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TRANSCONTINENTAL 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 JUNE 30, 2002

Commission File Number 1-9240

TRANSCONTINENTAL REALTY INVESTORS, INC.

-----  
(Exact Name of Registrant as Specified in Its Charter)

Nevada

94-6565852

-----  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

1800 Valley View Lane, Suite 300, Dallas, Texas

75234

-----  
(Address of Principal Executive Office)

-----  
(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  .

---

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

8,072,594

-----  
(Class)

-----  
(Outstanding at July 31, 2002)

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

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Operations - pages 4, 5

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

NOTE 7. "OPERATING SEGMENTS" - page 17 - 19

NOTE 8. "DISCONTINUED OPERATIONS" - page 19 - 20

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

"Results of Operations" - pages 24 - 28

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 six month periods ended June 30, 2002, have not been audited by independent certified public accountants, but in the opinion of the management of Transcontinental Realty Investors, Inc. ("TCI"), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of TCI's consolidated financial position, consolidated results of operations and consolidated cash flows at the dates and for the periods indicated, have been included.

TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS

	June 30, 2002	December 31, 2001
	-----	
	(dollars in thousands, except per share)	
Assets		
Real estate held for investment .....	\$ 769,673	\$ 712,832
Less - accumulated depreciation .....	(94,114)	(90,661)
	-----	-----
	675,559	622,171

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Real estate held for sale .....	29,143	516
Notes and interest receivable		
Performing (including \$15,085 in 2002 and \$1,970 in 2001 from related parties) .....	33,786	17,620
Nonperforming, nonaccruing .....	1,772	5,247
	-----	-----
	35,558	22,867
Less--allowance for estimated losses .....	(1,012)	(818)
	-----	-----
	34,546	22,049
Investment in real estate entities .....	14,512	14,230
Cash and cash equivalents .....	1,394	10,346
Other assets (including \$3,694 in 2002 and \$14,170 in 2001 from affiliates and related parties) .....	29,939	39,840
	-----	-----
	\$ 785,093	\$ 709,152
	=====	=====

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS - Continued

	June 30, 2002	De
	-----	-----
	(dollars in th except per	
Liabilities and Stockholders' Equity		
Liabilities		
Notes and interest payable .....	\$ 524,272	\$
Liabilities related to assets held for sale .....	16,734	
Other liabilities (including \$4,309 in 2002 and \$1,068 in 2001 to affiliates and related parties) .....	26,040	
	-----	-----
	567,046	
Commitments and contingencies		
Minority interest .....	5,609	
Stockholders' equity		
Preferred Stock		
Series A; \$.01 par value; authorized, 6,000 shares; issued and outstanding 5,829 shares (liquidation preference \$583) .....		--
Series C; \$.01 par value; authorized, issued		

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and outstanding 30,000 shares (liquidation preference \$3,000) .....	--
Common Stock, \$.01 par value; authorized, 10,000,000 shares; issued and outstanding 8,042,594 shares in 2002 and 2001 .....	80
Paid-in capital .....	271,761
Accumulated deficit .....	(58,352)
Accumulated other comprehensive loss .....	(1,051)
	-----
	212,438
	-----
	\$ 785,093
	=====

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2002	2001	2002	2001
	-----			
	(dollars in thousands, except per share)			
Property revenue				
Rents (including \$34 in 2002 and 2001 from related parties) .....	\$ 29,960	\$ 33,533	\$ 58,476	\$ 67,000
Property expense				
Property operations (including \$1,947 in 2002 and \$1,391 in 2001 to affiliates and related parties) .....	18,916	18,401	36,276	38,000
Operating income .....	11,044	15,132	22,200	29,000
Other income				
Interest and other .....	984	670	2,051	1,000
Equity in (loss) of equity investees .....	(291)	624	(1,567)	1,000
Gain on sale of real estate .....	--	20,623	--	25,000
	-----	-----	-----	-----
	693	21,917	484	27,000
Other expense				
Interest .....	9,631	10,254	17,989	21,000
Depreciation .....	4,889	4,513	9,779	9,000
Provision for asset impairment .....	1,879	--	1,879	1,000
Advisory fee to affiliates .....	1,279	1,439	2,694	2,000
Net income fee to affiliate .....	--	1,103	--	1,000
Incentive fee paid to affiliate .....	--	1,577	--	1,000
General and administrative (including				

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\$1,854 in 2002 and \$1,603 in 2001 to affiliates and related parties) .....	2,212	3,678	4,414	5
Provision for loss .....	349	--	349	
Minority interest .....	(26)	24	(84)	
	-----	-----	-----	-----
	20,213	22,588	37,020	42
Net income (loss) from continuing operations .....	(8,476)	14,461	(14,336)	15
Discontinued operations:				
Loss from operations .....	(645)	(130)	(1,550)	
Gain on sale of operations .....	7,085	--	9,593	
Equity in investees gain on sale of real estate .....	183	--	3,104	
	-----	-----	-----	-----
	6,623	(130)	11,147	
Net income (loss) .....	(1,853)	14,331	(3,189)	14
Preferred dividend requirement .....	(45)	(8)	(90)	
	-----	-----	-----	-----
Net income (loss) applicable to Common shares .....	\$ (1,898)	\$ 14,323	\$ (3,279)	\$ 14
	=====	=====	=====	=====

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2002	2001	2002	2001
	-----	-----	-----	-----
	(dollars in thousands, except per share)			
Basic earnings per share				
Net income (loss) from continued operations .....	\$ (1.05)	\$ 1.67	\$ (1.78)	\$ 1.67
Discontinued operations .....	.82	(.02)	1.39	
	-----	-----	-----	-----
Net income (loss) applicable to Common shares .....	\$ (.24)	\$ 1.65	\$ (.41)	\$ 1.67
	=====	=====	=====	=====
Diluted earnings per share				
Net income (loss) from continued operations .....	\$ (1.05)	\$ 1.65	\$ (1.78)	\$ 1.67
Discontinued operations .....	.80	(.01)	1.34	
	-----	-----	-----	-----

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Net income (loss) applicable to Common shares .....	\$	(.24)	\$	1.64	\$	(.41)	\$	
		=====		=====		=====		=====
Weighted average Common shares used in computing earnings per share								
Basic .....		8,042,594		8,661,091		8,042,594		8,661,091
Diluted .....		8,291,884		8,734,388		8,296,082		8,734,388

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock			Accumulated Distributions
	Shares	Amount	Paid-in Capital	in Excess of Accumulated Earnings
	-----	-----	-----	-----
	(dollars in thousands, except per share)			
Balance, January 1, 2002 .....	8,042,594	\$ 80	\$ 271,761	\$ (55,073)
Unrealized loss on foreign currency translation .....	--	--	--	--
Net income .....	--	--	--	(3,189)
Series A Preferred Stock cash dividend (\$2.50 per share) .....	--	--	--	(15)
Series C Preferred Stock cash dividend (\$2.50 per share) .....	--	--	--	(75)
	-----	-----	-----	-----
Balance, June 30, 2002 .....	8,042,594	\$ 80	\$ 271,761	\$ (58,352)
	=====	=====	=====	=====

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended June 30	
	----- 2002 ----- (dollars in thousands)	
<b>Cash Flows from Operating Activities</b>		
Rents collected (including \$133 in 2002 and \$70 in 2001 from related parties) .....	\$	64,360
Interest collected .....		1,577
Interest paid .....		(19,633)
Payments for property operations (including \$1,947 in 2002 and \$1,391 in 2001 to affiliates and related parties) .....		(39,184)
Advisory and net income fee paid to affiliate .....		(2,733)
Incentive fee paid to affiliate .....		--
General and administrative expenses paid (including \$1,217 in 2002 and \$1,603 in 2001 to affiliates and related parties) .....		(5,557)
Distributions from operating cash flow of equity investees .....		--
Other .....		--
		-----
Net cash used in operating activities .....		(1,170)
<b>Cash Flows from Investing Activities</b>		
Collections on notes receivable (including \$1,333 in 2002 from related parties) .....		7,340
Funding of notes receivable (including \$14,480 in 2002 to related parties) .....		(16,219)
Acquisition of real estate (including \$690 in 2002 and \$130 in 2001 to affiliates and related parties) .....		(5,317)
Real estate improvements .....		(2,778)
Real estate construction .....		(29,070)
Proceeds from sale of real estate .....		35,842
Deposits on pending purchases and financings .....		(1,123)
Contributions to equity investees .....		--
		-----
Net cash provided by (used in) investing activities .....		(11,325)
<b>Cash Flows from Financing Activities</b>		
Payments on notes payable .....		(45,613)
Proceeds from notes payable .....		64,642
Deferred financing costs (including \$54 in 2002 and \$45 in 2001 to affiliates and related parties) .....		(1,610)
Payments to advisor .....		(18,169)
Advance from affiliate .....		4,383
Dividends to stockholders .....		(90)
		-----
Net cash provided by (used in) financing activities .....		3,543
Net increase (decrease) in cash and cash equivalents .....		(8,952)
Cash and cash equivalents, beginning of period .....		10,346

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Cash and cash equivalents, end of period .....	-----	-----
	\$ 1,394	\$
	=====	==

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

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

	For the Six Months Ended June 30,	
	2002	2001
	----- (dollars in thousands) -----	
Reconciliation of net income to net cash used in operating activities		
Net income .....	\$ (3,189)	\$ 14,647
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation and amortization .....	10,290	10,049
Provision for loss .....	349	--
Gain on sale of real estate .....	(12,697)	(28,749)
Provision for asset impairment .....	1,879	--
Equity in loss of equity investees .....	1,567	2,366
Distributions from operating cash flow of equity investees .....	--	50
Increase in interest receivable .....	(354)	(55)
Decrease in other assets .....	968	1,376
Increase (decrease) in interest payable .....	(58)	221
Increase (decrease) in other liabilities .....	75	(1,289)
	-----	-----
Net cash used in operating activities .....	\$ (1,170)	\$ (1,384)
	=====	=====
Schedule of noncash investing and financing activities		
Notes payable assumed on purchase of real estate .....	\$ 56,405	\$ 1,051
Notes payable assumed by buyer on sale of real estate .....	--	(26,060)
Limited partnership interest received on sale of real estate .....	--	2,050
Notes receivable provided on sale of real estate .....	4,000	--
Real estate received on exchange with related party .....	4,145	--
Real estate exchanged with related party .....	(4,145)	--
Real estate received from related party as forgiveness		



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of debt ..... 79,287

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

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## TRANSCONTINENTAL REALTY INVESTORS, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. BASIS OF PRESENTATION

TCI is a Nevada corporation and successor to a California business trust which was organized on September 6, 1983. TCI invests in real estate through direct ownership, leases and partnerships. TCI also invests in mortgage loans on real estate.

The accompanying Consolidated Financial Statements have been prepared in accordance 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 six month period ended June 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 included in TCI's Annual Report on Form 10-K for the year ended December 31, 2001 (the "2001 Form 10-K").

On January 1, 2002, TCI adopted Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). The Statement superceded 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 business segments that are to be disposed. 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 TCI.

The financial statements and accompanying footnotes have been amended to revise the presentation of discontinued operations, pursuant to SFAS 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 will require TCI to reclassify prior period items that do not meet the extraordinary classification. The provisions of SFAS No. 145 that relate to the rescission of SFAS No.

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

## NOTE 1. BASIS OF PRESENTATION (Continued)

4 become effective in fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the consolidated financial position or results of operations of TCI.

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 accounting guidance, principally Emerging Issues Task Force ("EITF") Issue No. 94-3. TCI 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, TCI purchased the following properties:

Property	Location	Units/ Sq.Ft./Acres	Purchase Price	Net Cash Paid	Deb Incur
First Quarter					
Apartments					
Blue Lakes Villas/(1)/	Waxahachie, TX	186 Units	\$ 1,012	\$ 1,048	\$
Echo Valley/(1)/	Dallas, TX	216 Units	787	788	
Spy Glass/(1)/	Mansfield, TX	256 Units	1,280	1,042	2
Razor/(1) (2)/	Plano, TX	200 Units	2,319	310	
Shopping Center					
Oak Tree Village/(2)/	Lubbock, TX	45,623 Sq.Ft.	1,467	196	1,3
Land					
Lakeshore Villas/(2)/	Humble, TX	16.89 Acres	947	127	
Second Quarter					
Apartments					
DeSoto Ranch/(1)/	DeSoto, TX	248 Units	1,364	1,489	2,2
Office Building					
Centura/(4)/	Farmers Branch, TX	410,901 Sq.Ft.	50,000	--	43,7
Land					
Hollywood Casino/(4)/	Dallas, TX	42.64 Acres	16,987	--	6,2
Marine Creek/(4)/	Ft. Worth, TX	54 Acres	3,700	--	1,5
Mason Park/(4)/	Houston, TX	18 Acres	2,790	--	2,6

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Nashville/(4)/	Nashville, TN	16.57 Acres	1,890	--	9
Palm Desert/(4)/	Palm Desert, CA	61 Acres	3,920	--	

- 
- (1) Land purchased for apartment construction.  
(2) Property exchanged with American Realty Investors, Inc. ("ARI"), a related party, for the Plaza on Bachman Creek Retail Center.

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

NOTE 2. REAL ESTATE (Continued)

- (3) Assumed debt.  
(4) Property received from ARI, a related party, for forgiveness of debt.  
(5) Weighted average. The Centura Tower is encumbered by two loans, one for \$28.7 million at 10.5% and the other for \$15.0 million at 17.9%.  
(6) Extension negotiations are currently under way on these loans.

In the first six months of 2001, TCI purchased the following properties:

Property	Location	Units/ Acres/Sq.Ft.	Purchase Price	Net Cash Paid	D Inc
-----	-----	-----	-----	-----	-----
Apartments					
Courtyard	Midland, TX	133 Units	\$ 1,425	\$ 345	\$
Limestone Ranch	Lewisville, TX	10.5 Acres	505/(2)/	--	
Land					
Solco-Valley Ranch	Dallas, TX	6.07 Acres	1,454	1,525	
Mira Lago	Farmers Branch, TX	8.88 Acres	541/(2)/	--	

- 
- (1) Assumed debt.  
(2) Land was received from a related party in exchange for the Glenwood Apartments.

In 2002, TCI sold the following properties:

Property	Location	Units/Sq.Ft.	Sales Price	Net Cash Received
-----	-----	-----	-----	-----
First Quarter				
Apartments				
Primrose	Bakersfield, CA	162 Units	\$ 5,000	\$ 1,722
Office Building				

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Hartford	Dallas, TX	174,513 Sq.Ft.	4,000	--
Industrial Warehouse Central Storage	Dallas, TX	216,035 Sq.Ft.	4,000	2,095
Shopping Center Plaza on Bachman Creek/(2)/	Dallas, TX	80,278 Sq.Ft.	4,707	--
Second Quarter Apartments Southgreen	Bakersfield, CA	80 Units	3,600	1,011
Office Building Jefferson	Clear Lake, TX	78,159 Sq.Ft.	16,550	5,957
Nasa	Washington, DC	71,877 Sq.Ft.	2,600	2,341
Windsor Plaza	Windcrest, TX	80,522 Sq.Ft.	4,250	3,813
Third Quarter Apartments				
4242 Cedar Springs	Dallas, TX	76 Units	2,600	971
Camelot	Largo, FL	120 Units	5,263	1,616
Country Crossing	Tampa, FL	227 Units	5,800	1,836

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

NOTE 2. REAL ESTATE (Continued)

- (1) Excludes a \$920,000 deferred gain from seller financing. See NOTE 3. "NOTES AND INTEREST RECEIVABLE."  
(2) Property was exchanged with ARI, a related party, for the Oak Tree Village Shopping Center and two parcels of land; the Razor land parcel and Lakeshore Villas land parcel.

In the first six months of 2001, TCI sold the following properties:

Property	Location	Units/Sq.Ft./ Acres	Sales Price	Net Cash Received	Di
Apartments					
Bent Tree Gardens	Addison, TX	204 Units	\$9,000	\$ 2,669	
Fontenelle Hills	Bellevue, NE	338 Units	16,500	3,680	
Forest Ridge	Denton, TX	56 Units	2,000	682	
Glenwood	Addison, TX	168 Units	3,659/(2)/	--	
Heritage	Tulsa, OK	136 Units	2,286	206	
McCallum Glen	Dallas, TX	275 Units	8,450	2,633	
Park at Colonade	San Antonio, TX	211 Units	5,800	927	
Industrial Warehouse					
Zodiac	Dallas, TX	35,435 Sq.Ft.	762	183	
Technology Trading	Sterling, VA	197,659 Sq.Ft.	10,775	4,120	

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Office Buildings				
Daley	San Diego, CA	64,425 Sq.Ft.	6,211	2,412
Waterstreet	Boulder, CO	106,257 Sq.Ft.	22,250	7,126
Land				
McKinney 36	McKinney, TX	1.822 Acres	476	476
Moss Creek	Greensboro, NC	4.79 Acres	15	13
Round Mountain	Austin, TX	110.0 Acres	2,560	2,455

- (1) Excludes a \$550,000 deferred gain from a limited partnership interest in the sold property.
- (2) The Glenwood Apartments were exchanged with ARI, a related party, for two parcels of land; the 10.5 acre Limestone Ranch and the 8.88 acre Mira Lago.
- (3) Debt assumed by purchaser.
- (4) Excludes a \$1.5 million deferred gain from a limited partnership interest in the sold property.

At June 30, 2002, TCI had the following apartment properties under construction:

Property	Location	Units/Rooms	Amount Expended	Additional Amount to Expend
Blue Lake Villas	Waxahachie, TX	186 Units	\$ 5,368	\$ 7,2
DeSoto Ranch	DeSoto, TX	248 Units	1,845	16,6
Echo Valley	Dallas, TX	216 Units	1,084	13,1
Falcon Lakes	Arlington, TX	284 Units	1,850	13,8
River Oaks	Wiley, TX	180 Units	2,736	9,2
Sendero Ridge	San Antonio, TX	384 Units	6,914	21,7
Spyglass	Mansfield, TX	256 Units	2,786	15,2
Tivoli	Dallas, TX	190 Units	7,254	6,1
Verandas at City View	Fort Worth, TX	314 Units	5,906	17,0
Waters Edge IV	Gulfport, MS	80 Units	3,683	4

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

NOTE 2. REAL ESTATE (Continued)

In the second quarter of 2002, TCI completed the 252 unit Limestone Ranch in Lewisville, Texas, and the 165 room Hotel Akademia in Wroclaw, Poland.

NOTE 3. NOTES AND INTEREST RECEIVABLE

In January 2002, TCI purchased 100% of the outstanding common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, a related party, for \$4.4 million cash. Two Hickory owns the 96,217 sq. ft. Two Hickory Center Office Building in Farmers Branch, Texas. ARI has guaranteed that the

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asset shall produce at least a 12% annual return of the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% annual return, ARI shall pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the shares of Two Hickory for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI. In June 2002, the asset was refinanced. TCI received \$1.3 million of the proceeds as a principal reduction on its note receivable from ARI.

Also in January 2002, a mortgage loan with a principal balance of \$608,000 was paid off, including accrued but unpaid interest. With the payoff of the note, TCI recognized a previously deferred gain on the sale of the property of \$608,000.

In August 2001, TCI agreed to fund up to \$5.6 million under a revolving line of credit secured by an office building in Dallas, Texas. In 2002, TCI funded an additional \$1.3 million of the line of credit. At June 30, 2002, TCI had funded a total of \$3.1 million of the note.

In February 2002, TCI sold a \$2.0 million senior participation interest in a loan secured by a second lien on a retail center in Montgomery County, Texas to Income Opportunity Realty Investors, Inc. ("IORI"), a related party. TCI and IORI will receive 43% and 57%, respectively, of the remaining principal and interest payments. Also in February 2002, TCI extended the loan until April 2002, receiving \$23,000 as an extension fee. In April 2002, TCI extended the loan until July 2002, receiving \$6,500 as an extension fee. In July 2002, the loan was extended until September 2002 and TCI received \$6,500 as an extension fee.

Also in February 2002, TCI funded an additional \$231,000 to Sendera Ranch, under a loan secured by 1,714.16 acres of unimproved land in Tarrant County, Texas. In March 2002, TCI received a \$2.4 million payment from Sendera Ranch. TCI received \$1.8 million as a principal paydown, \$277,000 as accrued interest, and \$323,000 as a partnership distribution.

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

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

In March 2002, TCI sold the 174,513 sq.ft. Hartford Office Building in Dallas, Texas, for \$4.0 million and provided the \$4.0 million purchase price as seller financing and an additional \$1.4 million line of credit for leasehold improvements in the form of a mortgage note. The note bears interest at a variable interest rate, currently 6.0% per annum, requires monthly interest only payments of \$14,667 and matures in March 2007.

In April 2002, TCI purchased 100% of the following entities: ART One Hickory Corporation ("One Hickory"), Garden Confederate Point, LP ("Confederate Point"), Garden Foxwood, LP ("Foxwood"), and Garden Woodsong, LP ("Woodsong"), all wholly-owned subsidiaries of ARI, a related party, for \$10.0 million. One Hickory owns the 120,615 sq. ft. One Hickory Center Office Building in Farmers Branch, Texas. Confederate Point owns the 206 unit Confederate Apartments in Jacksonville, Florida. Foxwood owns the 220 unit Foxwood Apartments in Memphis, Tennessee. Woodsong owned the 190 unit Woodsong Apartments in Smyrna, Georgia.

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ARI has guaranteed that these assets shall produce at least a 12% return annually of the purchase price for a period of three years from the purchase date. If the assets fail to produce the 12% return, ARI shall pay TCI any shortfall. In addition, if the assets fail to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the entities for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI.

In July 2002, the Woodsong Apartments were sold. TCI received \$2.6 million from the proceeds as payment of principal and accrued but unpaid interest on the note receivable.

In May 2002, a mortgage loan with a principal balance of \$1.5 million was paid off, including accrued but unpaid interest. TCI agreed to a 5% discount on the note and recognized a loss of \$75,000 from the note. TCI also recognized a previously deferred gain of \$1.5 million on the sale of the property.

In July 2002, a mortgage loan with a principal balance of \$2.2 million was paid off, including accrued but unpaid interest.

### NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES

Prior to the first quarter of 2002, TCI accounted for its investments in Tri-City, Nakash and Jor-Trans on the equity method. TCI is a 63.7% limited partner and IORI is a 36.3% general partner in Tri-City, and TCI is a 60% general partner and IORI is a 40% limited partner in Nakash. TCI owns a non-controlling 55% limited and general partnership interest in Jor-Trans. TCI and IORI have the same Board of Directors and the same executive officers. Consequently, because TCI has significant influence and a greater than 50% ownership over the operations of Tri-

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

### NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES (Continued)

City, Nakash and Jor-Trans, the operations of the partnership have been consolidated. In the first quarter of 2002, TCI began accounting for its investment in Tri-City, Nakash and Jor-Trans using a consolidated basis. The effect of these consolidations increased TCI's assets, liabilities, and minority interest by \$5.4 million, \$3.9 million and \$1.5 million, respectively.

Real estate entities. TCI's investment in real estate entities at June 30, 2002, included equity securities of two publicly traded real estate entities, IORI and ARI, related parties, and interests in real estate joint venture partnerships. Basic Capital Management, Inc. ("BCM"), TCI's advisor, also serves as advisor to IORI and ARI.

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

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

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Investee	Percentage of TCI's Ownership at June 30, 2002	Carrying Value of Investment at June 30, 2002	Equivalent Investee Book Value at June 30, 2002	Market Value of Investment at June 30, 2002
IORI .....	24.0%	\$ 4,475	\$ 9,469	\$ 6,206
ARI .....	6.5%	9,526	4,949	8,344
		-----	-----	-----
		14,001	\$ 14,418	\$ 14,550
			=====	=====
Other .....		511		
		-----		
		\$ 14,512		
		=====		

Management continues to believe that the market value of each of IORI and ARI undervalues their assets and, therefore, TCI may continue to increase its ownership in these entities.

Set forth below is summarized results of operations of equity investees for the first six months of 2002 and 2001.

	2002	2001
Revenues .....	\$ 85,675	\$ 90,650
Equity in income of partnerships .....	(923)	5,708
Property operating expenses .....	(71,363)	(74,585)
Depreciation .....	(8,551)	(9,437)
Interest expense .....	(38,569)	(40,282)
	-----	-----
Loss before gains on sale of real estate .....	(33,731)	(27,946)
Gain on sale of real estate .....	28,374	46,291
	-----	-----
Net income (loss) .....	\$ (5,357)	\$ 18,345
	=====	=====

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

NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES (Continued)

TCI's share of equity investees' loss before gains on the sale of real estate was \$291,000 and \$1.6 million for the three and six months ended June 30, 2002, and its share of equity investees' gains on sale of real estate was \$183,000 and \$3.1 million for the three and six months ended June 30, 2002.

NOTE 5. OTHER ASSETS

Related Party. From time-to-time, TCI and its affiliates and related parties



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have made advances to each other, which generally have not had specific repayment terms and have been reflected in TCI's financial statements as other assets. At June 30, 2002, TCI had receivables of \$1.6 million, \$1.8 million and \$146,000 from BCM, GS Realty Services, Inc. and ARI, respectively, and payables of \$3.9 million and \$389,000 to IORI and GS Realty Services, Inc., respectively.

### NOTE 6. NOTES AND INTEREST PAYABLE

In 2002, TCI refinanced the following properties:

Property	Location	Sq.Ft./Units	Debt Incurred	Debt Discharged
First Quarter				
Industrial Warehouse Addison Hanger/(1)/	Addison, TX	23,650 Sq.Ft.	\$ 2,687	\$ 1,580
Second Quarter				
Apartments				
Paramount Terrace	Amarillo, TX	181 Units	2,700	2,797
Verandas at City View	Ft. Worth, TX	314 Units	2,779 /(3)/	2,197

- (1) The mortgage is cross-collateralized with the 29,000 sq. ft. Addison Hanger II in Addison, Texas.
- (2) Variable interest rate.
- (3) The Verandas at City View Apartments are under construction. The \$2.8 million debt incurred was to fund construction to date. The total construction funding for the project is \$19.4 million.

In April 2002, TCI sold 12 residential properties to partnerships controlled by Metra Capital, LLC ("Metra"). These properties include: the 75 unit Apple Lane Apartments in Lawrence, Kansas; the 195 unit Arbor Point Apartments in Odessa, Texas; the 264 unit Fairway View Estates Apartments in El Paso, Texas; the 152 unit Fairways Apartments in Longview, Texas; the 166 unit Fountain Lake Apartments in Texas City, Texas; the 172 unit Fountains of Waterford Apartments in Midland, Texas; the 122 unit Harper's Ferry Apartments in Lafayette, Louisiana; the 108 unit Oak Park IV Apartments in Clute, Texas; the 131 unit Quail Oaks Apartments in Balch Springs, Texas; the 300 unit Sunchase Apartments in Odessa, Texas; the 180 unit Timbers Apartments in Tyler, Texas; and the

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

### NOTE 6. NOTES AND INTEREST PAYABLE (Continued)

112 unit Willow Creek Apartments in El Paso, Texas. Innovo Group, Inc. ("Innovo") is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a director of ARI, a related party, controls approximately 11.67% of the outstanding common stock of Innovo. Management has determined to account for this sale as a refinancing transaction, in accordance with SFAS No. 66, "Accounting for Sales of Real Estate." TCI will continue to

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report the assets and the new debt incurred by the Metra partnerships on the TCI financial statements. The sales price for the properties totaled \$37.6 million. TCI received net cash of \$10.5 million after paying off the existing debt of \$18.0 million and various closing costs. The new debt of \$30.3 million bears interest at 7.57% per annum, requires monthly interest only payments of \$212,000 and matures in May 2012. TCI also received \$8.0 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 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.

### NOTE 7. 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 operating income and cash flow. Items of income that are not reflected in the segments are interest, equity in partnerships and equity gains on sales of real estate which totaled \$876,000 and \$3.6 million for the three and six months ended June 30, 2002, and \$1.3 million and \$1.8 million for the three and six months ended June 30, 2001. Expenses that are not reflected in the segments are general and administrative expenses, minority interest, incentive, advisory, net income fees and discontinued operations which totaled \$4.5 million and \$8.9 million for the three and six months ended June 30, 2002, and \$8.7 million and \$12.5 million for the three and six months ended June 30, 2001. Also excluded from segment assets are assets of \$81.1 million at June 30, 2002, and \$106.3 million at June 30, 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses.

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

#### NOTE 7. OPERATING SEGMENTS (Continued)

Presented below is the operating income of each operating segment for the three and six months ended June 30, 2002 and 2001, and each segment's assets at June 30.

Three Months Ended June 30, 2002	Land	Commercial Properties	Apartments	Hotels
Rents .....	\$ 131	\$ 15,336	\$ 12,844	\$ 1,649
Property operating expenses .....	343	8,607	8,451	1,515

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Operating income (loss) .....	\$ (212)	\$ 6,729	\$ 4,393	\$ 134	\$
Interest .....	\$ 191	\$ 4,442	\$ 4,312	\$ 686	\$
Depreciation .....	7	3,267	1,276	339	
Real estate improvements .....	62	1,093	13,035	2,182	
Provision for asset impairment .....	707	--	1,172	--	
Assets .....	91,931	330,401	246,404	35,966	

Property Sales:		Commercial Properties	Apartments		
Sales price .....		\$ 23,400	\$ 3,600		\$
Cost of sales .....		17,743	2,172		
Gain on sale .....		\$ 5,657	\$ 1,428		\$

(1) Includes \$1.5 million of previously deferred gains on sale of real estate.

Six Months Ended June 30, 2002	Land	Commercial Properties	Apartments	Hotels	
Rents .....	\$ 288	\$ 30,482	\$ 25,169	\$ 2,537	\$
Property operating expenses .....	710	16,971	16,232	2,363	
Operating income (loss) .....	\$ (422)	\$ 13,511	\$ 8,937	\$ 174	\$
Interest .....	\$ 369	\$ 8,885	\$ 7,737	\$ 998	\$
Depreciation .....	7	6,576	2,555	641	
Real estate improvements .....	102	2,630	23,344	5,772	
Provisions for asset impairment .....	707	--	1,172	--	
Assets .....	91,931	330,401	246,404	35,966	

Property Sales:		Commercial Properties	Apartments		
Sales price .....		\$ 36,107	\$ 8,600		\$
Cost of sales .....		29,209	5,905		
Gain on sale .....		\$ 6,898	\$ 2,695		\$

(2) Includes \$2.1 million of previously deferred gains on sale of real estate.

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

NOTE 7. OPERATING SEGMENTS (Continued)

Three Months Ended June 30, 2002	Land	Commercial Properties	Apartments	Hotels
Rents .....	\$ 189	\$ 16,178	\$ 15,217	\$ 1,949
Property operating expenses .....	183	8,313	8,755	1,150
Operating income .....	\$ 6	\$ 7,865	\$ 6,462	\$ 799
Interest .....	\$ 196	\$ 5,945	\$ 3,776	\$ 337
Depreciation .....	--	2,976	1,256	281
Real estate improvements .....	2,943	1,033	47	73
Assets .....	60,913	318,983	184,129	19,614

Property Sales:	Land	Commercial Properties	Apartments
Sales price .....	\$ 15	\$ 39,236	\$ 37,609
Cost of sales .....	86	25,083	31,068
Gain (loss) on sale .....	\$ (71)	\$ 14,153	\$ 6,541

Six Months Ended June 30, 2002	Land	Commercial Properties	Apartments	Hotels
Rents .....	\$ 325	\$ 33,329	\$ 31,006	\$ 3,279
Property operating expenses .....	565	17,316	18,025	2,348
Operating income (loss) .....	\$ (240)	\$ 16,013	\$ 12,981	\$ 931
Interest .....	\$ 507	\$ 11,783	\$ 8,269	\$ 698
Depreciation .....	--	4,533	4,388	533
Real estate improvements .....	2,943	2,284	81	216
Assets .....	60,913	318,983	184,129	19,614

Property Sales:	Land	Commercial Properties	Apartments
Sales price .....	\$ 3,051	\$ 39,998	\$ 47,695
Cost of sales .....	1,720	25,678	37,513
Gain on sale .....	\$ 1,331	\$ 14,320	\$ 10,182

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NOTE 8. DISCONTINUED OPERATIONS

Effective January 1, 2002, TCI adopted Financial Accounting Standards Board Statement 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 sold, be presented as discontinued operations in the statement of operations for all periods presented, and the properties intended to be sold are to be designated as "held-for-sale" on the balance sheet.

For the three and six months ended June 30, 2002 and 2001, income from discontinued operations relates to 11 properties that TCI sold during

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

NOTE 8. DISCONTINUED OPERATIONS (Continued)

2002. The following table summarizes revenue and expense information for these properties sold and held-for-sale.

	For the Three Months Ended June 30,		For the Six Months Ended Jun
	2002	2001	2002
Revenue			
Rental .....	\$ 1,509	\$ 2,841	\$ 3,861
Property operations .....	1,302	1,929	3,410
	-----	-----	-----
	207	912	451
Expenses			
Interest .....	693	500	1,491
Depreciation .....	159	542	510
	-----	-----	-----
	852	1,042	2,001
Net loss from discontinued operations before gains on sale of real estate .....	(645)	(130)	(1,550)
Gain on sale of operations .....	7,085	--	9,593
Equity in investees gain on sale of real estate .....	183	--	3,104
	-----	-----	-----
Net income from discontinued operations .....	\$ 6,623	\$ (130)	\$11,147
	=====	=====	=====

Discontinued operations have not been segregated in the consolidated statements of cash flows. Therefore, amounts for certain captions will not agree with respective consolidated statements of operations.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Liquidity. Management anticipates that TCI will generate excess cash from operations in 2002 due to increased rental rates and occupancy at its properties, however, such excess will not be sufficient to discharge all of TCI's debt obligations as they mature. Management intends to selectively sell income producing real estate, refinance real estate and incur additional borrowings against real estate to meet its cash requirements.

Commitments. In January 2001, TCI exercised its option under the loan documents to extend the maturity date of three loans with a principal balance of \$30.6 million secured by three office buildings in New Orleans, Louisiana. The lender has disputed TCI's right to extend the loans. This dispute is subject to litigation pending in the United States District Court for the Eastern District of Louisiana.

Litigation. TCI is involved in various lawsuits arising in the ordinary course of business. Except for the Olive Litigation (see PART II. OTHER INFORMATION, ITEM 1. "LEGAL PROCEEDINGS), management is of the opinion that the outcome of these lawsuits will have no material impact on TCI's financial condition, results of operations or liquidity.

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

NOTE 10. 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. TCI had a loss for federal income tax purposes in the first two quarters of 2002 and 2001; therefore, it recorded no provision for income taxes.

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

Introduction

TCI invests in real estate through acquisitions, leases and partnerships. TCI also invests in mortgage loans. TCI is the successor to a business trust organized on September 6, 1983, and commenced operations on January 31, 1984.

Critical Accounting Policies

Critical accounting policies are those that are both important to the presentation of TCI's financial condition and results of operations and require management's most difficult, complex or subjective judgements. TCI'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 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. TCI'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. TCI's estimates are subject to revision as market conditions and TCI's assessments of them change. In the second quarter of 2002, TCI recognized \$1.9 million as impairment losses.

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

Critical Accounting Policies (Continued)

TCI'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 such information 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 TCI's assessment of its ability to meet its lease or interest obligations. TCI'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

Cash and cash equivalents totaled \$1.4 million at June 30, 2002, compared with \$10.3 million at December 31, 2001. TCI's principal sources of cash have been and will continue to be from property operations, proceeds from property sales, the collection of mortgage notes receivable and borrowings. Management anticipates that TCI's cash on hand, as well as cash generated from property operations, the sale of properties and the refinancing of certain of TCI's mortgage debt will be sufficient to meet TCI's cash requirements, including debt service obligations and expenditures for property maintenance and improvements.

Net cash used in operating activities was \$1.2 million for the six months ended June 30, 2002, compared to \$1.4 million for the six months ended June 30, 2001. The primary factors affecting TCI's cash from operations are discussed in the following paragraphs.

Cash from property operations (rents collected less payments for expenses applicable to rental income) was \$25.2 million in the six months ended June 30, 2002, compared to \$29.0 million for the six months ended June 30, 2001.

Rents collected decreased by \$5.4 million in the six months ended June 30, 2002 from 2001. Of this decrease, \$9.5 million and \$3.3 million was due to the sale of 19 apartments and 13 commercial properties, respectively, in 2002 and 2001. Increases in rents collected of \$4.4 million were due to the purchase of six properties in 2002 and 2001, and the completion of the Limestone Ranch Apartments and Hotel Akademia in 2002. Rents collected also increased by \$435,000 due to overall increased rents and stable occupancies at TCI's

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apartments and by \$2.5 million due to lease buy outs and collections of outstanding receivables at TCI's commercial properties.

Payments for property operations decreased to \$39.2 million in the six months ended June 30, 2002, compared to \$40.8 million in 2001. Of this decrease, \$5.5 million and \$1.6 million was due to the sale of 19 apartments and 13 commercial properties, respectively, in 2002 and 2001 and \$457,000 was due to decreased operations at the U.S. hotels. This increase was offset by increases of \$455,000 and \$687,000 due to the completion of the Limestone Ranch Apartments and Hotel

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

#### Liquidity and Capital Resources (Continued)

Akademia, respectively, in the second quarter of 2002. Increases of \$2.7 million were due to the purchase of five existing apartments in 2001 and \$88,000 was due to the purchase of one shopping center in 2002. Payments for property operations also increased by \$1.1 million, \$637,000 and \$300,000 at TCI's apartments, commercial and land properties, respectively. These increases were mainly from increased taxes and insurance payments.

Interest collected increased to \$1.6 million in the six months ended June 30, 2002, from \$700,000 in 2001. The increase was primarily due TCI funding of seven loans in 2001 and seven loans in 2002.

Interest paid decreased to \$19.6 million in the six months ended June 30, 2002, from \$20.6 million in the six months ended June 30, 2001. Of the decrease, \$4.3 million was from the sale of 27 properties in 2002 and 2001 subject to debt, and \$100,000 was from loan payoffs and principal paydowns in 2002 and 2001. These decreases were offset by increases of \$1.6 million from the purchase of seven properties in 2002 and 2001 subject to debt, and \$1.6 million was due to the refinancing of 14 properties in 2002 and one property in 2001.

Advisory, incentive and net income fees paid decreased to \$2.7 million in the six months ended June 30, 2002, from \$5.1 million in the six months ended June 30, 2001. The decrease was primarily due to no incentive or net income fees paid in 2002. The incentive fee is equal to 10% of the amount by which the aggregate sales consideration for all TCI's properties sold during the year exceeds the total cost of the property plus a simple 8% annual return to TCI's net investment in such property.

General and administrative expenses paid decreased to \$5.6 million in the six months ended June 30, 2002, from \$5.9 million in the six months ended June 30, 2001. This decrease was mainly due to a decrease in legal fees and cost reimbursements to the advisor.

In the first six months of 2002, TCI sold two apartments, one warehouse, one shopping center and four office buildings for a total of \$44.7 million, receiving net cash of \$16.9 million after the payoff of existing debt and the payment of various closing costs.

Also in the first six months of 2002, TCI financed an industrial warehouse and 14 apartments for a total of \$38.5 million, receiving \$9.0 million in cash after the payment of various closing costs.

Further in the first six months of 2002, TCI purchased five parcels of unimproved land for apartment construction, one shopping center, one office



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building and six parcels of unimproved land for a total of \$88.5 million. TCI paid \$5.0 million in cash, including various closing costs, assumed existing mortgage debt of \$56.4 million and acquired new debt of \$2.5 million for the purchases. TCI also expended \$28.5 million

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

#### Liquidity and Capital Resources (Continued)

on property construction, of which \$21.2 million was funded by debt. For the remainder of 2002 and the first quarter of 2003, TCI expects to expend an additional \$121.3 million on property construction projects, of which \$113.5 million will be funded by debt.

Also in the first six months of 2002, TCI advanced funds to affiliated parties, including its advisor, for a total of \$38.7 million. For this funding, TCI received 12% return guarantees for \$14.4 million, and real estate valued at \$79.3 million and assumed the existing debt of \$55.0 million.

In the third quarter of 2002, TCI sold three apartments for a total of \$16.9 million, receiving net cash of \$4.4 million after the payoff of existing debt and the payment of various closing costs, and received \$4.8 million on the payment of two mortgage loans.

Management reviews the carrying values of TCI's properties and mortgage notes receivable at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow from the property (undiscounted and without interest) is less than the carrying amount of the property. For notes receivable, impairment is considered to exist if it is probable that all amounts due under the terms of the note will not be collected. If impairment is found to exist, a provision for loss is recorded by a charge against earnings. The mortgage note receivable review includes an evaluation of the collateral property securing each note. The property review generally includes: (1) selective property inspections; (2) a review of the property's current rents compared to market rents; (3) a review of the property's expenses; (4) a review of maintenance requirements; (5) a review of the property's cash flow; (6) discussions with the manager of the property; and (7) a review of properties in the surrounding area.

#### Results of Operations

TCI had net losses of \$1.9 million and \$3.2 million in the three and six months ended June 30, 2002, including gains on sale of real estate totaling \$7.2 million and \$12.7 million, compared to net income of \$14.3 million and \$14.6 million in the corresponding periods in 2001, including gains on sale of real estate totaling \$21.2 million and \$26.4 million. Fluctuations in this and other components of revenues and expenses between the 2002 and 2001 periods are discussed below.

Rents in the three months ended June 30, 2002, decreased to \$30.0 million compared to \$33.5 million in 2001. Of this decrease, \$463,000 and \$478,000 was due to decreases in occupancies at TCI's commercial properties and four U.S. hotels, respectively. Occupancies decreased to 79% in the second quarter of 2002 compared to 86% in the second quarter of 2001 from commercial properties located in Texas, Georgia, Florida

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

Results of Operations (Continued)

and Virginia. These properties represented approximately 43% of the revenues in TCI's commercial portfolio. The remaining difference is primarily due to the sale of 26 operating properties during 2001.

Rents in the six months ended June 30, 2002, decreased to \$58.5 million compared to \$67.9 million in 2001. Of this decrease, \$923,000 was due to decreases in occupancies at TCI's four U.S. hotels. Overall occupancies for the commercial portfolio remained constant for the six months ended June 30, 2002. However, occupancies decreased to 80% from 86% in the six months ended June 30, 2002, from commercial properties located in Texas, Georgia, Florida and Virginia. These properties represented approximately 44% of the revenues in TCI's commercial portfolio. The remaining difference is primarily due to the sale of 26 properties during 2001. Rents are expected to remain constant or decrease in the remaining quarters of 2002 as commercial occupancies continue to decrease.

Property operations expense increased to \$18.9 million and decreased to \$36.3 million in the three and six months ended June 30, 2002, compared to \$18.4 million and \$38.3 million in 2001. Of these three and six month changes, \$455,000 and \$487,000 was due to the completion of the Limestone Ranch Apartments and Hotel Akademia, respectively, in the second quarter of 2002. Increases of \$1.2 million and \$2.7 million for the quarter and six months, were due to the purchase of five existing apartments in 2001 and \$74,000 and \$88,000 was due to the purchase of one shopping center in 2002. Property operations expenses for TCI's apartments increased by \$881,000 and \$1.1 million in the three and six months ended June 30, 2002. These increases include \$301,000 and \$550,000 from taxes and insurance, \$247,000 and \$293,000 from replacements and \$137,000 and \$264,000 from personnel expenses. Property operations expenses for TCI's commercial properties increased by \$559,000 and \$1.2 million in the three and six months ended June 30, 2002. These increases include \$314,000 and \$473,000 from taxes and insurance, \$155,000 and \$405,000 from repairs and \$171,000 and \$318,000 from personnel expenses. Property operations expenses for TCI's land properties increased by \$299,000 and \$330,000 in the three and six months ended June 30, 2002, due to increased taxes. These increases were offset by decreases of \$106,000 and \$459,000 due to decreases in occupancies from the U.S. hotels. Property operations expenses for the remaining quarters of 2002 are expected to increase as TCI continues to upgrade its apartments and improve its commercial leasing potential.

Interest and other income increased to \$984,000 and \$2.1 million in the three and six months ended June 30, 2002, compared to \$670,000 and \$1.3 million in 2001. The increase was primarily due to TCI funding seven loans in 2001 and seven loans in 2002. Interest income for the remaining quarters of 2002 are expected to increase from the additional loans funded in 2002.

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

Results of Operations (Continued)

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Equity in losses of investees increased to \$291,000 and \$1.6 million in the three and six months ended June 30, 2002 from gains of \$624,000 and \$524,000 in the three and six months ended June 30, 2001. The increase in losses from equity investees is primarily attributed to increased operating losses at ARI.

Interest expense decreased to \$9.6 million in the three months ended June 30, 2002, from \$10.3 million in 2001. The decrease is primarily due to lower variable rates and principal paydowns at TCI's apartments and commercial properties, respectively.

Interest expense decreased to \$18.0 million in the six months ended June 30, 2002, compared to \$21.3 million in 2001. The decrease was due to lower variable interest rates and principal paydowns at TCI's apartments and commercial properties, respectively. The remaining variance is primarily due to the 26 properties sold during 2001.

Depreciation expense increased to \$4.9 million and \$9.8 million in the three and six months ended June 30, 2002, from \$4.5 million and \$9.4 million in 2001. Of these increases, \$281,000 and \$558,000 were due to the purchase of five apartments in 2002 and 2001. Depreciation expense for the remaining quarters of 2002 is expected to increase as TCI completes its apartment construction projects.

For the three and six months ended June 30, 2002, TCI recorded a \$1.9 million provision for asset impairment representing the write down of certain operating properties to current estimated fair value. These assets include the following properties:

Property	Location	Units/Acres	Fair Value	Property Basis	Cost
<b>Apartments</b>					
Apple Lane	Lawrence, KS	75 Units	\$ 1,580	\$ 1,593	\$
Fairway View	El Paso, TX	264 Units	5,700	5,242	
Fountains of Waterford	Midland, TX	172 Units	1,900	2,006	
Sunchase	Odessa, TX	300 Units	4,100	3,479	
<b>Land</b>					
Red Cross	Dallas, TX	2.89 Acres	8,400	8,348	

The Red Cross land is under contract to sell and the sales price was used as fair value. The fair value determined for the four apartments above were agreed upon purchase prices as part of the refinancing transaction with Metra Capital, LLC. The costs to sell were actual fees paid to refinance the properties.

Advisory fee decreased to \$1.3 million and \$2.7 million in the three and six months ended June 30, 2002, from \$1.4 million and \$2.9 million in 2001. These decreases were due to a decrease in TCI's gross assets, the basis for such fee. Advisory fees are expected to decrease with decreases in TCI's gross assets.

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### Results of Operations (Continued)

Net income fee to affiliate was \$1.1 million in the three and six months ended June 30, 2001. The net income fee is payable to TCI's advisor based on 7.5% of TCI's net income. TCI had a net loss for the six months ended June 30, 2002 and no such fee has been accrued.

Incentive fee to affiliate was \$1.6 million in the three and six months ended June 30, 2001. The incentive fee is payable to TCI's advisor based on 10% of aggregate sales consideration less TCI's cost of all properties sold during the year. In the six months ended June 30, 2002, the criteria for the fee has not been met.

General and administrative expenses decreased to \$2.2 million and \$4.4 million in the three and six months ended June 30, 2002, from \$3.5 million and \$5.9 million in 2001. These decreases were mainly due to a decrease in legal fees and other professional fees.

In October 2000, TCI's stockholders approved the Director's Stock Option Plan (the "Director's Plan") which provides for options to purchase up to 140,000 shares of TCI's Common Stock. Options granted pursuant to the Director's Plan are immediately exercisable and expire on the earlier of the first anniversary of the date on which a Director ceases to be a Director or 10 years from the date of grant. Each Independent Director was granted an option to purchase 5,000 Common shares at an exercise price of \$14.875 per share on October 10, 2000, the date stockholders approved the plan. On January 1, 2001 and 2002, each Independent Director was granted an option to purchase 5,000 Common shares at an exercise price of \$8.875 and \$16.05, respectively, per common share. In February 2002, TCI purchased 20,000 options outstanding from retired directors R. Douglas Leonhard and Edward Zampa for \$82,000. In July 2002, Ted Stokely and Martin White exercised their options for 15,000 shares. As of July 31, 2002, no options were outstanding.

In the three and six months of 2002, gains on sale of real estate totaling \$7.1 million and \$9.6 million were recognized, \$659,000 on the sale of the Primrose Apartments, \$1.2 million on the sale of the Central Storage Warehouse, a \$608,000 deferred gain on the sale of the Madison at Bear Creek Apartments, \$1.3 million on the sale of the NASA Office Building, a \$1.5 million deferred gain on the sale of McCallum Glen Apartments, \$3.4 million on the sale of Jefferson Office Building, \$895,000 on the sale of Windsor Office Building and a \$72,000 loss on the sale of South Green Apartments.

In the three and six months ended June 30, 2001, gains on sale of real estate totaling \$20.6 million and \$25.8 million were recognized. The gains included \$1.6 million on the sale of the Heritage Apartments, \$167,000 on the sale of Zodiac Warehouse, \$355,000 on the sale of a tract of the McKinney 36 land parcel, \$1.0 million on the sale of Forest Ridge Apartments, \$1.0 million on the sale of Park at Colonade Apartments, \$1.0 million on the sale of a tract of the Round Mountain land parcel, \$4.6 million on the sale of Fontenelle Apartments, \$601,000

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

#### Results of Operations (Continued)

on the sale of Bent Tree Gardens Apartments, \$9.1 million on the sale of Waterstreet Office Building, \$4.2 million on the sale of Technology Trading

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Center, \$1.4 million on the sale of McCallum Glen Apartments, \$836,000 on the sale of Daley Office Plaza, and a loss of \$71,000 on the Moss Creek land parcel.

### 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 in the first six months of 2002 and 2001; therefore, it recorded no provision for income taxes.

### Inflation

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

### Environmental Matters

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

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At June 30, 2002, TCI's exposure to a change in interest rates on its debt is as follows:

	Balance -----	Weighted Average Interest Rate -----	Effect of 1% Increase In Base Rates -----
Notes payable:			
Variable rate .....	\$ 160,244 =====	6.20%	\$ 1,602 =====
Total decrease in TCI's annual net income .....			\$ 1,602 =====
Per share .....			\$ .20

=====

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In February 1990, TCI, together with Continental Mortgage and Equity Trust ("CMET"), IORI and National Income Realty Trust, three real estate entities with, at the time, the same officers, directors or trustees and advisor as TCI, entered into a settlement (the "Settlement") of a class and derivative action entitled Olive et al. v. National Income Realty Trust et al., relating to the operation and management of each of the entities. On April 23, 1990, the Court granted final approval of the terms of the Settlement. The Settlement was modified in 1994 (the "Modification").

On January 27, 1997, the parties entered into an Amendment to the Modification effective January 9, 1997 (the "Olive Amendment"). The Olive Amendment provided for the settlement of additional matters raised by plaintiffs' counsel in 1996. The Court issued an order approving the Olive Amendment on July 3, 1997.

The Olive Amendment provided that TCI's Board retain a management/compensation consultant or consultants to evaluate the fairness of the BCM advisory contract and any contract of its affiliates with TCI, CMET and IORI, including, but not limited to, the fairness to TCI, CMET and IORI of such contracts relative to other means of administration. In 1998, the Board engaged a management/compensation consultant to perform the evaluation which was completed in September 1998.

In 1999, plaintiffs' counsel asserted that the Board did not comply with the provision requiring such engagement and requested that the Court exercise its retained jurisdiction to determine whether there was a breach of this provision of the Olive Amendment. In January 2000, the Board engaged another management/compensation consultant to perform the required evaluation again. This evaluation was completed in April 2000 and was provided to plaintiffs' counsel. The Board believes that any

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ITEM 1. LEGAL PROCEEDINGS (Continued)

alleged breach of the Olive Amendment has been fully remedied by the Board's engagement of the second consultant. Although several status conferences have been held on this matter, there has been no Court order resolving whether there was any breach of the Olive Amendment.

In June 2000, plaintiffs' counsel asserted that loans made by TCI to BCM and American Realty Trust, Inc. breached the provisions of the Modification. The Board believes that the provisions of the Settlement, the Modification and Olive Amendment terminated on April 28, 1999. However, the Court has ruled that certain provisions continue to be effective after the termination date. This ruling was appealed by TCI and IORI.

On October 23, 2001, TCI, IORI and American Realty Investors, Inc. ("ARI") jointly announced a preliminary agreement with the plaintiff's legal counsel for complete settlement of all disputes in the lawsuit. In February 2002, the court granted final approval of the proposed settlement. Under the proposal, the pending appeal has been dismissed and ARI will acquire all of the outstanding

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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 would 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 elect to receive ARI preferred stock in lieu of cash. ARI would 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 elect to receive ARI preferred stock in lieu of cash. Each share of Series G Preferred Stock will be convertible into 2.5 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. TCI has the same board as IORI and the same advisor as IORI and ARI. Earl D. Cecil, a Director of TCI and IORI, is also a Director for ARI.

### ITEM 4. SUBMISSION OF MATTERS TO SECURITY HOLDERS

The annual meeting was held on July 2, 2002, at which meeting stockholders were asked to consider and vote upon the election of Directors. At the meeting, stockholders elected the following individuals as Directors:

Director	Shares Voting	
	For	Withheld Authority
Henry A. Butler .....	6,845,106	80,885
Earl D. Cecil .....	6,845,372	80,618
Ted P. Stokely .....	6,843,907	82,083
Martin L. White .....	6,845,867	80,124

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### ITEM 4. SUBMISSION OF MATTERS TO SECURITY HOLDERS (Continued)

There were no abstentions or broker non-votes on the election of Directors.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit Number	Description
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K as follows:

None.

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SIGNATURES

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: March 4, 2003

By: /s/ Ronald E. Kimbrough

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Ronald E. Kimbrough  
Executive Vice President  
and Chief Financial Officer  
(Principal Financial and  
Accounting Officer and  
Acting Principal Executive  
Officer)

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CERTIFICATION

I, Ronald E. Kimbrough, Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer and Acting Principal Executive Officer) of Transcontinental Realty Investors, Inc. ("TCI"), certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of TCI;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. I am responsible for establishing and maintaining internal controls and procedures and have:
  - a. designed such internal controls to insure that material information relating to TCI and its consolidated subsidiaries is made known to me



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by others within those entities, particularly for the periods presented in this quarterly report;

- b. evaluated the effectiveness of TCI's internal controls as of a date within 90 days prior to the filing date of this quarterly report; and
  - c. presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on a date within 90 days prior to the filing date of this quarterly report;
5. I have disclosed to TCI's auditors and Audit Committee of the Board of Directors (or persons fulfilling the equivalent function):
- a. all significant deficiencies in the design or operation of internal controls which could adversely affect TCI's ability to record, process, summarize, and report financial data and have identified for TCI's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in TCI's internal controls; and

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6. I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of my most recent evaluation, including corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 4, 2003

/s/ Ronald E. Kimbrough

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Ronald E. Kimbrough  
Executive Vice President  
and Chief Financial Officer  
(Principal Financial and  
Accounting Officer and  
Acting Principal Executive Officer)

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TRANSCONTINENTAL REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q/A

For the Quarter ended June 30, 2002

Exhibit Number	Description	Page Number
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	36

