-	48	-	48
Segment operating income (loss)	\$ (2,129)	\$ (3,594)	\$ (5,215)	\$ 4,372	\$ (6,566)
Capital expenditures	6,050	283	364	-	6,697
Real estate assets	151,783	511,543	171,151	-	834,477
Property Sales					
Sales price	\$ 26,974	\$ 50,122	\$ 2,250	\$ -	\$ 79,346
Cost of sale	14,914	37,790	2,298	-	55,002
Gain (loss) on sale	\$ 12,060	\$ 12,332	\$ (48)	\$ -	\$ 24,344

For the Nine Months Ended September 30, 2012	Commercial				
	Properties	Apartments	Land	Other	Total
Rental and other property revenues	\$ 21,413	\$ 57,675	\$ -	\$ 48	\$ 79,136
Property operating expenses	12,131	25,190	651	282	38,254
Depreciation and amortization	4,226	10,645	-	-	14,871
Mortgage and loan interest	4,501	20,148	4,484	3,453	32,586
Deferred borrowing costs	64	2,126	109	-	2,299
Loan charges and prepayment penalties	-	6,118	79	-	6,197
Interest income	-	-	-	8,129	8,129
Gain on land sales	-	-	8,074	-	8,074
Segment operating income (loss)	\$ 491	\$ (6,552)	\$ 2,751	\$ 4,442	\$ 1,132
Capital expenditures	2,004	504	40	-	2,548
Real estate assets	169,652	561,375	178,098	-	909,125

Property Sales

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Sales price	\$ 9,825	\$ 47,131	\$ 36,390	\$-	\$ 93,346
Cost of sale	10,196	41,587	28,931	-	80,714
Deferred current gain	-	-	615	-	615
Gain (loss) on sale	\$(371)	\$ 5,544	\$ 8,074	\$-	\$ 13,247

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

	For the Nine Months Ended	
	September 30,	
	2013	2012
Segment operating income (loss)	\$ (6,566)	\$ 1,132
Other non-segment items of income (expense)		
General and administrative	(4,990)	(4,176)
Provision on impairment of notes receivable and real estate assets	(214)	-
Advisory fee to related party	(6,377)	(6,719)
Other income	257	4,529
Loss on sale of investment	(283)	(118)
Earnings from unconsolidated joint ventures and investees	(28)	(58)
Litigation settlement	(2,727)	(135)
Income tax benefit	8,476	1,279
Net loss from continuing operations	\$ (12,452)	\$ (4,266)

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

	September 30,	
	2013	2012
Segment assets	\$ 834,477	\$ 909,125
Investments in real estate partnerships	5,508	4,992
Notes and interest receivable	60,812	56,449
Other assets	70,449	73,699
Total assets	\$ 971,246	\$ 1,044,265

NOTE 8. 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 September 30, 2013. Included in discontinued operations are a total of six and eleven properties for 2013 and 2012, respectively. Properties sold in 2013 have been reclassified to discontinued operations for current and prior year reporting periods. In 2013, we sold two apartment complexes (Laguna Vista and Verandas at City View), three commercial properties (225 Baronne, Amoco and Eton Square), and have one commercial property held for sale (Ergon). In 2012, we sold two apartment complexes (Portofino and Wildflower Villas) and three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza). 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 September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues				
Rental and other property revenues	\$(8	) \$2,412	\$3,760	\$10,262
Other income (expense)	-	(1,126	) 20	(187
	(8	) 1,286	3,780	10,075
Expenses				
Property operating expenses	154	1,945	1,744	6,779
Interest expense	4	(256	) 892	1,659
Loan cost amortization	-	5	4	17
Loan fee expense	-	-	-	849
General and administrative	232	227	823	551
Depreciation and amortization	-	463	511	1,794
Losses from unconsolidated joint ventures and investees	-	-	(20	) (56
	390	2,384	3,954	11,593
Loss from discontinued operations before gains on sale of real estate, taxes, and fees	(398) (1,098) (174) (1,518
Gain on sale of discontinued operations	127	82	24,392	5,173

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Income (loss) from discontinued operations	(271)	(1,016)	24,218		3,655
Income tax benefit (expense)	95		356		(8,476)	(1,279
Net income (loss) from discontinued operations	\$ (176	)	\$ (660	)	\$ 15,742		\$ 2,376

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 9. COMMITMENTS AND CONTINGENCIES AND LIQUIDITY

Dynex Commercial, Inc. and Dynex Capital, Inc.

On February 13, 2013, the Court of Appeals, Fifth District of Texas at Dallas (the “Fifth Court of Appeals”) rendered an opinion involving Transcontinental Realty Investors, Inc. (the “Issuer” or “TCI”) in Case No. 05-04-01358-CV styled Basic Capital Management, Inc., American Realty Trust, Inc., Transcontinental Realty Investors, Inc., Continental Poydras Corp., Continental Common, Inc. and Continental Baronne, Inc. v. Dynex Commercial, Inc. and Dynex Capital, Inc. The case was on appeal from the 68th Judicial District Court of Dallas County, Texas, had previously been appealed to the Fifth Court of Appeals and further appealed to the Supreme Court of the State of Texas which had remanded the instant case back to the Fifth Court of Appeals to address certain issues. The case had its origin with Dynex Commercial making loans to Continental Poydras Corp., Continental Common, Inc. and Continental Baronne, Inc. (subsidiaries of Continental Mortgage & Equity Trust (“CMET”), an entity which merged into TCI in 1999 after the original suit was filed). Under the original loan commitment, \$160,000,000 in loans were to be made to the entities. The loans were conditioned on the execution of a commitment between Dynex Commercial and Basic Capital Management, Inc. (“Basic”).

An original trial to a jury resulted in the jury awarding significant damages to Basic for “lost opportunity,” awarding damages in “increased costs” and “lost opportunity” damages to American Realty Trust, Inc. (“ART”) and damages of \$960,646.28 in “increased costs” and \$11,161,520 for “lost opportunity” damages in favor of TCI and its subsidiaries (a total of \$12,122,166.28). The original Trial Court ignored the jury’s findings and entered a “Judgment Notwithstanding the Verdict” (“JNOV”) in Dynex’s favor; the Fifth Court of Appeals has now ruled that the JNOV was improper because there was sufficient evidence to support the jury’s findings. As a result, the Fifth Court of Appeals ordered the Trial Court to enter a new judgment consistent with the jury’s original findings.

The Fifth Court of Appeals also determined that TCI was entitled to damages for “lost opportunities” relating to tenant improvements and awarded TCI an additional \$252,577. Issues relating to attorneys fees were also addressed with the Fifth Court of Appeals ordering the Trial Court to “re-try” the issue of attorney’s fees to determine the amount of fees to which TCI would be entitled on a “breach of commitment” claim. In addition, as a result of the changes in amounts awarded and passage of time, the Fifth Court of Appeals also ordered the Trial Court to recalculate the correct amounts of pre and post-judgment interest owed to Appellants.

While the fifteen year old controversy is not yet fully resolved, the Fifth Court of Appeals opinion is favorable to TCI, but TCI expects continued challenges by Dynex to the Fifth Court of Appeals opinion and any ultimate award of damages by the Trial Court.

Liquidity. Management believes that TCI will generate excess cash from property operations in 2013; such excess, however, will not be sufficient to discharge all of TCI’s obligations as they become due. Management intends to sell land and income-producing real estate, refinance real estate and obtain additional borrowings primarily secured by real estate to meet its liquidity requirements.

Partnership Buyouts. TCI is the limited partner in various partnerships related to the construction of residential properties. As permitted in the respective partnership agreements, TCI 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 buy out the non-affiliated partners are limited to development fees earned by the non-affiliated partners, and are set forth in the respective partnership agreements.

Litigation. The ownership of property and provision of services to the public as tenants entails an inherent risk of liability. Although the Company and its subsidiaries are involved in various items of litigation incidental to and in the

ordinary course of its business, in the opinion of management, the outcome of such litigation will not have a material adverse impact upon the Company's financial condition, results of operation or liquidity.

The Company is involved in and vigorously defending against, a number of deficiency claims with respect to assets that have been foreclosed by various lenders. Such claims are generally against a consolidated subsidiary as the borrower or the Company as a guarantor of indebtedness or performance. Some of these proceedings may ultimately result in an unfavorable determination for the Company and/or one of its consolidated subsidiaries. While we cannot predict the final result of such proceedings, management believes that the maximum exposure to the Company and its consolidated subsidiaries, if any, will not exceed approximately \$20 million in the aggregate and will occur, if at all, in future years.

NOTE 10. 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 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 September 30, 2013, we have 5,000 shares of stock options outstanding, which will expire on January 1, 2015 if not exercised. These options are considered in the computation of diluted earnings per share if the effect of applying the “treasury stock” method is dilutive. We have 30,000 shares of Series C cumulative convertible preferred stock issued and outstanding. The stock has a liquidation preference of \$100.00 per share. After September 30, 2006, the stock may be converted into common stock at 90% of the daily average closing price of the common stock for the prior five trading days. The effects of the Series C Cumulative Convertible Preferred Stock are included in the dilutive earnings per share if applying the if-converted method is dilutive. As of September 30, 2013, the preferred stock and the stock options were anti-dilutive and thus not included in the EPS calculation.

NOTE 11. SUBSEQUENT EVENTS

On October 11, 2013, the Company refinanced the existing mortgage on 600 Las Colinas, a 510,173 square foot commercial building located in Irving, Texas, for a new mortgage of \$41.0 million. TCI paid off the existing mortgage of \$31.0 million and \$5.3 million in closing costs and escrows. The note accrues interest at 5.31% and payments of interest and principal are due monthly based upon a 30-year amortization schedule, maturing on November 1, 2023.

On October 15, 2013, the Company recorded the transfer of ownership of a 26,000 square foot commercial building known as the Ergon building and 7.95 acres of land known as Jackson Capital City land, located in Jackson, Mississippi, to the existing lender for a settlement price of \$3.7 million. The proceeds of this sale were used to pay down stock secured loans with Armed Forces Bank.

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, 2012.

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 matters on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these 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, 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 nine months ended September 30, 2013, we sold \$79.8 million of land and income-producing properties. As of September 30, 2013, we owned 8,033 units in 45 residential apartment communities and 10 commercial properties of comprising approximately 2.3 million rentable square feet. In addition, we owned 4,105 acres of land held for 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 and leasing office, retail and industrial space to commercial tenants. We have no employees.

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.

Pillar Income Asset Management, Inc. ("Pillar") is the Company's external Advisor and Cash Manager. Although the Board of Directors is directly responsible for managing the affairs of TCI, and for setting the policies which guide it, the day-to-day operations of TCI are performed by Pillar, as the contractual Advisor, under the supervision of the Board. Pillar's duties include, but are not limited to, locating, evaluating and recommending real estate and real estate-related investment opportunities and arranging debt and equity financing for the Company with third party lenders and investors. Additionally, Pillar serves as a consultant to the Board with regard to their decisions in connection with TCI's business plan and investment policy. Pillar also serves as an Advisor and Cash Manager to ARL and IOT.

Regis Realty Prime, LLC ("Regis") manages our commercial properties and provides brokerage services for our real estate portfolio. TCI engages third-party companies to lease and manage its apartment properties. TCI also has a development agreement with Unified Housing Foundation, Inc. ("UHF"), a non-profit corporation that provides management services for the development of residential apartment projects in the future.

Critical Accounting Policies

We present our financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). The FASB Accounting Standards Codification ("ASC") 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 its accounting methodologies under the previous accounting standards hierarchy. Instead, we refer to the ASC Codification 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 ARL is accounted for under the equity method.

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.

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.

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.

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.

Acquisitions from our parent, ARL, have previously been reflected at the fair value purchase price. Upon discussion with the SEC and in review of the guidance pursuant to ASC 250-10-45-22 to 24, we have adjusted those assets, in the prior year, to reflect a basis equal to ARL’s cost basis in the asset at the time of the sale. The related party payables to ARL were reduced for the lower asset price.

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.

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

Revenue Recognition on the Sale of Real Estate

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

Non-Performing Notes Receivable

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

Interest Recognition on Notes Receivable

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

Allowance for Doubtful Accounts

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.

Related Parties

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

Results of Operations

The discussion of our results of operations is based on management's review of operations, which is based on our segments. Our segments consist of apartments, commercial buildings, 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 and nine months ended September 30, 2013 and 2012, as included in Part I, Item 1. "Financial Statements" of this report. The prior year's property portfolios have been adjusted for subsequent sales. Continuing operations relates to income-producing properties that were held during those years as adjusted for sales in the subsequent years.

At September 30, 2013 and 2012, we owned or had interests in a portfolio of 55 and 60 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 September 30 for the period presented. Discontinued operations 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 September 30, 2013 for the periods presented.

The table below shows the number of income-producing properties held at the quarter ended:

	September 30,	
	2013	2012
Continuing operations	54	54
Held for sale/subsequent sales	1	6
Total property portfolio	55	60

Comparison of the three months ended September 30, 2013 to the same period ended 2012

For the three months ended September 30, 2013, we reported a net loss applicable to common shares of \$6.2 million or \$0.74 per diluted earnings per share, as compared to a net loss applicable to common shares of \$0.5 million or \$0.07 per diluted earnings per share for the same period ended 2012.

Revenues

Rental and other property revenues were \$26.6 million for the three months ended September 30, 2013. This represents a decrease of \$0.3 million, as compared to the prior period revenues of \$26.9 million. The change, by segment, is an increase in the apartment portfolio of \$0.9 million, a decrease in the commercial portfolio of \$1.3 million and an increase in of \$0.1 million in the land and other portfolios. Within the apartment portfolio, the increase is due primarily to increased rent revenues. Our apartment portfolio continues to thrive in the current economic conditions with occupancies averaging nearly 94%. Within our commercial portfolio, the same properties decreased

by \$1.3 million related to some larger square-foot tenants down-sizing or moving out. We continue to market our properties aggressively to attract new tenants and strive for continuous improvement of our properties in order to maintain our existing tenants. Within the land and other portfolio, the increase is due to oil and gas royalties.

Expenses

Depreciation and amortization expenses were \$5.3 million for the three months ended September 30, 2013. This represents an increase of \$0.3 million, as compared to the prior period depreciation and amortization expenses of \$5.0 million. The majority of this change is in the commercial portfolio related to an increase in tenant improvements and lease commissions due to new leases.

General and administrative expenses were \$1.5 million for the three months ended September 30, 2013. This represents an increase of \$0.5 million, as compared to the prior period expenses of \$1.0 million. The majority of the increase is related to professional services and an increase in our cost reimbursements due to our Advisor.

Other income (expense)

Interest income was \$2.1 million for the three months ended September 30, 2013. This represents an increase of \$1.1 million, as compared to the prior period interest income of \$1.0 million. This increase was due to an agreement made on January 1, 2013, where the Company extended the maturity on the surplus cash flow notes receivable from UHF for an additional term of five years in exchange for the early termination of the preferred interest rate. The original notes gave a five-year period of preferred interest rate at 5.25%, before returning to the original note rate of 12.0%.

Other income was \$77,000 for the three months ended September 30, 2013. This represents a decrease of \$1.1 million, as compared to the prior period other income of \$1.2 million. The prior year income relates to the agreement between UHF and TCI for consulting services related to the development of apartment projects. There were no development projects in progress during the current period.

Mortgage and loan interest was \$8.9 million for the three months ended September 30, 2013. This represents a decrease of \$1.3 million, as compared to the prior period interest expense of \$10.2 million. This change, by segment, is a decrease in the apartment portfolio of \$0.9 million, a decrease in the commercial portfolio of \$0.1 million and a decrease in the other portfolio of \$0.3 million. Within the apartment portfolio, the majority of the decrease relates to the same apartment portfolio due to the refinances closed with long-term, low interest rates. The other portfolio decreased primarily due to the reduction of the related party obligation, resulting in less interest expense owed in the current period.

Deferred borrowing costs amortization was \$0.1 million for the three months ended September 30, 2013. This represents an increase of \$0.6 million as compared to the prior period. The majority of the prior period amount resulted from an adjustment done on a refinance entry in the previous period.

Loss on the sale of investments was \$0.3 million for the three months ended September 30, 2013. This represents an increase of \$0.3 million as compared to the prior period expense. The loss relates to investments made in new apartment development projects that were never realized.

Litigation settlement expense was \$2.7 million for the three months ended September 30, 2013. This represents an increase of \$2.6 million as compared to the prior period expense of \$0.1 million. The settlement expenses relate to guarantor settlements on various land parcels that were foreclosed upon in prior years. In order to avoid future litigation and legal expenses, we settled and are making payment plans on the agreed upon deficiencies.

There were no land sales for the three months ended September 30, 2013. In the prior period we sold 102.28 acres of land in seven separate transactions for an aggregate sales price of \$16.1 million and recorded a gain of \$2.9 million.

Discontinued operations relates to properties that were either sold or held for sale as of the period ended September 30, 2013. Included in discontinued operations are a total of six and eleven properties for 2013 and 2012, respectively. Properties sold in 2013 have been reclassified to discontinued operations for current and prior year reporting periods. In 2013, we sold two apartment complexes (Laguna Vista and Verandas at City View), three commercial properties (225 Baronne, Amoco and Eton Square), and have one commercial property held for sale (Ergon). In 2012, we sold two apartment complexes (Portofino and Wildflower Villas) and three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza). 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 these properties sold and held for sale (dollars in thousands):

	For the Three Months Ended	
	September 30,	
	2013	2012
Revenues		
Rental and other property revenues	\$ (8)	\$ 2,412
Other expense	-	(1,126)
	(8)	1,286
Expenses		
Property operating expenses	154	1,945
Interest expense	4	(256)
Loan cost amortization	-	5
General and administrative	232	227
Depreciation and amortization	-	463
	390	2,384
Loss from discontinued operations before gains on sale of real estate, taxes, and fees	(398)	(1,098)
Gain on sale of discontinued operations	127	82
Income (loss) from discontinued operations	(271)	(1,016)
Income tax expense benefit	95	356
Net loss from discontinued operations	\$ (176)	\$ (660)

Comparison of the nine months ended September 30, 2013 to the same period ended 2012

For the nine months ended September 30, 2013, we reported a net income applicable to common shares of \$2.1 million or \$0.25 per diluted earnings per share, as compared to a net loss applicable to common shares of \$3.0 million or \$0.36 per diluted earnings per share for the same period ended 2012.

Revenues

Rental and other property revenues were \$78.9 million for the nine months ended September 30, 2013. This represents a decrease of \$0.2 million, as compared to the prior period revenues of \$79.1 million. The change, by segment, is an increase in the apartment portfolio of \$3.5 million, a decrease in the commercial portfolio of \$3.8 million and an increase in the land and other portfolios of \$0.1 million. Within the apartment portfolio, the increase is due primarily to increased rent revenues spread across various properties. Our apartment portfolio continues to thrive in the current economic conditions with occupancies averaging nearly 94%. Within our commercial portfolio, the same properties decreased by \$3.8 million related to some larger square-foot tenants down-sizing or moving out. We continue to market our properties aggressively to attract new tenants and strive for continuous improvement of our properties in order to maintain our existing tenants. Within the land and other portfolio, the increase is due to oil and gas royalties and parking revenue.

Expenses

Property operating expenses were \$37.5 million for the nine months ended September 30, 2013. This represents a decrease of \$0.7 million, as compared to the prior period operating expenses of \$38.2 million. This change, by segment, is an increase in the apartment portfolio of \$1.1 million, a decrease in the commercial portfolio of \$1.7 million, an increase in the land portfolio of \$0.1 million, and a decrease in the other portfolio of \$0.2 million. Within the apartment portfolio, there was an increase of \$0.9 million in the same properties and an increase of \$0.2 million in the development properties due to an increase in real estate taxes for several properties in the current period. Within the commercial portfolio, the same properties decreased by \$1.7 million due to real estate tax refunds from protests and litigations for several properties and lease commissions that were expensed in the prior period and adjusted to capitalize according to the lease terms in the current period. The other portfolio decreased from consulting fees incurred in the prior period.

Depreciation and amortization expenses were \$15.5 million for the nine months ended September 30, 2013. This represents an increase of \$0.6 million, as compared to the prior period depreciation expense of \$14.9 million. The majority of this change is in the commercial portfolio related to an increase in tenant improvements and lease commissions.

General and administrative expenses were \$5.0 million for the nine months ended September 30, 2013. This represents an increase of \$0.8 million, as compared to the prior period expenses of \$4.2 million. The majority of the increase is related to professional services and an increase in our cost reimbursements due to our Advisor.

Other income (expense)

Interest income was \$6.4 million for the nine months ended September 30, 2013. This represents a decrease of \$1.7 million, as compared to the prior period interest income of \$8.1 million. The decrease relates to the cash received on the surplus cash flow notes from Unified Housing Foundation, Inc., in the prior period. There were refinance proceeds received on one of the notes and mid-year surplus cash received which allowed for the recognition of previously deferred interest income. This decrease was offset by an agreement made on January 1, 2013, where the Company extended the maturity on the surplus cash flow notes receivable from UHF for an additional term of five years in exchange for the early termination of the preferred interest rate. The original notes gave a five-year period of preferred interest rate at 5.25%, before returning to the original note rate of 12.0%.

Other income was \$257,000 for the nine months ended September 30, 2013. This represents a decrease of \$4.2 million, as compared to the prior period other income of \$4.5 million. The prior year income relates to the agreement between UHF and TCI for consulting services related to the development of apartment projects. There were no development projects in progress during the current period.

Mortgage and loan interest was \$28.1 million for the nine months ended September 30, 2013. This represents a decrease of \$4.5 million, as compared to the prior period interest expense of \$32.6 million. This change, by segment, is a decrease in the apartment portfolio of \$2.9 million, a decrease in the land portfolio of \$0.2 million and a decrease in the other portfolio by \$1.4 million. Within the apartment portfolio, the majority of the decrease relates to the same apartment portfolio due to the refinances closed with long-term, low interest rates. The other portfolio decreased primarily due to the reduction of the related party obligation, resulting in less interest expense owed in the current period.

Deferred borrowing costs amortization was \$3.5 million for the nine months ended September 30, 2013. This represents an increase of \$1.2 million as compared to the prior period expense of \$2.3 million. The majority of the increase is in the same-store apartment portfolio due to the higher loan deferred borrowing costs written off upon the refinance into a new mortgage note in the current period than in the prior period.

Loan charges and prepayment penalties were \$7.2 million for the nine months ended September 30, 2013. This represents an increase of \$1.0 million, as compared to the prior period expense of \$6.2 million. The majority of the increase is in the same-store apartment portfolio due to the prepayment penalties from the refinancing of several existing mortgage notes. There were more refinances completed in the current period than in the prior period.

Loss on the sale of investments was \$0.3 million for the nine months ended September 30, 2013. This represents an increase of \$0.2 million as compared to the prior period expense. The loss relates to investments made in new apartment development projects that were never realized.

Litigation settlement expense was \$2.7 million for the nine months ended September 30, 2013. This represents an increase of \$2.6 million as compared to the prior period expense of \$0.1 million. The settlement expenses relate to

guarantor settlements on various land parcels that were foreclosed upon in prior years. In order to avoid future litigation and legal expenses, we settled and are making payment plans on the agreed upon deficiencies.

Gain (loss) on land sales decreased for the nine months ended September 30, 2013 as compared to the prior period. In the current period we sold 28.4 acres of land in two separate transactions for an aggregate sales price of \$2.75 million and recorded a loss of \$0.1 million. In the prior period, we sold 618.61 acres of land in 16 separate transactions for an aggregate sales price of \$35.1 million and recorded a gain of \$8.1 million.

Discontinued operations relates to properties that were either sold or held for sale as of the period ended September 30, 2013. Included in discontinued operations are a total of six and eleven properties for 2013 and 2012, respectively. Properties sold in 2013 have been reclassified to discontinued operations for current and prior year reporting periods. In 2013, we sold two apartment complexes (Laguna Vista and Verandas at City View), three commercial properties (225 Baronne, Amoco and Eton Square), and have one commercial property held for sale (Ergon). In 2012, we sold two apartment complexes (Portofino and Wildflower Villas) and three commercial properties (305 Baronne, Clarke Garage and Dunes Plaza). 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 these properties sold and held for sale (dollars in thousands):

	For the Nine Months Ended September 30,	
	2013	2012
Revenues		
Rental and other property revenues	\$ 3,760	\$ 10,262
Other income (expense)	20	(187)
	3,780	10,075
Expenses		
Property operating expenses	1,744	6,779
Interest expense	892	1,659
Loan cost amortization	4	17
Loan fee expense	-	849
General and administrative	823	551
Depreciation and amortization	511	1,794
Losses from unconsolidated joint ventures and investees	(20)	(56)
	3,954	11,593
Loss from discontinued operations before gains on sale of real estate, taxes, and fees	(174)	(1,518)
Gain on sale of discontinued operations	24,392	5,173
Income (loss) from discontinued operations	24,218	3,655
Income tax expense	(8,476)	(1,279)
Net income from discontinued operations	\$ 15,742	\$ 2,376

Liquidity and Capital Resources

Our principal liquidity needs are:

- fund normal recurring expenses;
- meet debt service and principal repayment obligations including balloon payments on maturing debt;
- fund capital expenditures, including tenant improvements and leasing costs;
- fund development costs not covered under construction loans; and
- fund possible property acquisitions.

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

- property operations;
- proceeds from land and income-producing property sales;
- collection of mortgage notes receivable;
- collection of receivables from related party companies;
- refinancing of existing debt; and
- additional borrowing, including mortgage notes payable and lines of credit.

We draw on multiple financing sources to fund our long-term capital needs. We generally fund our development projects with construction loans. Management anticipates that our available cash from property operations may not be sufficient to meet all of our cash requirements. Management intends to selectively sell land and income-producing assets, refinance or extend real estate debt and seek additional borrowing secured by real estate to meet its liquidity requirements. Although the past cannot predict the future, historically, management has been successful at extending a portion of our current maturity obligations and selling assets as necessary to meet current obligations.

Cash Flow Summary

The following summary discussion of our cash flows is based on the statements of cash flows as presented in Part I, Item 1. "Financial Statements" and is not meant to be an all-inclusive discussion of the changes in our cash flow (dollars in thousands):

	September 30,		
	2013	2012	Variance
Net cash used in operating activities	\$(16,476)	\$(41,034)	\$24,558
Net cash provided by investing activities	\$70,925	\$77,319	\$(6,394)
Net cash used in financing activities	\$(61,993)	\$(49,954)	\$(12,039)

Our primary use of cash for operations is daily operating costs, general and administrative expenses, advisory fees, and land holding costs. Our primary source of cash from operating activities is from rental income on properties. In addition, we have a related party account in which excess cash is transferred to or from. We used less cash to pay down related party payables and other payables than in the prior period.

Our primary cash outlays for investing activities are for construction and development, acquisition of land and income-producing properties, and capital improvements to existing properties. Our primary sources of cash from investing activities are from the proceeds on the sale of land and income-producing properties. In the current period, we received less proceeds from notes receivable, and we also spent less on the acquisition of land for development.

Our primary sources of cash from financing activities are from proceeds on notes payables either through refinancing our existing loans or by obtaining new financing. Our primary cash outlays are for recurring debt payments and payments on maturing notes payable. There were more sales proceeds used to pay off debt obligations in the current period than in the prior period.

Environmental Matters

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

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

Inflation

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

Tax Matters

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. TCI had a loss for federal income tax purposes after the use of net operating loss carryforwards in the first nine months of 2013, and a loss in 2012 and 2011; therefore, it recorded no provision for income taxes.

At September 30, 2013, TCI had a net deferred tax asset of \$72.4 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that TCI will realize the benefit of the deferred tax assets, a 100% valuation allowance has been established.

In prior periods, TCI was part of the ARL consolidated federal group. During the third quarter 2012, Realty Advisors Management, Inc. and its subsidiaries acquired stock of ARL such that more than 80% of ARL was owned by Realty Advisors Management, Inc. As a result, TCI joined the Realty Advisors Management, Inc. consolidated group for federal income tax reporting.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At September 30, 2013, our exposure to a change in interest rates on our debt is as follows (dollars in thousands, except per share):

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
Notes payable:			
Variable rate	\$ 114,721	4.33%	\$ 1,147
Total decrease in TCI's annual net income			1,147
Per share			\$ 0.14

ITEM 4. CONTROLS AND PROCEDURES

Based on an evaluation by our management (with the participation of our Principal Executive Officer and Principal Financial Officer), as of the end of the period covered by this report, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, to allow timely decisions regarding required disclosures.

There has been no change in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In December 1989, the Board of Directors approved a share repurchase program, authorizing the repurchase of a total of 687,000 shares of TCI's common stock. In June 2000, the Board increased this authorization to 1,387,000 shares. On August 10, 2010, the Board of Directors approved an increase in the share repurchase program for up to an additional 250,000 shares of common stock which results in a total authorization under the repurchase program for up to 1,637,000 shares of our common stock. This repurchase program has no termination date. The following table represents shares repurchased on a monthly basis during the third quarter of 2013:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program
Balance at June 30, 2013			1,230,535	406,465
July 31, 2013	-	\$ -	1,230,535	406,465
August 31, 2013	-	\$ -	1,230,535	406,465
September 30, 2013	-	\$ -	1,230,535	406,465
Total	-			

ITEM 6.

EXHIBITS

The following exhibits are filed with this report or incorporated by reference as indicated;

Exhibit

Number Description

- 3.0 Articles of Incorporation of Transcontinental Realty Investors, Inc., (incorporated by reference to Exhibit No. 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1991).
- 3.1 Certificate of Amendment to the Articles of Incorporation of Transcontinental Realty Investors, Inc., (incorporated by reference to the Registrant's Current Report on Form 8-K, dated June 3, 1996).
- 3.2 Certificate of Amendment of Articles of Incorporation of Transcontinental Realty Investors, Inc., dated October 10, 2000 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
- 3.3 Articles of Amendment to the Articles of Incorporation of Transcontinental Realty Investors, Inc., setting forth the Certificate of Designations, Preferences and Rights of Series A Cumulative Convertible Preferred Stock, dated October 20, 1998 (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998).
- 3.4 Certificate of Designation of Transcontinental Realty Investors, Inc., setting forth the Voting Powers, Designations, References, Limitations, Restriction and Relative Rights of Series B Cumulative Convertible Preferred Stock, dated October 23, 2000 (incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000).
- 3.5 Certificate of Designation of Transcontinental Realty Investors, Inc., setting forth the Voting Powers, Designating, Preferences, Limitations, Restrictions and Relative Rights of Series C Cumulative Convertible Preferred Stock, dated September 28, 2001 (incorporated by reference to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001).
- 3.6 Articles of Amendment to the Articles of Incorporation of Transcontinental Realty Investors, Inc., Decreasing the Number of Authorized Shares of and Eliminating Series B Preferred Stock dated December 14, 2001 (incorporated by reference to Exhibit 3.7 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
- 3.7 By-Laws of Transcontinental Realty Investors, Inc. (incorporated by reference to Exhibit No. 3.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1991).

- 3.8 Certificate of Designation of Transcontinental Realty Investors, Inc., setting forth the Voting Powers, Designations, Preferences, Limitations, Restrictions and Relative Rights of Series D Cumulative Preferred Stock filed August 14, 2006 with the Secretary of State of Nevada (incorporated by reference to Registrant's Current Report on Form 8-K for event dated November 21, 2006 at Exhibit 3.8 thereof).
- 10.1 Advisory Agreement dated as of April 30, 2011, between Transcontinental Realty Investors, Inc., and Pillar Income Asset Management, Inc. (incorporated by reference to Exhibit 10.1 to the registrant's current report on Form 8-K for event occurring May 2, 2011).
- 31.1* Certification of the Principal Executive Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
- 31.2* Certification by the Principal Financial Officer pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
- 32.1* Certification pursuant to 18 U.S.C. 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T.

*

Filed herewith.

SIGNATURE PAGE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TRANSCONTINENTAL REALTY INVESTORS, INC.

Date: November 14, 2013

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

Date: November 14, 2013

By: /s/ Gene S. Bertcher
Gene S. Bertcher
Executive Vice President and Chief Financial
Officer
(Principal Financial Officer)

