

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

AMERICAN REALTY INVESTORS INC  
Form 10-Q/A  
March 04, 2003

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

FORM 10-Q/A  
AMENDMENT NO. 1

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED SEPTEMBER 30, 2002  
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Commission File Number 1-15663  
-----

AMERICAN REALTY INVESTORS, INC.  
-----

(Exact Name of Registrant as Specified in Its Charter)

Nevada  
-----

(State or Other Jurisdiction of  
Incorporation or Organization)

75-2847135  
-----

(I.R.S. Employer  
Identification No.)

1800 Valley View Lane, Suite 300, Dallas, Texas  
-----

(Address of Principal Executive Offices)

75234  
-----

(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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APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

Common Stock, \$.01 par value  
-----

(Class)

11,375,127  
-----

(Outstanding at October 31, 2002)

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This Form 10-Q/A Amendment No. 1 amends the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 as follows:

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Operations - pages 4, 5

NOTE 1. "BASIS OF PRESENTATION" - pages 9, 10

NOTE 10. "OPERATING SEGMENTS - pages 23 - 25

NOTE 11. "DISCONTINUED OPERATIONS" - pages 25, 26

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

Results of Operations - pages 38 - 41

This amendment is made pursuant to the SEC Staff comment letter dated January 7, 2003, to revise the presentation of discontinued operations, pursuant to Statement of Financial Accounting Standards No. 144. See NOTE 1. "BASIS OF PRESENTATION."

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The accompanying Consolidated Financial Statements as of and for the three and nine month periods ended September 30, 2002, have not been audited by independent certified public accountants but in the opinion of the management of American Realty Investors, Inc. ("ARI"), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of consolidated results of operations, consolidated financial position and consolidated cash flows at the dates and for the periods indicated, have been included.

AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS

	September 30, 2002	December 31, 2001
	-----	-----
Assets -----	(dollars in thousands, except per share)	
Real estate held for investment .....	\$ 429,566	\$ 495,437
Less - accumulated depreciation .....	(107,318)	(121,777)
	-----	-----
	322,248	373,660
Real estate held for sale .....	181,791	214,543
Notes and interest receivable		
Performing (\$26,795 in 2002 and \$18,896 in 2001 from		

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affiliates) .....	38,806	22,612
Nonperforming (\$6,632 in 2002 and \$6,994 in 2001 from affiliates) .....	7,650	10,347
	-----	-----
	46,456	32,959
Less--allowance for estimated losses .....	(3,077)	(2,577)
	-----	-----
	43,379	30,382
Pizza parlor equipment .....	12,455	10,454
Less - accumulated depreciation .....	(4,567)	(3,747)
	-----	-----
	7,888	6,707
Leasehold interest - oil and gas properties .....	--	4,719
Less - accumulated depletion .....	--	(1)
	-----	-----
	--	4,718
Oilfield equipment .....	--	511
Less - accumulated depreciation .....	--	(21)
	-----	-----
	--	490
Marketable equity securities, at market value .....	68	96
Cash and cash equivalents .....	3,283	709
Investments in equity investees .....	82,996	77,933
Goodwill, net of accumulated amortization (\$1,763 in 2002 and 2001) .....	11,858	11,858
Other intangibles, net of accumulated amortization (\$948 in 2002 and \$903 in 2001) .....	1,651	1,678
Other assets .....	39,893	35,989
	-----	-----
	\$ 695,055	\$ 758,763
	=====	=====

The accompanying notes are an integral part of these Consolidated Financial Statements.

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AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS - Continued

September 30, December 31,  
2002 2001

-----  
(dollars in thousands,  
except per share)

Liabilities and Stockholders' Equity

Liabilities

Notes and interest payable (\$6,929 in 2002 and \$1,598 in 2001 to affiliates) .....	\$ 380,738	\$ 412,704
Liabilities related to assets held for sale .....	124,309	151,594

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Margin borrowings .....	10,990	28,040
Accounts payable and other liabilities (\$29,873 in 2002 and \$11,389 in 2001 to affiliates) .....	89,618	48,960
	605,655	641,298
Minority interest .....	19,589	27,612
Series F Preferred Stock, 3,968.75 shares in 2001 (liquidation preference \$3,969) .....	--	3,969
Commitments and contingencies		
Stockholders' equity		
Preferred Stock, \$2.00 par value, authorized 50,000,000 shares, issued and outstanding		
Series A, 3,324,910 shares in 2002 and 2,724,910 shares in 2001 (liquidation preference \$33,249), including 900,000 shares in 2002 and 300,000 shares in 2001 held by subsidiaries .....		
	4,850	4,850
Series E, 50,000 shares in 2002 and 2001 (liquidation preference \$5,000) .....		
	100	100
Common Stock, \$.01 par value, authorized 100,000,000 shares; issued 11,375,127 shares in 2002 and 2001 .....		
	114	114
Paid-in capital .....		
	95,336	97,140
Accumulated deficit .....		
	(32,997)	(16,320)
Accumulated other comprehensive income .....		
	2,408	--
	69,811	85,884
	\$ 695,055	\$ 758,763

The accompanying notes are an integral part of these Consolidated Financial Statements.

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AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2002	2001	2002	2001
Property revenue	(dollars in thousands, except per share)			
Rents .....	\$ 26,545	\$ 28,968	\$ 77,966	\$ 87,822
Property operations expenses .....	18,525	19,668	55,306	64,453
Operating income .....	8,020	9,300	22,660	23,369
Land operations				

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Sales .....	18,681	8,229	39,382	41,806
Cost of sales .....	16,063	4,682	33,401	33,546
	-----	-----	-----	-----
Gain on land sales .....	2,618	3,547	5,981	8,260
Pizza parlor operations				
Sales .....	9,274	8,723	27,550	25,282
Cost of sales .....	7,645	7,164	22,392	20,715
	-----	-----	-----	-----
Gross margin .....	1,629	1,559	5,158	4,567
Income from operations .....	12,267	14,406	33,799	36,196
Other income (loss)				
Interest income .....	509	837	1,906	1,997
Equity in loss of investees .....	(4,790)	(3,137)	(14,023)	(8,425)
Equity in gain on sale of real estate by equity investees .....	--	6,589	--	17,969
Loss on sale of investments in equity investees .....	--	--	(531)	(387)
Gain on sale of real estate .....	--	12,334	--	54,600
Other .....	190	(19)	516	58
	-----	-----	-----	-----
	(4,091)	16,604	(12,132)	65,812
Other expenses				
Interest .....	13,656	17,107	45,751	49,793
Depreciation and amortization .....	3,403	3,655	9,861	10,736
General and administrative .....	3,322	4,610	9,803	9,083
Advisory fee to affiliate .....	1,573	1,437	4,825	4,971
Net income fee to affiliate .....	--	(1,128)	--	638
Incentive fee to affiliate .....	--	1,642	--	7,477
Writedown of assets held for sale .....	445	--	445	--
Minority interest .....	436	1,003	1,996	2,483
	-----	-----	-----	-----
	22,835	28,326	72,681	85,181
Net income (loss) from continuing operations .....	(14,659)	2,684	(51,014)	16,827
Discontinued operations:				
Loss from operations .....	(434)	(1,618)	(3,699)	(4,838)
Gain on sale of real estate .....	15,375	--	23,140	--
Equity in gain on sale of real estate by equity investees .....	6,616	--	14,896	--
	-----	-----	-----	-----
Net income (loss) from discontinued operations .....	21,557	(1,618)	34,337	(4,838)
Net income (loss) .....	6,898	1,066	(16,677)	11,989
Preferred dividend requirement .....	(601)	(620)	(1,801)	(1,868)
	-----	-----	-----	-----
Net income (loss) applicable to Common shares ....	\$ 6,297	\$ 446	\$ (18,478)	\$ 10,121
	=====	=====	=====	=====

The accompanying notes are an integral part of these Consolidated Financial Statements.

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	For the Three Months Ended September 30,	
	2002	2001
	(dollars in thousands, except per share amounts)	
Earnings per share - basic and diluted		
Net income (loss) from continuing operations .....	\$ (1.34)	\$ .20
Discontinued operations .....	1.89	(.16)
Net income (loss) applicable to Common shares .....	\$ .55	\$ .04
Weighted average Common shares used in computing earnings per share .....	11,375,127	10,193,217

Options to purchase 110,450 and 107,450 of ARI's Common Stock were excluded in the computation of diluted earnings available to common shares for the three and nine months ended September 30, 2002 and 2001, respectively, because the effect would be antidilutive.

The accompanying notes are an integral part of these Consolidated Financial Statements.

AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
For the Nine Months Ended September 30, 2002

	Series A Preferred Stock	Series E Preferred Stock	Common Stock	Paid-in Capital	Accumulated Deficit
	(dollars in thousands, except per share amounts)				
Balance, January 1, 2002 .....	\$ 4,850	\$ 100	\$ 114	\$ 97,140	\$ (16,300)
Comprehensive income					
Foreign currency translation gain .....	--	--	--	--	--
Net loss .....	--	--	--	--	(16,600)
Common Stock dividends (pre-merger) .....	--	--	--	(25)	--

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Preferred dividends					
Series A Preferred Stock (\$.75 per share) .....	--	--	--	(1,778)	
Series E Preferred Stock (\$.45 per share) .....	--	--	--	(23)	
Other .....	--	--	--	22	
	-----	-----	-----	-----	-----
Balance, September 30, 2002 .....	\$ 4,850	\$ 100	\$ 114	\$ 95,336	\$ (32,9
	=====	=====	=====	=====	=====

The accompanying notes are an integral part of these Consolidated Financial Statements.

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AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

		For the Nine Months Ended September 30,
		-----
		2002
		-----
		(dollars in thousand)
Cash Flows From Operating Activities		
Rents collected .....	\$ 86,322	\$
Pizza parlor sales collected .....	27,314	
Interest collected .....	979	
Distributions received from equity investees' operating cash flow .....	--	
Payments for property operations .....	(59,422)	
Payments for pizza parlor operations .....	(22,458)	
Payments for oil and gas operations .....	--	
Interest paid .....	(42,611)	
Advisory fee paid to affiliate .....	(4,825)	
Incentive fees paid to affiliate .....	--	
Distributions to minority interest holders .....	(1,966)	
General and administrative expenses paid .....	(9,803)	
Other .....	(5,746)	
	-----	
Net cash used in operating activities .....	(32,216)	
Cash Flows From Investing Activities		
Collections on notes receivable .....	5,473	
Pizza parlor equipment purchased .....	(2,034)	
Proceeds from sale of real estate .....	69,677	
Notes receivable funded .....	(1,965)	
Earnest money .....	868	
Investment in real estate entities .....	(2,554)	
Acquisition of real estate .....	(1,359)	
Construction and development .....	(12,303)	
Real estate improvements .....	(3,492)	
Settlement of interest rate swap contract .....	(199)	
Acquisition of leasehold interests .....	--	

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Purchase of oil field equipment .....	--	
	-----	
Net cash provided by investing activities .....	52,112	
Cash Flows from Financing Activities		
Proceeds from notes payable .....	80,893	
Payments on notes payable .....	(95,280)	
Deferred borrowing costs .....	(4,684)	
Net advances from affiliates .....	20,630	
Margin borrowings, net .....	(17,100)	
Preferred dividends paid .....	(1,778)	
Stock sale profits received from affiliate .....	22	
Repurchase of Common Stock .....	--	
Common dividends paid .....	(25)	
	-----	
Net cash used in financing activities .....	(17,322)	
Net increase in cash and cash equivalents .....	2,574	
Cash and cash equivalents, beginning of period .....	709	
	-----	
Cash and cash equivalents, end of period .....	\$ 3,283	\$
	=====	==

The accompanying notes are an integral part of these Consolidated Financial Statements.

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AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued

	For the Nine Months Ended September 30,	
	2002	2001
	-----	
	(dollars in thousands)	
Reconciliation of net income (loss) to net cash used in operating activities		
Net income (loss) .....	\$ (16,677)	\$ 11,989
Adjustments to reconcile net income (loss) to net cash used in operating activities		
Depreciation and amortization .....	11,549	13,169
Gain on sale of real estate .....	(29,121)	(62,860)
Writedown of assets held for sale .....	445	--
Distributions from equity investees' operating cash flow .....	--	53
Increase (decrease) in minority interest .....	30	(214)
Equity in income of investees .....	(873)	(9,544)
Loss on sale of investments in equity investees .....	531	387
Increase in accrued interest receivable .....	(927)	(1,600)
(Increase) decrease in other assets .....	(96)	11,294
Increase in accrued interest payable .....	2,541	28
Increase (decrease) in accounts payable and other		



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liabilities .....	382	(1,907)
	-----	-----
Net cash used in operating activities .....	\$ (32,216)	\$ (39,205)
	=====	=====

Schedule of noncash investing and financing activities

Notes payable from acquisition of real estate .....	\$ --	\$ 2,549
Notes payable assumed by buyer on sale of properties .....	56,495	30,263
Notes receivable from sale of real estate .....	10,321	4,329
Exchange of real estate at carrying value .....	--	3,726
Issuance of Series A Preferred Stock .....	--	35
Issuance of Series F Preferred Stock .....	--	3,969
Cancellation of Series F Preferred Stock .....	(3,969)	--
Note receivable from sales of leasehold interests .....	1,300	--
Sale of real estate to affiliate to satisfy debt .....	24,886	--
Acquisition of assets from affiliate to satisfy debt .....	(16,268)	--
Change in fair value of interest rate swap .....	614	--

The accompanying notes are an integral part of these Consolidated Financial Statements.

AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying Consolidated Financial Statements have been prepared in conformity with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Dollar amounts in tables are in thousands, except per share amounts. Certain balances for 2001 have been reclassified to conform to the 2002 presentation.

Operating results for the nine month period ended September 30, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the Consolidated Financial Statements and Notes thereto included in ARI's Annual Report on Form 10-K for the year ended December 31, 2001 (the "2001 Form 10-K").

On January 1, 2002, ARI adopted Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). The Statement superceded

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Statement 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS No. 121") and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), for segments of a business to be disposed of. SFAS 144 retains the requirements of SFAS No. 121 relating to the recognition and measurement of an impairment loss and resolves certain implementation issues resulting from SFAS No. 121. The adoption of SFAS No. 144 did not have a material impact on the consolidated financial position or results of operations of ARI.

The financial statements and accompanying footnotes have been amended to revise the presentation of discontinued operations, pursuant to Statement of Financial Accounting Standards No. 144. The revision had no impact on the net income (loss) for the periods reported.

In April 2002, the FASB issued Statement 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction" ("SFAS No. 145"). Statement 4, "Reporting Gains and Losses from Extinguishment of Debt" ("SFAS No. 4"), required that gains and losses from the extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary item. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 become effective in fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 will not have a material impact on the consolidated financial position or results of operations of ARI.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous

AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 1. BASIS OF PRESENTATION (Continued)

accounting guidance, principally Emerging Issues Task Force ("EITF") Issue No. 94-3. ARI will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a company's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized.

NOTE 2. REAL ESTATE

In 2002, ARI purchased the following properties:

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurred
----------	----------	------------------------	-------------------	------------------	------------------

First Quarter  
Shopping Center

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Plaza on Bachman Creek/(1)/	Dallas, TX	80,278 Sq.Ft.	\$ 3,103	\$ --	\$ --
Second Quarter Apartments					
Pinecrest/(2)/	North Augusta, SC	120 Units	2,979	--	1,423/(3)
Tiberon Trails/(2)/	Merrillville, IN	376 Units	12,336	--	6,417/(3)
Shopping Center					
Alta Mesa/(2)/	Ft. Worth, TX	59,933 Sq.Ft.	3,797	--	1,804/(3)
Land					
Pioneer Crossing	Austin, TX	79.4 Acres	1,165	1,213	--
Willow Springs	Beaumont, CA	20.7 Acres	140	146	--

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- (1) Exchanged with Transcontinental Realty Investors, Inc. ("TCI"), a related party, for the Oaktree Village Shopping Center, Rasor land parcel and Lakeshore Villas land parcel.
- (2) Property received from Basic Capital Management, Inc. ("BCM"), a related party, for forgiveness of debt. The purchase price was determined using a market rate multiple of net operating income.
- (3) Assumed debt of seller.

In 2001, ARI purchased the following properties:

Property	Location	Units	Purchase Price	Net Cash Paid	Debt Incurred
-----	-----	-----	-----	-----	-----
Second Quarter Apartments					
Glenwood	Addison, TX	168 Units	\$ 6,246	\$ --/(1)/	\$ 2,549/(2)

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- (1) 8.88 acres of Hollywood Casino land and 10.5 acres of Vista Ridge land given as consideration. Exchanged with TCI, a related party.

AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 2. REAL ESTATE (Continued)

- (2) Assumed debt of seller. Exchanged with TCI, a related party.

In 2002, ARI sold the following properties:

Units/	Sales	Net Cash Received/
--------	-------	--------------------

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Property	Location	Acres/Sq.Ft.	Price	(Paid)
First Quarter				
Apartments				
Mallard Lake/(1)/	Greensboro, NC	336 Units	\$ 14,400	\$ --
Villas	Plano, TX	208 Units	8,525	3,701
Land				
Katrina	Palm Desert, CA	2.1 Acres	1,323	(40)
Lakeshore Villas/(2)/	Harris County, TX	16.9 Acres	1,499	215
Rasor/(2)/	Plano, TX	24.5 Acres	1,211	174
Thompson II	Dallas County, TX	.2 Acres	21	20
Vista Ridge	Lewisville, TX	10.0 Acres	1,525	130
Shopping Center				
Oaktree Village/(2)/	Lubbock, TX	45,623 Sq.Ft.	2,302	131
Second Quarter				
Apartments				
Oak Hill	Tallahassee, FL	92 Units	3,200	156/(4)
Regency	Tampa, FL	78 Units	3,200	851
Stonebridge	Florissant, MO	100 Units	4,340	1,142
Office Building				
Centura	Dallas, TX	410,901 Sq.Ft.	50,000	--
Land				
Hollywood Casino	Farmers Branch, TX	42.8 Acres	16,987	--
Marine Creek	Ft. Worth, TX	54.2 Acres	3,700	--
Mason Goodrich	Houston, TX	7.9 Acres	672	46
Mason Goodrich	Houston, TX	10.3 Acres	1,444	93
Mason Goodrich	Houston, TX	18.0 Acres	2,790	--
Monterrey	Riverside, CA	61.0 Acres	4,625	--
Nashville	Nashville, TN	16.6 Acres	1,890	--
Third Quarter				
Apartments				
Conradi House	Tallahassee, FL	98 Units	1,809	388
Lee Hills	Tallahassee, FL	16 Units	445	355
Morning Star	Tallahassee, FL	82 Units	2,217	718
Pheasant Ridge	Bellevue, NE	264 Units	10,400	2,576
Stonegate	Tallahassee, FL	83 Units	1,785	486
Valley Hi	Tallahassee, FL	54 Units	1,452	75
White Pines	Tallahassee, FL	85 Units	764	10
Woodsong	Smyrna, GA	190 Units	9,200	(45)
Land				
Elm Fork	Denton County, TX	14.5 Acres	2,745	(105)
Elm Fork	Denton County, TX	14.2 Acres	1,526	(54)
Elm Fork	Denton County, TX	16.7 Acres	1,617	(299)
Katrina	Palm Desert, CA	80.0 Acres	6,778	(1,382)
Messick	Palm Desert, CA	71.0 Acres	6,015	(163)

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NOTE 2. REAL ESTATE (Continued)

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received/(Paid)
Fourth Quarter				
Apartments				
Daluce	Tallahassee, FL	112 Units	\$ 3,634	\$ 779
Office Building				
Melrose Business Park	Oklahoma City, OK	124,200 Sq.Ft.	1,890	953
Shopping Center				
Alta Mesa	Fort Worth, TX	59,933 Sq.Ft.	3,617	1,399
Land				
Nashville	Nashville, TN	1.0 Acres	140	(4)
Varner Road	Riverside, CA	129.7 Acres	3,700	571

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- /(1)/ Exchanged for Governor's Square, Grand Lagoon, Park Avenue, Greenbriar, Regency and Westwood Apartments.
  - /(2)/ Exchanged with TCI, a related party, for the Plaza on Bachman Creek Shopping Center.
  - /(3)/ Debt assumed by purchaser.
  - /(4)/ Represents dividends on and redemption of Innovo Preferred Stock. See NOTE 7. "NOTES PAYABLE."
  - /(5)/ Sold to TCI, a related party, to satisfy debt. Gain deferred until sale to unrelated party.
  - /(6)/ Sold to TCI, a related party, to satisfy debt. In September 2002, 36 acres sold to unrelated party. Remaining gain deferred until sale to unrelated party.

In 2001, ARI sold the following properties:

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received/(Paid)
First Quarter				
Apartments				
Carriage Park	Tampa, FL	46 Units	\$ 2,005	\$ 757
Rockborough	Denver, CO	345 Units	16,675	3,654
Land				
Frisco Bridges	Collin County, TX	27.8 Acres	4,500	4,130
Katrina	Palm Desert, CA	20.0 Acres	2,831	(124)
Las Colinas	Las Colinas, TX	1.7 Acres	825	233
Plano Parkway	Plano, TX	11.3 Acres	1,445	312
Scoggins	Tarrant County, TX	232.8 Acres	2,913	892
Scout	Tarrant County, TX	408.0 Acres	5,087	1,586
Tree Farm	Dallas County, TX	10.4 Acres	2,888	(87)
Shopping Center				
Regency Pointe	Jacksonville, FL	67,063 Sq.Ft.	7,350	5,126

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Second Quarter

Apartments

Bent Tree	Addison, TX	292 Units	12,050	2,480
Glenwood	Addison, TX	168 Units	6,650	3,166
Kimberly Woods	Tucson, AZ	279 Units	8,450	1,667
Place One	Tulsa, OK	407 Units	12,935	3,310
Shadowood	Addison, TX	184 Units	7,125	1,980

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AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 2. REAL ESTATE (Continued)

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received/(Paid)
Second Quarter				
Land				
Katrina	Palm Desert, CA	20.0 Acres	\$ 2,940	\$ 78
Mason/Goodrich	Houston, TX	22.1 Acres	4,168	(34)
Plano Parkway	Plano, TX	12.0 Acres	740	672
Yorktown	Harris County, TX	120.4 Acres	5,239	(160)
Third Quarter				
Apartments				
Ashford	Tampa, FL	56 Units	2,145	593
Chalet I	Topeka, KS	162 Units	5,650	1,288
Chalet II	Topeka, KS	72 Units	2,100	485
Club Mar	Sarasota, FL	248 Units	8,500	1,905
Covered Bridge	Gainesville, FL	176 Units	7,900	2,463
Crossing at Church	Tampa, FL	52 Units	1,880	750
Land				
Chase Oaks	Plano, TX	22.3 Acres	2,875	663
Chase Oaks	Plano, TX	4.9 Acres	1,973	1,832
Elm Fork	Denton County, TX	10.0 Acres	1,002	(30)
Katrina	Palm Desert, CA	6.1 Acres	1,196	1,108
Katrina	Palm Desert, CA	2.2 Acres	800	(24)
Nashville	Nashville, TN	2.0 Acres	26	(1)
Nashville	Nashville, TN	1.2 Acres	8	--
Razor	Plano, TX	6.6 Acres	350	267

(1) Debt assumed by purchaser.

(2) Gain deferred until 2002, when ARI-provided financing was collected.

NOTE 3. NOTES RECEIVABLE

In May 2002, ARI sold its leasehold interests in various oil and gas mineral development properties for \$1.3 million, receiving a note from the buyer for the purchase price. The note bears interest at 10.0% per annum, matures in May 2004 and requires monthly payments of principal and accrued interest. See NOTE 4.

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"OIL AND GAS OPERATIONS."

In August 2002, ARI sold a 14.2 acre tract of its Elm Fork land parcel for \$1.5 million, paying \$54,000 after payment of closing costs and debt paydown and providing purchase money financing of \$763,000. The loan bore interest at 10.0% per annum and matured in October 2002. All principal and interest were due at maturity. In October 2002, the note was collected in full, including accrued but unpaid interest.

In September 2002, ARI sold its Messick land parcel and an 80.0 acre tract of its Katrina land parcel for \$12.8 million, paying \$1.5 million after payment of closing costs and debt paydown and providing purchase money financing of \$9.6 million. The loan bears interest at 8.0% per annum, matures in September 2004 and requires quarterly payments of accrued interest. All principal and accrued interest are due at maturity.

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 3. NOTES RECEIVABLE (Continued)

In October 2002, ARI sold its Varner Road land parcel for \$3.7 million, receiving \$571,000 after payment of closing costs and providing purchase money financing of \$2.8 million. The loan bears interest at 9.0% per annum, matures in October 2004 and requires quarterly interest payments. All principal and accrued but unpaid interest are due at maturity.

In March 2001, ARI sold a 20.0 acre tract of its Katrina land parcel for \$2.8 million, receiving \$700,000 in cash and providing purchase money financing of the remaining \$2.1 million of the sales price. The loan bore interest at 12.0% per annum and matured in July 2001. All principal and interest were due at maturity. In January 2002, \$274,000 in principal and \$226,000 in interest was collected. In March 2002, the note was collected in full, including accrued but unpaid interest.

In November 2001, ARI sold a 12.7 acre tract of its Santa Clarita parcel for \$1.9 million, receiving \$1.5 million in cash and providing purchase money financing of the remaining \$437,000 of the sales price. The loan bears interest at 8.0% per annum and matures in November 2002. All principal and accrued but unpaid interest are due at maturity.

Also in November 2001, ARI sold the Blackhawk Apartments for \$7.1 million, receiving \$1.5 million in cash after the assumption of \$4.0 million of mortgage debt and providing purchase money financing of the remaining \$1.6 million of the sales price. The loan bore interest at 10.0% per annum and matured in May 2002. Monthly principal and interest payments were required. In April 2002, the note was collected in full, including accrued but unpaid interest.

In December 1999, a note with a principal balance of \$1.2 million, secured by a pledge of a partnership interest in a partnership which owns real estate in Addison, Texas, matured. The maturity date was extended to April 2000 in exchange for an increase in the interest rate to 14.0% per annum. All other terms remained the same. In February 2001, the loan amount was increased to \$1.6 million and the maturity date was extended to June 2001. In February 2002, \$1.5 million in principal and \$87,000 in interest was collected. In May 2002, \$10,000 in principal and accrued interest was collected. In July 2002, the note was collected in full, including accrued but unpaid interest.

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Related Party. In June 2002, ARI converted \$4.5 million of its receivable from BCM, a related party, to a recourse note receivable. This transaction was to provide ARI with additional security over that provided by an unsecured receivable. The note bears interest at 10.0% per annum, matures in March 2004 and requires quarterly payments of principal and accrued interest. The first payment is due in December 2002.

In March 2001, ARI funded \$13.6 million of a \$15.0 million unsecured line of credit to One Realco Corporation ("One Realco"), which owns approximately 14.7% of the outstanding shares of ARI's Common Stock. One Realco periodically borrows money to meet its cash obligations. The

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 3. NOTES RECEIVABLE (Continued)

line of credit bears interest at 12.0% per annum. All principal and interest were due at maturity in February 2002. The line of credit is guaranteed by BCM. In June 2001, \$394,000 in principal and \$416,000 in interest was collected. In December 2001, \$21,000 in principal and \$804,000 in interest was collected. In February 2002, the line of credit was increased to \$18.0 million, accrued but unpaid interest of \$217,000 was added to the principal and the maturity date was extended to February 2004. In March 2002, ARI funded an additional \$1.8 million, increasing the outstanding principal balance to \$15.2 million. All principal and interest are due at maturity. Ronald E. Kimbrough, Executive Vice President and Chief Financial Officer of ARI, is a 10% shareholder of One Realco. Mr. Kimbrough does not participate in day-to-day operations or management of One Realco.

In December 2000, an unsecured loan with a principal balance of \$1.8 million to Warwick of Summit, Inc. ("Warwick") matured. The loan was made to provide funds to purchase, renovate and expand a shopping center property in Warwick, Rhode Island. All principal and interest were due at maturity. In February 2002, \$275,000 of interest was received. In May 2002, \$33,000 of principal and \$267,000 of interest was collected. At September 2002, the loan, with a current principal balance of \$1.7 million and \$97,000 of accrued interest, remained unpaid. Richard D. Morgan, a Warwick shareholder, served as a director of ARI until October 2001.

In December 2000, a loan with a principal balance of \$1.6 million to Bordeaux Investments Two, L.L.C. ("Bordeaux"), matured. The loan, to provide funds to purchase and renovate a shopping center property in Oklahoma City, Oklahoma, is secured by (1) a 100% interest in Bordeaux, which owns a shopping center in Oklahoma City, Oklahoma; (2) 100% of the stock of Bordeaux Investments One, Inc., which owns 6.5 acres of undeveloped land in Oklahoma City, Oklahoma; and (3) the personal guarantees of the Bordeaux members. At September 2002, the loan, and \$633,000 of accrued interest, remained unpaid. Richard D. Morgan, a Bordeaux member, served as a director of ARI until October 2001.

In March 2000, a loan with a principal balance of \$2.5 million to Lordstown, L.P., matured. The loan, to provide funds to purchase for resale various parcels of land, is secured by a second lien on land in Ohio and Florida, by 100% of the general and limited partner interest in Partners Capital, Ltd., the limited partner of Lordstown, L.P., and a profits interest in subsequent land sales. At September 2002, the loan, and \$980,000 of accrued interest, remained unpaid. Tara Group, Inc., a corporation controlled by Richard D. Morgan, is the general



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partner of Lordstown, L.P. Mr. Morgan served as a director of ARI until October 2001.

In October 1999, ARI funded a \$4.7 million loan to Realty Advisors, Inc., the parent company of BCM. The loan, to provide funds for

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 3. NOTES RECEIVABLE (Continued)

acquisitions or working capital needs, was secured by all of the outstanding shares of common stock of American Reserve Life Insurance Company. The loan bore interest at 10.25% per annum and matured in November 2001. In January 2000, \$100,000 was collected. In November 2001, the maturity date was extended to November 2004. The collateral was changed to a subordinate pledge of 850,000 shares of ARI Common Stock owned by BCM. The shares are also pledged to a lender on ARI's behalf. The interest rate was changed to 2% over the prime rate, currently 6.25% per annum, and the accrued but unpaid interest of \$984,000 was added to the principal. The new principal balance is \$5.6 million. All principal and accrued interest are due at maturity.

#### NOTE 4. OIL AND GAS OPERATIONS

In May 2001, ARI purchased the leasehold interests in 37 oil and gas mineral development properties, which include 131 drilled wells. The total proved reserves were 6.5 million barrels of oil and 3.3 billion cubic feet of natural gas. The total purchase price was \$4.7 million, plus a 40% profit participation. The Operator's Interest was purchased for \$375,000, with \$25,000 cash paid at closing. ARI gave a note payable for the remaining \$350,000. The note bore no interest, and matured in May 2002. Monthly principal payments of \$25,000 were required. The Working Interests were purchased for \$4.3 million, with \$125,000 cash paid at closing. ARI gave a note payable for \$250,000. The note bore no interest, and matured in November 2001. One-half of the principal was paid in August 2001. The remaining \$4.0 million was paid by issuing 3,968.75 shares of ARI Series F Preferred Stock, which was redeemable quarterly in an amount equal to 20% of net cash flow from the oil and gas operations. The stock had a liquidation value of \$1,000 per share, and paid no dividends.

In May 2002, ARI sold the leasehold interests for \$1.3 million, receiving a note from the buyer for the purchase price. The note bears interest at 10.0% per annum, matures in May 2004 and requires monthly payments of principal and accrued interest. As part of the sale, the notes payable given by ARI for the purchase of the Operator's Interest (\$350,000) and the Working Interests (\$250,000) were canceled. The 3,968.75 shares of ARI Series F Preferred Stock were also returned to ARI and canceled.

#### NOTE 5. INVESTMENTS IN EQUITY INVESTEEES

Real estate entities. ARI's investment in real estate entities at September 30, 2002, included equity securities of two publicly traded real estate companies, Income Opportunity Realty Investors, Inc. ("IORI") and TCI, and interests in real estate joint venture partnerships. BCM, ARI's advisor, serves as advisor to IORI and TCI.

ARI accounts for its investment in IORI and TCI and the joint venture partnerships using the equity method. The equity securities of IORI and

AMERICAN REALTY INVESTORS, INC.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 5. INVESTMENTS IN EQUITY INVESTEES (Continued)

TCI are pledged as collateral for borrowings. See NOTE 8. "MARGIN BORROWINGS."

ARI's investment in real estate entities, accounted for using the equity method, at September 30, 2002 was as follows:

Investee	Percentage of ARI's Ownership at September 30, 2002	Carrying Value of Investment at September 30, 2002	Equivalent Investee Book Value at September 30, 2002	Market Value of Investment at September 30, 2002
IORI .....	28.49%	\$ 7,628	\$ 10,873	\$ 5,227
TCI .....	49.81	68,508	107,340	66,302
		-----		-----
		76,136		\$ 71,529
				=====
Other .....		6,860		
		-----		
		\$ 82,996		
		=====		

Management continues to believe that the market value of both IORI and TCI undervalues their assets, and, therefore, ARI may continue to increase its ownership in these entities in 2002, as its liquidity permits. On October 3, 2000, ARI and IORI entered into a stock option agreement which provided IORI and ARI with an option to purchase 1,858,900 shares of TCI common stock from a third party. On October 19, 2000, IORI assigned all of its rights to purchase such shares to ARI. The total cost to purchase the TCI shares was \$30.8 million. In October 2000, ARI paid \$5.6 million of the option price. In April 2001, the remainder of the option price was paid and ARI acquired the TCI shares. See ITEM 2. "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS" for discussion of the proposed acquisition of TCI and IORI by ARI.

Set forth below are summarized results of operations of equity investees for the nine months ended September 30, 2002:

Revenues .....	\$ 93,156
Equity in loss of partnerships .....	(1,344)
Property operating expenses .....	73,747
Depreciation .....	15,476
Interest expense .....	30,921
Loss from discontinued operations .....	(1,587)
	-----
Loss before gains on sale of real estate .....	(29,919)
Gain on sale of real estate .....	32,884
	-----
Net income .....	\$ 2,965
	=====

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ARI's share of equity investees' loss before gains on the sale of real estate was \$14.1 million for the nine months ended September 30, 2002, and its share of equity investees' gains on sale of real estate was \$14.9 million for the nine months ended September 30, 2002.

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 5. INVESTMENTS IN EQUITY INVESTEES (Continued)

ARI's cash flow from IORI and TCI is dependent on the ability of each entity to make distributions. In the fourth quarter of 2000, IORI and TCI suspended distributions.

Realty Advisors - Korea. In June 2002, ARI purchased BCM's investment in Realty Advisors - Korea for \$6.0 million. The purchase price was based on the fair value of the interests, which was determined by management and approved by the respective boards of directors, based on expected management fees that will be collected. The business purpose of this transaction was to reduce the affiliate payable owed by BCM to ARI. ARI's receivable from BCM was reduced by \$6.0 million, and no cash was paid by ARI.

ART Florida Portfolio II, Ltd. In January 2002, Investors Choice Florida Public Funds II, in which ART Florida Portfolio II, Ltd. owned an interest, sold Villas Continental Apartments. ARI received \$1.0 million in cash from the sale. ARI's share of the loss incurred on the sale was \$531,000, which is included in loss on sale of investments in equity investees in the accompanying Consolidated Statements of Operations.

#### NOTE 6. MARKETABLE EQUITY SECURITIES - TRADING PORTFOLIO

Since 1994, ARI has been purchasing equity securities of entities other than those of IORI and TCI to diversify and increase the liquidity of its margin accounts. These equity securities are considered a trading portfolio and are carried at market value. In the first nine months of 2002, ARI did not purchase or sell any such securities. At September 30, 2002, ARI recognized an unrealized decrease in the market value of its trading portfolio securities of \$28,000. Unrealized and realized gains and losses on trading portfolio securities are included in other income in the accompanying Consolidated Statements of Operations.

#### NOTE 7. NOTES PAYABLE

In 2002, ARI financed/refinanced or obtained second mortgage financing on the following:

Property	Location	Units/ Acres/Sq.Ft.	Debt Incurred	Debt Discharged	Net Cash Received/ (Paid)
-----	-----	-----	-----	-----	-----
First Quarter					
Land					
Walker	Dallas County, TX	90.6 Acres	\$ 8,500	\$ 8,500	\$ (1,411)
Shopping Center					

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Plaza on Bachman Creek	Dallas, TX	80,278 Sq.Ft.	5,000	--	4,444
Second Quarter Apartments					
Lee Hills	Tallahassee, FL	16 Units	1,750	/(2)/ 117	590
Valley Hi	Tallahassee, FL	54 Units	--	/(2)/ 878	--
White Pines	Tallahassee, FL	85 Units	--	/(2)/ --	--

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 7. NOTES PAYABLE (Continued)

Property	Location	Units/ Acres/Sq.Ft.	Debt Incurred	Debt Discharged	Net Cash Received	Inte Ra
Second Quarter - Continued						
Office Buildings						
Four Hickory Centre	Farmers Branch, TX	221,000 Sq.Ft.	\$ 12,500	/(3)/ \$ --	\$ 3,399	13.0
Fourth Quarter						
Shopping Center						
University Square	Anchorage, AK	22,260 Sq.Ft.	1,250	--	1,229	8.5

Related Party Transactions. In each of the following transactions, except those footnoted as (6), a related party has purchased an entity, which owns the listed property asset, from ARI. ARI has guaranteed that the asset will produce at least a 12% return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay the purchaser any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, the purchaser may require ARI to repurchase the entity for the purchase price. Management has classified these related party transactions as notes payable.

Property	Location	Units/Sq.Ft.	Debt Incurred	Debt Discharged	Net Cash Received	Inte Ra
First Quarter						
Office Building						
Rosedale Towers	Minneapolis, MN	84,798 Sq.Ft.	\$ 5,109	\$ --	\$ 5,109	12.
Two Hickory Centre	Farmers Branch, TX	96,127 Sq.Ft.	4,448	--	4,448	12.
Second Quarter						
Apartments						
Bay Anchor	Panama City, FL	12 Units	255	--	203	5.
Confederate Point	Jacksonville, FL	206 Units	1,929	--	--	12.

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Foxwood	Memphis, TN	220 Units	1,093	--	--	12.
Governor Square	Tallahassee, FL	168 Units	4,480	3,196	611	7.
Grand Lagoon	Panama City, FL	54 Units	2,083	1,209	655	5.
Oak Hill	Tallahassee, FL	92 Units	2,550	1,875	478	5.
Park Avenue	Tallahassee, FL	121 Units	4,400	2,756	1,341	7.
Seville	Tallahassee, FL	62 Units	1,955	1,263	473	5.
Westwood	Mary Ester, FL	120 Units	3,382	2,327	1,023	7.
Windsor Tower	Ocala, FL	64 Units	1,989	1,128	702	5.
Woodhollow	San Antonio, TX	546 Units	8,160	5,349	2,775	7.
Woodsong	Smyrna, GA	190 Units	2,544	--	--	12.
Office Building						
One Hickory Centre	Farmers Branch, TX	102,615 Sq.Ft.	4,468	--	--	12.

- 
- (1) Variable interest rate.
  - (2) Single note with all properties as collateral.
  - (3) \$10.1 million funded at September 30, 2002.
  - (4) IORI, a related party, purchased 100% of the outstanding common shares of Rosedale Corporation ("Rosedale"), a wholly-owned subsidiary of ARI, for \$5.1 million. The purchase price was determined based upon the market value of the property, using a

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 7. NOTES PAYABLE (Continued)

market rate multiple of net operating income. Rosedale owns the Rosedale Towers Office Building. The business purpose of this transaction was for IORI to make an equity investment in Rosedale, anticipating a profitable return, and for ARI to receive cash for its equity investment.

- (5) TCI, a related party, purchased 100% of the common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, for \$4.4 million. The purchase price was determined based upon the market value of the property, using a market rate multiple of net operating income. Two Hickory owns the Two Hickory Centre Office Building. The business purpose of this transaction was for TCI to make an equity investment in Two Hickory, anticipating a profitable return, and for ARI to receive cash for its equity investment.
- (6) Properties sold to partnerships controlled by Metra Capital, LLC ("Metra"). Innovo Group, Inc. ("Innovo") is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a Director of ARI, controls approximately 11.67% of the outstanding common stock of Innovo. Management has determined to treat this sale as a refinancing transaction. ARI will continue to report the assets and the new debt incurred by Metra on its financial statements. ARI also received \$6.3 million of 8% non-recourse, non-convertible Series A Preferred Stock ("Preferred Shares") of Innovo.

The dividend on the Preferred Shares will be funded entirely and solely through member distributions from cash flows generated by the operation

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and subsequent sale of the sold properties. In the event the cash flows for the properties are insufficient to cover the 8% annual dividend, Innovo will have no obligation to cover any shortfall.

The Preferred Shares have a mandatory redemption feature, and are redeemable from the cash proceeds received by Innovo from the operation and sale of the properties. All member distributions that are in excess of current and accrued 8% dividends must be used by Innovo to redeem the Preferred Shares. Since redemption of these shares is subject to the above future events, management has elected to record no basis in the Preferred Shares.

- (7) TCI, a related party, purchased all of the general and limited partnership interests in Garden Confederate Point, L.P. ("Confederate Point") from ARI for \$1.9 million. The purchase price was determined based upon the market value of the property, using a market rate multiple of net operating income. Confederate Point owns the Confederate Point Apartments. The business purpose of this transaction was for TCI to make an equity investment in Confederate Point, anticipating a profitable return, and for ARI to receive a return on its equity investment.

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 7. NOTES PAYABLE (Continued)

- (8) TCI, a related party, purchased all of the general and limited partnership interests in Garden Foxwood, L.P. ("Foxwood") from ARI for \$1.1 million. The purchase price was determined based upon the market value of the property, using a market rate multiple of net operating income. Foxwood owns the Foxwood Apartments. The business purpose of this transaction was for TCI to make an equity investment in Foxwood, anticipating a profitable return, and for ARI to receive a return on its equity investment.
- (9) TCI, a related party, purchased all of the general and limited partnership interests in Garden Woodsong, L.P. ("Woodsong") from ARI for \$2.5 million. The purchase price was determined based upon the market value of the property, using a market rate multiple of net operating income. Woodsong owns the Woodsong Apartments. The business purpose of this transaction was for TCI to make an equity investment in Woodsong, anticipating a profitable return, and for ARI to receive a return on its equity investment. TCI sold the Woodsong Apartments in July 2002.
- (10) Sold to unrelated buyer in June 2002.
- (11) TCI, a related party, purchased 100% of the common shares of ART One Hickory Corporation ("One Hickory"), a wholly-owned subsidiary of ARI, for \$4.5 million. The purchase price was determined based upon the market value of the property, using a market rate multiple of net operating income. One Hickory owns the One Hickory Centre Office Building. The business purpose of this transaction was for TCI to make an equity investment in One Hickory, anticipating a profitable return, and for ARI to receive a return on its equity investment.

In 2001, ARI financed/refinanced or obtained second mortgage financing on the following:

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Property -----	Location -----	Acres/Rooms/ Sq.Ft. -----	Debt Incurred -----	Debt Discharged/ (Paid) -----	N R -----
First Quarter					
Land					
Mason/Goodrich	Houston, TX	235.0 Acres	\$ 6,750	\$ --	\$
Pioneer Crossing	Austin, TX	350.1 Acres	7,000	--	
Pioneer Crossing	Austin, TX	14.5 Acres	2,500	--	
Second Quarter					
Land					
Hollywood Casino	Farmers Branch, TX	51.7 Acres	2,500/(1)/	--	
Valwood	Dallas County, TX	19.4 Acres	--/(1)/	--	
Katrina	Palm Desert, CA	300.5 Acres	22,000	15,584	
Jeffries Ranch	Oceanside, CA	82.4 Acres	5,250/(3)/	750	
Willow Springs	Riverside, CA	1,485.7 Acres	--/(3)/	--	
Hotel					
Williamsburg					
Hospitality House	Williamsburg, VA/(4)/	296 Rooms	10,309	--	

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 7. NOTES PAYABLE (Continued)

Property -----	Location -----	Acres/Rooms/ Sq.Ft. -----	Debt Incurred -----	Debt Discharged -----	N R -----
Second Quarter - Continued					
Shopping Center					
Cullman	Cullman, AL	92,486 Sq.Ft.	\$ --/(3)/	\$ 129	
Third Quarter					
Apartments					
Sun Hollow	El Paso, TX	216 Units	--/(5)/	--	
Waters Edge III	Gulfport, MS	238 Units	--/(5)/	--	
Woodlake	Carrollton, TX	256 Units	--/(5)/	--	
Office Building					
Centura Tower	Farmers Branch, TX	410,910 Sq.Ft.	28,739	28,384	
Rosedale Towers	Minneapolis, MN	84,798 Sq.Ft.	7,500/(5)/	--	
Land					
Chase Oaks	Plano, TX	6.9 Acres	1,633	1,000	
Marine Creek	Fort Worth, TX	54.2 Acres	1,500	750	
Mercer Crossing	Carrollton, TX	31.3 Acres	2,937	1,986	
Vista Ridge	Lewisville, TX	90.3 Acres	9,085	9,119	
Vista Ridge	Lewisville, TX	23.0 Acres	1,345	1,000	

- 
- (1) Single note, with both properties as collateral.
  - (2) Variable interest rate.
  - (3) Single note, with all properties as collateral.
  - (4) Also secured by 1,846,000 shares of TCI common stock.
  - (5) Single note, with all properties as collateral.

In August 2002, the lender on one of ARI's hotel properties notified ARI that ARI was in default under the provisions of the loan agreement regarding timely payment and debt service coverage ratio. ARI is negotiating with the lender and expects to resolve the issue.

NOTE 8. MARGIN BORROWINGS

ARI has margin arrangements with various financial institutions and brokerage firms which provide for borrowing of up to 50% of the market value of marketable equity securities. The borrowings under such margin arrangements are secured by equity securities of IORI and TCI and ARI's trading portfolio securities and bear interest rates ranging from 5.25% to 24.0%. Margin borrowing totaled \$11.0 million at September 30, 2002.

In April 2000, ARI obtained a security loan in the amount of \$5.0 million from a financial institution. ARI received net cash of \$4.6 million after paying various closing costs. The loan bore interest at 1% over the prime rate, currently 5.25% per annum, required monthly payments of interest and matured in September 2002. In September 2002, the interest rate was increased to 7.00% per annum, and the maturity date was extended to February 2003. The loan is secured by 1,050,000 shares of ARI Common Stock held by BCM, ARI's advisor.

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 8. MARGIN BORROWINGS (Continued)

In March 2001, ARI obtained a security loan in the amount of \$3.5 million from a financial institution. ARI received net cash of \$3.5 million after paying various closing costs. The loan bore interest at 16.0% per annum. In April and May 2001, a total of \$2.0 million in principal paydowns were made. In July 2001, the loan was repaid in full, including accrued but unpaid interest. The loan was secured by 472,000 shares of TCI common stock owned by ARI and 128,000 shares of ARI Common Stock owned by One Realco.

In September 2001, ARI obtained a security loan in the amount of \$20.0 million from a financial institution. ARI received net cash of \$16.1 million after the payment of various closing costs and \$3.4 million repayment of principal and accrued interest on an existing loan with the same lender. Of the total loan amount, \$19.5 million bore interest at 24% per annum, while the remaining \$500,000 bore interest at 20% per annum. The loan required monthly payments of interest only and matured in September 2002. In September 2002, \$15.0 million of the principal was repaid. The loan is secured by 2,602,608 shares of TCI common stock held by ARI and 920,507 shares of TCI common stock held by BCM, ARI's advisor.

In October 2001, ARI obtained a security loan in the amount of \$1.0 million from a financial institution. ARI received net cash of \$1.0 million after payment of



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various closing costs. The loan bears interest at 1% over the prime rate, currently 5.25% per annum, requires monthly payments of interest only and matures in October 2003. The loan is callable upon 60 days prior notice, and is secured by 200,000 shares of ARI Common Stock held by BCM, ARI's advisor.

### NOTE 9. INCOME TAXES

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. ARI had no taxable income or provision for income taxes in the nine months ended September 30, 2002 or 2001.

### NOTE 10. OPERATING SEGMENTS

Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative 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 equity in loss of investees, equity in gain on sale of real estate by equity investees, loss on sale of investments in equity investees and other income which totaled \$2.0 million and \$858,000 for the three and nine months ended September 30, 2002 and \$3.4 million and

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

### NOTE 10. OPERATING SEGMENTS (Continued)

\$9.2 million for 2001. Expenses that are not reflected in the segments are general and administrative expenses, minority interest, incentive fees, advisory fees, net income fees, provision for loss and discontinued operations, which totaled \$6.2 million and \$20.8 million for the three and nine months ended September 30, 2002 and \$9.4 million and \$31.2 million for 2001. Excluded from operating segment assets are assets of \$125.8 million in 2002 and \$119.9 million in 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses, and ARI conducted all of its business within the United States, with the exception of Hotel Sofia, which is located in Bulgaria.

Presented below are ARI's reportable segments operating income for the three and nine months ended September 30, 2002 and 2001, and segment assets at September 30, 2002 and 2001.

Three Months Ended September 30, 2002 -----	Commercial Properties -----	Apartments -----	U.S. Hotels -----	Inter- national Hotels -----	Land -----	\$
Operating revenue .....	\$ 7,300	\$ 9,073	\$ 8,926	\$ 1,250	\$ 15	\$
Interest income .....	--	--	--	--	--	\$
Operating expenses .....	4,030	6,129	6,315	675	1,358	\$
	-----	-----	-----	-----	-----	\$
Operating income (loss) ...	\$ 3,270	\$ 2,944	\$ 2,611	\$ 575	\$ (1,343)	\$

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	=====	=====	=====	=====	=====
Depreciation .....	\$ 1,323	\$ 786	\$ 776	\$ 221	\$ --
Interest .....	2,202	2,329	1,088	338	4,617
Capital expenditures .....	5,194	211	387	--	759
Assets .....	139,870	92,294	66,488	23,596	181,791

Property Sales:	Apartments	Land
	-----	----
Sales price .....	\$28,072	\$ 18,681
Cost of sale .....	12,697	16,063
Gain on sale .....	\$15,375	\$ 2,618/(1)/
	=====	=====

(1) Includes \$34,000 gain recognized in September 2002 upon the sale of land by TCI to an unrelated party. The gain was deferred in June 2002 when the land was sold to TCI by ARI.

Nine Months Ended September 30, 2002	Commercial Properties	Apartments	U.S. Hotels	Inter- national Hotels	Land
-----	-----	-----	-----	-----	----
Operating revenue .....	\$ 23,310	\$25,810	\$24,628	\$ 3,718	\$ 76
Interest income .....	--	--	--	--	--
Operating expenses .....	13,644	16,351	17,734	1,998	5,438
Operating income (loss) ...	\$ 9,666	\$ 9,459	\$ 6,894	\$ 1,720	\$ (5,362)
	=====	=====	=====	=====	=====
Depreciation .....	\$ 3,674	\$ 2,279	\$ 1,939	\$ 1,128	\$ --
Interest .....	8,268	8,093	3,211	368	16,013
Capital expenditures .....	12,227	759	745	--	2,064
Assets .....	139,870	92,294	66,488	23,596	181,791

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 10. OPERATING SEGMENTS (Continued)

Property Sales:	Commercial Properties	Apartments	Land
	-----	-----	----
Sales price .....	\$ 52,302	\$ 50,769	\$ 39,382
Cost of sale .....	52,302	27,629	33,401
	-----	-----	-----

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Gain on sale .....	\$	--	\$ 23,140	\$ 5,981/(1)/
	=====		=====	=====

-----  
(1) Includes \$830,000 gain recognized in 2002 upon collection of note receivable for 2001 land sale.

Three Months Ended September 30, 2001 -----	Commercial Properties -----	Apartments -----	U.S. Hotels -----	Inter- national Hotels -----	Land -----
Operating revenue .....	\$ 7,783	\$ 10,919	\$ 8,750	\$ 1,283	\$ 40
Interest income .....	--	--	--	--	--
Operating expenses .....	4,036	7,739	4,283	1,396	2,206
Operating income (loss) ....	\$ 3,747	\$ 3,180	\$ 4,467	\$ (113)	\$ (2,166)
	=====	=====	=====	=====	=====
Depreciation .....	\$ 1,229	\$ 879	\$ 629	\$ 554	\$ --
Interest .....	2,662	2,684	1,102	325	7,940
Capital expenditures .....	5,700	--	116	--	1,006
Assets .....	166,811	115,326	68,024	25,952	228,476

Property Sales:	Apartments -----	Land -----
Sales price .....	\$ 28,175	\$ 8,229
Cost of sale .....	15,841	4,682
Gain on sale .....	\$ 12,334	\$ 3,547
	=====	=====

Nine Months Ended September 30, 2001 -----	Commercial Properties -----	Apartments -----	U.S. Hotels -----	Inter- national Hotels -----	Land -----
Operating revenue .....	\$ 22,635	\$ 36,860	\$ 24,688	\$ 3,009	\$ 145
Interest income .....	--	--	--	--	--
Operating expenses .....	12,432	23,583	18,781	2,821	6,750
Operating income (loss) ....	\$ 10,203	\$ 13,277	\$ 5,907	\$ 188	\$ (6,605)
	=====	=====	=====	=====	=====
Depreciation .....	\$ 3,691	\$ 2,948	\$ 1,938	\$ 1,204	\$ --
Interest .....	8,206	11,843	3,375	519	21,308
Capital expenditures .....	10,511	20	436	1,000	1,322
Assets .....	166,811	115,326	68,024	25,952	228,476

Property Sales:	Commercial Properties -----	Apartments -----	Land -----
Sales price .....	\$ 7,350	\$ 94,065	\$ 41,806
Cost of sale .....	5,058	41,757	33,546
	-----	-----	-----

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Gain on sale .....	\$ 2,292	\$ 52,308	\$ 8,260
	=====	=====	=====

NOTE 11. DISCONTINUED OPERATIONS

Effective January 1, 2002, ARI adopted Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which established a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. This statement requires that the operations related to properties that have been sold or properties that are intended to be

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 11. DISCONTINUED OPERATIONS (Continued)

sold be presented as discontinued operations in the statement of operations for all periods presented, and properties intended to be sold are to be designated as "held-for-sale" on the balance sheet.

For the three and nine months ended September 30, 2002 and 2001, income from discontinued operations relates to 15 properties and leasehold interest in oil and gas properties that ARI sold during the first nine months of 2002. The following table summarizes revenue and expense information for these properties sold and held-for-sale.

	For the Three Months Ended September 30,		For the
	2002	2001	En
	-----	-----	-----
Revenue			20
Rental .....	\$ 574	\$ 3,841	\$ 7,
Property operations .....	760	2,670	4,
	-----	-----	-----
	(186)	1,171	3,
Expenses			
Interest .....	189	1,954	5,
Depreciation .....	59	835	1,
	-----	-----	-----
	248	2,789	6,
	-----	-----	-----
Net loss from discontinued operations .....	(434)	(1,618)	(3,
Gain on sale of real estate .....	15,375	--	23,
Equity in gain on sale of real estate by equity investees .....	6,616	--	14,
	-----	-----	-----
Net income (loss) from discontinued operations .....	\$ 21,557	\$ (1,618)	\$34,
	=====	=====	=====

Discontinued operations have not been segregated in the consolidated statements

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of cash flows. Therefore, amounts for certain captions will not agree with respective consolidated statements of operations.

### NOTE 12. COMMITMENTS AND CONTINGENCIES

Liquidity. Management expects that cash generated from operations during the remainder of 2002 will not be sufficient to discharge all of ARI's debt obligations as they mature. Therefore, ARI will rely on aggressive land sales, selected income producing property sales and, to the extent necessary, additional borrowings to meet its cash requirements.

Commitments. In March 1999, ARI reached an agreement with the Class A unitholders of Valley Ranch, L.P. to acquire their eight million Class A units for \$1.00 per unit. In 1999, three million units were purchased. Additionally, one million units were purchased in January 2000, two million units were purchased in May 2001 and one million units were purchased in May 2002. The remaining one million units were purchased in August 2002.

Litigation. In August 2002, ARI obtained a favorable jury verdict in the legal action entitled American Realty Trust v. Matisse. However,

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

### NOTE 12. COMMITMENTS AND CONTINGENCIES (Continued)

the judge set aside the jury verdict and imposed a judgment against ARI in excess of \$6.0 million. The judgment is being appealed, and, in the opinion of ARI's management and legal counsel, there is a reasonable probability that the adverse judgment will be set aside and the jury verdict reinstated. Therefore, ARI has not recognized any expense nor established any reserve for this judgment.

In addition to the Matisse litigation, and the Olive litigation as discussed in ITEM 2. "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS," ARI is involved in various lawsuits arising in the ordinary course of business. In the opinion of ARI's management, the outcome of these lawsuits will not have a material impact on ARI's financial condition, results of operations or liquidity.

### NOTE 13. GOODWILL AND OTHER INTANGIBLES - ADOPTION OF SFAS 142

In June 2001, the Financial Accounting Standards Board finalized Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141"), and No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations initiated after June 30, 2001. SFAS 141 also requires that ARI recognize acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001. It also requires, upon adoption of SFAS 142, that ARI reclassify the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires that ARI identify reporting units in order to assess

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potential future impairment of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. SFAS 142 requires that an intangible asset with an indefinite useful life be tested for impairment in accordance with specified guidelines. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 required ARI to complete a transitional goodwill impairment test six months from the date of adoption. ARI was also required to reassess the useful lives of other intangible assets within the first interim quarter after adoption of SFAS 142.

The adoption of SFAS 141 did not have a material impact on ARI's results of operations and financial position. ARI adopted SFAS 142 on January 1, 2002, and accordingly ceased amortizing costs in excess of net assets acquired. In connection with the adoption of SFAS 142, ARI completed

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### AMERICAN REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

#### NOTE 13. GOODWILL AND OTHER INTANGIBLES - ADOPTION OF SFAS 142 (Continued)

the first step of the goodwill impairment test during the quarter ended June 30, 2002. Based on the results of this step, ARI believes that the fair value of its reporting unit that carries goodwill exceeds its carrying amount. Since the first step of the goodwill impairment test indicates that goodwill is not impaired, the second step of the goodwill impairment test is not necessary.

Transitional Disclosures. Net income (loss) applicable to Common shares and earnings per share, including the after-tax effect of amortization expense related to costs in excess of net assets acquired for the three and nine months ended September 30, 2002 and 2001 are as follows:

	Three Months Ended September 30,		Nine Months September	
	2002	2001	2002	
Net income (loss) applicable to Common shares .....	\$ 6,297	\$ 446	\$(18,478)	\$
Add back:				
Amortization of costs in excess of net assets acquired .....	--	89	--	
Adjusted net income (loss) applicable to Common shares .....	\$ 6,297	\$ 535	\$(18,478)	\$
 Earnings per share:				
Net income (loss) applicable to Common shares .....	\$ .55	\$ .04	\$ (1.62)	\$
Amortization of costs in excess of net assets acquired .....	--	.01	--	
Adjusted net income (loss) applicable to Common shares .....	\$ .55	\$ .05	\$ (1.62)	\$

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Acquisitions. ARI made no acquisitions resulting in goodwill during the three and nine months ended September 30, 2002 and 2001.

Intangible Assets not Subject to Amortization. The carrying value of ARI's costs in excess of net assets acquired is as follows:

	September 30, 2002	Decemb 200
	-----	-----
Costs in excess of net assets acquired, net of accumulated amortization of \$1,763 in 2002 and 2001 .....	\$ 11,858 =====	\$ 11, =====

NOTE 14. DERIVATIVE FINANCIAL INSTRUMENTS

During the first quarter of 2002, ARI entered into an interest rate swap agreement with a bank. This agreement contains a notional amount of \$13.1 million and requires ARI to pay the bank a fixed rate of 4.3%, and requires the bank to pay to ARI based on the 30 day LIBOR rate. This agreement was entered into in order to effectively fix the rate on ARI's debt associated with the Lakeshore Villas property. The swap agreement expires on December 25, 2004.

ARI has not designated the interest rate swap agreement as a hedge, as defined within Statement of Financial Accounting Standards No. 133,

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AMERICAN REALTY INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 14. DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

"Accounting for Derivative Instruments and Hedging Activities," and, as such, changes in the fair value of the swap agreement are recognized in earnings during the period of change and reflected in the statement of operations as interest expense.

The fair value of the swap agreement at September 30, 2002 represents a liability to ARI of \$614,000 and is included within other liabilities in the accompanying balance sheet. Amounts paid or received under the swap agreement are settled monthly and are reflected as a reduction in the liability when paid. Interest expense for the nine months ended September 30, 2002, was increased by \$813,000 representing both amounts paid to the bank under the agreement and increases in the fair value of the related liability.

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

Introduction

ARI's predecessor was organized in 1961 to provide investors with a professionally managed, diversified portfolio of equity real estate and mortgage loan investments selected to provide opportunities for capital appreciation as well as current income.

On October 23, 2001, ARI, TCI, and IORI jointly announced a preliminary

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agreement with the plaintiff's legal counsel of the derivative action entitled Olive et al. V. National Income Realty Trust, et al. for complete settlement of all disputes in the lawsuit. In February 2002, the court granted final approval of the proposed settlement. Under the proposal, ARI will acquire all of the outstanding common shares of IORI and TCI not currently owned by ARI for a cash payment or shares of ARI preferred stock. ARI will pay \$17.50 cash per TCI share and \$19.00 cash per IORI share for the stock held by non-affiliated stockholders. ARI will issue one share of Series G Preferred Stock with a liquidation value of \$20.00 per share for each share of TCI Common Stock for stockholders who affirmatively elect to receive ARI Preferred Stock in lieu of cash. ARI will issue one share of Series H Preferred Stock with a liquidation value of \$21.50 per share for each share of IORI Common Stock for stockholders who affirmatively elect to receive ARI Preferred Stock in lieu of cash. All affiliated stockholders will receive ARI Preferred Stock. Each share of Series G Preferred Stock will be convertible into 2.5 shares of ARI Common Stock, and each share of Series H Preferred Stock will be convertible into 2.25 shares of ARI Common Stock during a 75-day period that commences fifteen days after the date of the first ARI Form 10-Q filing that occurs after the closing of the merger transaction. Upon the acquisition of IORI and TCI shares, TCI and IORI would become wholly-owned subsidiaries of ARI. The transaction is subject to the negotiation of a definitive merger agreement and a vote of the shareholders of all three entities. ARI has

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Introduction (Continued)

the same advisor as TCI and IORI, and TCI and IORI have the same board of directors. Earl D. Cecil, a Director of ARI, is also a Director of TCI and IORI.

On November 7, 2002, ARI announced that it intends to commence, through subsidiaries, a tender offer for shares of common stock of TCI and IORI. The price per share to be paid will be \$17.50 for TCI shares and \$19.00 for IORI shares. ARI has developed a financing plan, consisting primarily of new debt and refinancing of existing debt. The tender offers are being made to cure a default under the settlement resulting from ARI's failure to timely complete the SEC review process of the registration statement for the proposed mergers with TCI and IORI. ARI will defer further action on the mergers, pending completion of the tender offers.

#### Critical Accounting Policies

Critical accounting policies are those that are both important to the presentation of ARI's financial condition and results of operations and require management's most difficult, complex or subjective judgements. ARI's critical accounting policies relate to the evaluation of impairment of long-lived assets and the evaluation of the collectibility of accounts and notes receivable.

If events or changes in circumstances indicate that the carrying value of a rental property to be held and used or land held for development may be impaired, management performs a recoverability analysis based on estimated undiscounted cash flows to be generated from the property in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows the property is written down to estimated fair value and an impairment loss is recognized. If management decides to sell rental properties or land held for development, management evaluates the recoverability of the carrying amounts of the assets. If the evaluation indicates that the carrying value is not



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recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell and an impairment loss is recognized within income from continuing operations. ARI's estimates of cash flow and fair values of the properties are based on current market conditions and consider matters such as rental rates and occupancies for comparable properties, recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. ARI's estimates are subject to revision as market conditions and ARI's assessments of them change.

ARI's allowance for doubtful accounts receivable and notes receivable is established based on analysis of the risk of loss on specific accounts. The analysis places particular emphasis on past due accounts. Management considers the information such as the nature and age of the receivable, the payment history of the tenant or other debtor, the financial condition of the tenant or other debtor, and ARI's assessment

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Critical Accounting Policies (Continued)

of its ability to meet its lease or interest obligations. ARI's estimate of the required allowance, which is reviewed on a quarterly basis, is subject to revision as these factors change and is sensitive to the effects of economic and market conditions.

#### Liquidity and Capital Resources

General. Cash and cash equivalents at September 30, 2002, totaled \$3.3 million, compared with \$709,000 at December 31, 2001. Although ARI anticipates that during the remainder of 2002 it will generate cash from operations, as discussed below, such excess cash is not sufficient to discharge all of ARI's debt obligations as they mature. ARI will therefore again rely on externally generated funds, including aggressive land sales, selected sales of income producing properties, borrowings against its investments in various real estate entities, refinancing of properties, and, to the extent necessary, borrowings to meet its debt service obligations, pay taxes, interest and other non-property related expenses.

At December 31, 2001, notes payable totaling \$267.5 million had either scheduled maturities or required principal reduction payments during 2002. During the first nine months of 2002, ARI either extended, refinanced, paid down, paid off or received commitments from lenders to extend or refinance \$180.2 million of the debt scheduled to mature in 2002.

Net cash used in operating activities decreased to \$32.2 million in the nine months ended September 30, 2002, from \$39.2 million in the nine months ended September 30, 2001. Fluctuations in the components of cash flow from operations are discussed in the following paragraphs.

Net cash from property operations (rents collected less payments for expenses applicable to rental income) increased to \$26.9 million in the nine months ended September 30, 2002 from \$19.1 million in 2001. The increase was primarily attributable to a decline in the payments for operating expenses in 2002 from an elevated level in 2001, when there was a significant paydown of accounts payable. ARI expects a decrease in cash flow from property operations during the remainder of 2002. Such decrease is expected to result from the continued

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selective sale of income producing properties.

Net cash from pizza operations (sales less cost of sales) increased to \$4.9 million in the nine months ended September 30, 2002, from \$4.3 million in 2001. The increase was primarily attributable to the opening of three new stores during 2001.

No net cash was used in oil and gas operations (sales collected less payments for lease operating expenses) in the nine months ended September 30, 2002, compared to a use of \$175,000 in 2001. See NOTE 4. "OIL AND GAS OPERATIONS."

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Liquidity and Capital Resources (Continued)

Interest collected increased to \$979,000 in the nine months ended September 30, 2002, from \$397,000 in 2001. The increase was primarily attributable to the collection of \$542,000 in past due interest.

Interest paid decreased to \$42.6 million in the nine months ended September 30, 2002, from \$45.7 million in 2001. The decrease was primarily attributable to reduced mortgage balances as a result of property sales.

Advisory fees paid of \$4.8 million in the nine months ended September 30, 2002, approximated the \$5.0 million in 2001.

No incentive fees were paid in the nine months ended September 30, 2002, compared to \$1.6 million in 2001.

General and administrative expenses paid increased to \$9.8 million in the nine months ended September 30, 2002 from \$9.1 million in 2001. The increase is primarily attributable to an increase in legal fees.

ARI's cash flow from its investments in IORI and TCI is dependent on the ability of each of the entities to make distributions. In the fourth quarter of 2000, IORI and TCI suspended distributions. Accordingly, ARI received no current distributions in the first nine months of 2002 and 2001. However, in May 2001, ARI received \$53,000 in accumulated dividends on shares of Continental Mortgage and Equity Trust that should have been exchanged for TCI Common Stock in 1999.

Other cash used in operating activities was \$5.7 million in the nine months ended September 30, 2002, compared to other cash from operations of \$1.2 million in 2001. The change was primarily attributable to a \$2.7 million increase in escrow deposits in 2002 compared to a \$3.5 million decrease in 2001.

In the first nine months of 2002, ARI received a total of \$5.5 million on the collection of three mortgage notes receivable and partial paydown of three mortgage notes receivable.

In 2002, ARI purchased the following property:

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurred
-----	-----	-----	-----	-----	-----

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First Quarter  
Shopping Center  
Plaza on Bachman  
Creek/(1)/

Dallas, TX 80,278 Sq.Ft. \$ 3,103 \$ -- \$ --

Second Quarter  
Apartments

Pinecrest/(2)/ North Augusta, SC 120 Units 2,979 -- 1,423/(3)  
Tiberon Trails/(2)/ Merrillville, IN 376 Units 12,336 -- 6,417/(3)

Shopping Center

Alta Mesa/(2)/ Ft. Worth, TX 59,933 Sq.Ft. 3,797 -- 1,804/(3)

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

Liquidity and Capital Resources (Continued)

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurr
Second Quarter - Continued					
Land					
Pioneer Crossing	Austin, TX	79.4 Acres	\$1,165	\$ 1,213	\$ --
Willow Springs	Beaumont, CA	20.7 Acres	140	146	--

(1) Exchanged with TCI, a related party, for the Oaktree Village Shopping Center, Razor land parcel and Lakeshore Villas land parcel.

(2) Property received from BCM, a related party, for forgiveness of debt. The purchase price was determined using a market rate multiple of net operating income.

(3) Assumed debt of seller.

In 2002, ARI sold the following properties:

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received/(Paid)
First Quarter				
Apartments				
Mallard Lake/(1)/	Greensboro, NC	336 Units	\$ 14,400	\$ --
Villas	Plano, TX	208 Units	8,525	3,701
Land				
Katrina	Palm Desert, CA	2.1 Acres	1,323	(40)
Lakeshore Villas/(2)/	Harris County, TX	16.9 Acres	1,499	215
Razor/(2)/	Plano, TX	24.5 Acres	1,211	174
Thompson II	Dallas County, TX	.2 Acres	21	20
Vista Ridge	Lewisville, TX	10.0 Acres	1,525	130

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Shopping Center				
Oaktree Village/(2)/	Lubbock, TX	45,623 Sq.Ft.	2,302	131
Second Quarter				
Apartments				
Oak Hill	Tallahassee, FL	92 Units	3,200	156 / (4) /
Regency	Tampa, FL	78 Units	3,200	851
Stonebridge	Florissant, MO	100 Units	4,340	1,142
Office Building				
Centura	Dallas, TX	410,901 Sq.Ft.	50,000	--
Land				
Hollywood Casino	Farmers Branch, TX	42.8 Acres	16,987	--
Marine Creek	Ft. Worth, TX	54.2 Acres	3,700	--
Mason Goodrich	Houston, TX	7.9 Acres	672	46
Mason Goodrich	Houston, TX	10.3 Acres	1,444	93
Mason Goodrich	Houston, TX	18.0 Acres	2,790	--
Monterrey	Riverside, CA	61.0 Acres	4,625	--
Nashville	Nashville, TN	16.6 Acres	1,890	--
Third Quarter				
Apartments				
Conradi House	Tallahassee, FL	98 Units	1,809	388
Lee Hills	Tallahassee, FL	16 Units	445	355
Morning Star	Tallahassee, FL	82 Units	2,217	718
Pheasant Ridge	Bellevue, NE	264 Units	10,400	2,576
Stonegate	Tallahassee, FL	83 Units	1,785	486

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

Liquidity and Capital Resources (Continued)

Units/	Sale	Net Cash
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