

PREFERRED APARTMENT COMMUNITIES INC
Form 10-Q
November 13, 2012

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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

OR

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

For the transition period from _____ to _____
Commission File No. 001-34995

Preferred Apartment Communities, Inc.
(Exact name of registrant as specified in its charter)

Maryland	27-1712193
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3625 Cumberland Boulevard, Suite 400, Atlanta, GA 30339	
(Address of principal executive offices) (Zip Code)	
Registrant's telephone number, including area code: (770) 818-4100	

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 ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐

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

The number of shares outstanding of the registrant's Common Stock, as of November 7, 2012 was 5,181,280.

INDEX

Page No.

PART I - FINANCIAL INFORMATION

Item 1.	Financial Statements	
	Consolidated Balance Sheets (unaudited) – as of September 30, 2012 and December 31, 2011	1
	Consolidated Statements of Operations (unaudited) – Three Months and Nine Months Ended September 30, 2012 and 2011	2
	Consolidated Statements of Equity and Accumulated Deficit (unaudited) – Nine Months Ended September 30, 2012 and 2011	3
	Consolidated Statements of Cash Flows (unaudited) – Nine Months Ended September 30, 2012 and 2011	4
	Notes to Consolidated Financial Statements (unaudited)	6
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	51
Item 4.	Controls and Procedures	52

PART II - OTHER INFORMATION

Item 1.	Legal Proceedings	52
Item 1A	Risk Factors	52
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	52
Item 3.	Defaults Upon Senior Securities	52
Item 4.	Mine Safety Disclosures	52
Item 5.	Other Information	52
Item 6.	Exhibits	52
	SIGNATURES	53
	EXHIBIT INDEX	54

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

Preferred Apartment Communities, Inc.
Consolidated Balance Sheets
(Unaudited)

	September 30, 2012	December 31, 2011
Assets		
Real estate		
Land	\$ 13,052,000	\$ 13,052,000
Building and improvements	60,281,597	60,268,867
Furniture, fixtures, and equipment	8,729,062	8,392,446
Construction in progress	3,023	67,877
Gross real estate	82,065,682	81,781,190
Less: accumulated depreciation	(5,495,254)	(2,698,305)
Net real estate	76,570,428	79,082,885
Real estate loans	31,190,708	6,000,000
Total real estate and real estate loans, net	107,761,136	85,082,885
Cash and cash equivalents	2,496,308	4,548,020
Restricted cash	691,912	567,346
Notes receivable	930,544	—
Revolving line of credit to related party	345,200	—
Deferred interest receivable on real estate loans	318,296	—
Tenant receivables, net of allowance of \$9,439 and \$15,924	25,938	23,811
Deferred loan costs, net of amortization of \$155,953 and \$64,480	784,106	551,660
Deferred offering costs	2,677,192	1,388,421
Other assets	842,180	303,397
Total assets	\$ 116,872,812	\$ 92,465,540
Liabilities and equity		
Liabilities		
Mortgage notes payable	\$ 55,637,000	\$ 55,637,000
Accounts payable and accrued expenses	1,057,330	1,158,530
Revolving credit facility	15,000,000	—
Accrued interest payable	216,187	176,084
Dividends payable	787,761	646,916
Security deposits and prepaid rents	287,897	163,663
Other deferred income	299,013	65,446
Total liabilities	73,285,188	57,847,639
Commitments and contingencies (Note 11)		
Equity		
Stockholder's equity		

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Series A Redeemable Preferred Stock, \$0.01 par value per share; 150,000 shares authorized; 12,178 and 0 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	122	—
Common Stock, \$0.01 par value per share; 400,066,666 shares authorized; 5,179,093 and 5,149,325 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	51,791	51,493
Additional paid in capital	53,359,638	43,828,030
Accumulated deficit	(9,823,928) (9,261,623)
Total stockholders' equity	43,587,623	34,617,900
Non-controlling interest	1	1
Total equity	43,587,624	34,617,901
Total liabilities and equity	\$ 116,872,812	\$ 92,465,540

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

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Preferred Apartment Communities, Inc.
Consolidated Statements of Operations
(Unaudited)

	Three months ended		Nine months ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenues:				
Rental revenues	\$2,309,943	\$2,250,514	\$6,783,328	\$3,942,177
Other property revenues	297,159	258,619	843,379	443,894
Interest income on loans and notes receivable	636,149	124,495	1,112,426	125,828
Total revenues	3,243,251	2,633,628	8,739,133	4,511,899
Operating expenses:				
Property operating and maintenance	598,037	579,992	1,790,523	1,016,793
Property management fees	104,320	100,519	304,827	175,572
Real estate taxes	191,262	181,484	558,170	324,630
General and administrative	41,394	51,436	132,496	86,821
Depreciation and amortization	905,988	3,623,732	2,800,404	6,425,841
Acquisition costs	—	18,272	912	1,680,432
Organizational costs	—	—	1,593	94,372
Insurance	45,001	37,748	129,664	66,426
Professional fees	71,246	72,952	241,559	304,702
Other	30,891	36,544	105,679	70,402
Total operating expenses	1,988,139	4,702,679	6,065,827	10,245,991
Operating income (loss)	1,255,112	(2,069,051)	2,673,306	(5,734,092)
Management fees	214,684	177,475	583,660	322,741
Insurance	41,377	39,069	124,132	128,247
Interest expense	615,300	537,591	1,688,957	972,233
Equity compensation to directors and executives	315,600	77,519	921,207	157,501
Other (income)	(80,770)	(1)	(82,345)	(262)
Net income (loss)	148,921	(2,900,704)	(562,305)	(7,314,552)
Less consolidated net income (loss) attributable to non-controlling interests	—	—	—	—
Net income (loss) attributable to the Company	148,921	(2,900,704)	(562,305)	(7,314,552)
Dividends to preferred stockholders	(163,059)	—	(242,744)	—
Earnings attributable to unvested restricted stock	(4,626)	(3,250)	(12,302)	(6,500)
Net loss attributable to common stockholders	\$(18,764)	\$(2,903,954)	\$(817,351)	\$(7,321,052)
Net loss per share of Common Stock attributable to				

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common stockholders, basic and diluted	\$—	\$(0.56) \$(0.16) \$(2.17)
Dividends declared on Common Stock	\$729,699	\$646,675	\$2,080,357	\$1,293,162	
Weighted average number of shares of Common					
Stock outstanding, basic and diluted	5,178,822	5,146,845	5,169,467	3,375,384	

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

2

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Preferred Apartment Communities, Inc.
Consolidated Statements of Equity and Accumulated Deficit
For the nine months ended September 30, 2012 and 2011
(Unaudited)

	Series A Redeemable Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Deficit	Total Stockholders' Equity	Non Controlling Interest	Total Equity
Balance at December 31, 2011	\$ —	\$51,493	\$43,828,030	\$(9,261,623)	\$34,617,900	\$ 1	\$34,617,901
Equity compensation to directors and executives	—	38	921,169	—	921,207	—	921,207
Issuance of Units	122	—	12,165,498	—	12,165,620	—	12,165,620
Syndication and offering costs	—	—	(1,231,698)	—	(1,231,698)	—	(1,231,698)
Vesting of restricted stock	—	260	(260)	—	—	—	—
Net loss	—	—	—	(562,305)	(562,305)	—	(562,305)
Dividends to preferred stockholders	—	—	(242,744)	—	(242,744)	—	(242,744)
Dividends to common stockholders	—	—	(2,080,357)	—	(2,080,357)	—	(2,080,357)
Balance at September 30, 2012	\$ 122	\$51,791	\$53,359,638	\$(9,823,928)	\$43,587,623	\$ 1	\$43,587,624
Balance at December 31, 2010	\$ —	\$366	\$109,632	\$(766,199)	\$(656,201)	\$ 1	\$(656,200)
Issuance of warrant to purchase Common Stock	—	—	462,330	—	462,330	—	462,330
Proceeds from sale of Common Stock	—	51,074	51,022,536	—	51,073,610	—	51,073,610
Equity compensation to executives and directors	—	34	157,467	—	157,501	—	157,501
	—	—	(6,043,712)	—	(6,043,712)	—	(6,043,712)

Syndication and
offering costs

Net loss	—	—	—	(7,314,552)	(7,314,552)	—	(7,314,552)
Dividends to common stockholders	—	—	(1,293,162)	—	(1,293,162)	—	(1,293,162)
Balance at September 30, 2011	\$ —	\$51,474	\$44,415,091	\$(8,080,751)	\$36,385,814	\$ 1	\$36,385,815

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

3

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Preferred Apartment Communities, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended September 30, 2012	September 30, 2011
Operating activities:		
Net loss attributable to the Company	\$(562,305)	\$(7,314,552)
Reconciliation of net loss to net cash provided by (used in) operating activities:		
Depreciation expense	2,796,950	1,725,746
Amortization expense	3,454	4,700,095
Deferred fee income amortization	(41,236)	(4,489)
Deferred interest income on real estate loans	(318,296)	—
Deferred loan cost amortization	91,473	42,986
Equity compensation to executives and directors	921,207	157,501
Changes in operating assets and liabilities:		
(Increase) in tenant receivables	(2,127)	(35,680)
(Increase) in other assets	(338,579)	(175,621)
Increase in accounts payable and accrued expenses	291,743	483,797
Increase in accrued interest payable	40,103	153,892
Increase in security deposits	10,079	8,168
Increase (decrease) in prepaid rents	114,155	(8,055)
Increase in deferred income	16,275	—
Net cash provided by (used in) operating activities	3,022,896	(266,212)
Investing activities:		
Investment in real estate loans	(25,190,708)	(6,000,000)
Notes receivable issued	(1,580,544)	—
Notes receivable repaid	650,000	—
Draw on line of credit by related party	(590,233)	—
Repayments of line of credit by related party	245,032	—
Acquisition fees received on real estate loans	517,057	134,333
Acquisition fees paid on real estate loans	(258,528)	(60,000)
Refund of deposit on real estate investment	—	150,000
Acquisition of properties, net	—	(87,449,341)
Additions to real estate assets - improvements	(290,051)	(328,848)
Increase in restricted cash	(124,566)	(43,773)
Net cash used in investing activities	(26,622,541)	(93,597,629)
Financing activities:		
Proceeds from mortgage notes payable	—	55,637,000
Payments for mortgage loan costs	(309,500)	(616,139)
Payments on revolving lines of credit	—	(200,000)
Payments on non-revolving lines of credit	—	(1,240,000)
Proceeds from non-revolving lines of credit	15,000,000	434,102
Payments on note payable to related parties	—	(465,050)
Proceeds from sales of common stock, net of offering costs	—	46,117,662
Proceeds from sales of Units, net of offering costs	10,951,202	—
Common Stock dividends declared and paid	(1,997,573)	(646,487)

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Preferred Stock dividends declared and paid	(184,552)	—	
Payments for deferred offering costs	(1,911,644)	(133,369)
Net cash provided by financing activities	21,547,933		98,887,719	
Net (decrease) increase in cash and cash equivalents	(2,051,712)	5,023,878	
Cash and cash equivalents, beginning of period	4,548,020		22,275	
Cash and cash equivalents, end of period	\$2,496,308		\$5,046,153	

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

4

Preferred Apartment Communities, Inc.
Consolidated Statements of Cash Flows - continued
(Unaudited)

Supplemental cash flow information:

Cash paid for interest	\$1,636,010	\$775,093
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Supplemental disclosure of non-cash activities:

Accrued capital expenditures	\$26,967	\$27,982
Dividends payable - common	\$729,699	\$646,675
Dividends payable - preferred	\$58,062	\$—
Accrued deferred offering costs	\$291,329	\$554,496
Reclass of offering costs from deferred asset to equity	\$31,158	\$—
Reclass of deferred offering costs to receivable	\$234,679	\$—

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

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements
September 30, 2012
(unaudited)

1. Organization

Preferred Apartment Communities, Inc., or the Company, was formed as a Maryland corporation on September 18, 2009, and has elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended (the "Code") effective with its tax year ended December 31, 2011. The Company was formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As part of its business strategy, the Company may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the construction of multifamily communities and other properties. As a secondary strategy, the Company also may acquire or originate senior mortgage loans, subordinate loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets and invest not more than 10% of its total assets in other real estate related investments, as determined by its Manager (as defined below) as appropriate for the Company. The Company is externally managed and advised by Preferred Apartment Advisors, LLC, or its Manager, a Delaware limited liability company and related party (see Note 6).

On February 22, 2011, the Company effected a change in the designation of its issued and outstanding and authorized but unissued shares of Class A Common Stock, \$0.01 par value per share, to shares of common stock, par value \$0.01 per share, or Common Stock, and effected a change of each of its issued and outstanding shares of Class B Common Stock, \$0.01 par value per share, into one issued and outstanding share of Common Stock, all pursuant to an amendment to the Company's charter. As a result of these actions, NELL Partners, Inc. held 36,666 shares of Common Stock as of February 22, 2011. The consolidated statement of equity and accumulated deficit for the nine-month period ended September 30, 2011 has been retroactively restated to reflect this change.

On February 25, 2011, the Company amended its prior authorization to issue up to \$75.0 million in Class A Common Stock in accordance with the change in designation of all shares of Class A Common Stock to shares of Common Stock, as described above, and, as a result, the board of directors of the Company authorized the issuance and sale of up to \$75.0 million in Common Stock in an initial public offering.

The Company completed its initial public offering, or IPO, on April 5, 2011. The IPO resulted in the sale of 4.5 million shares of Common Stock at a price per share of \$10.00, generating gross proceeds of \$45.0 million. The aggregate proceeds to the Company, net of underwriters' discounts and commissions and other offering costs, were approximately \$39.8 million. Concurrently with the closing of the IPO, in a separate private placement pursuant to Regulation D under the Securities Act of 1933, as amended, or the Securities Act, the Company sold 500,000 shares of its Common Stock to the Williams Opportunity Fund, LLC, or WOF, at the public offering price of \$10.00 per share, for gross proceeds to the Company of \$5.0 million. Aggregated estimated offering expenses in connection with the private placement were approximately \$297,700. WOF is an affiliate of the Company and its Manager.

On May 4, 2011, in conjunction with the IPO, the Company issued and sold 107,361 shares of Common Stock at \$10.00 per share pursuant to the underwriters' exercise of their over-allotment option, for gross proceeds of approximately \$1.1 million. After deducting underwriters' commissions and offering expenses, net proceeds to the Company from the over-allotment option were approximately \$1.0 million.

The consolidated financial statements include the accounts of the Company and Preferred Apartment Communities Operating Partnership, L.P., or the Operating Partnership. The Company controls the Operating Partnership through

its sole general partner interest and plans to conduct substantially all of its business through the Operating Partnership.

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited consolidated financial statements include all of the accounts of the Company and the Operating Partnership as of September 30, 2012, presented in accordance with accounting principles generally accepted in the United States of America, or GAAP. All significant intercompany transactions have been eliminated in consolidation. Certain adjustments have been made consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair presentation of the Company's

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

financial condition and results of operations. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Acquisitions and Impairments of Real Estate Assets

The Company generally records its initial investments in income-producing real estate at fair value at the acquisition date, in accordance with ASC 805-10, Business Combinations. Acquisition costs, which include fees and expenses for due diligence, legal, environmental and consulting services, generally will be expensed as incurred.

The aggregate purchase price of acquired properties is apportioned to the tangible and identifiable intangible assets and liabilities acquired at their estimated fair values. The value of acquired land, buildings and improvements is estimated by formal appraisals, observed comparable sales transactions, and information gathered during pre-acquisition due diligence activities and the valuation approach considers the value of the property as if it were vacant. The values of furniture, fixtures, and equipment are estimated by calculating their replacement cost and reducing that value by factors based upon estimates of their remaining useful lives.

Intangible assets include the values of in-place leases and customer relationships. In-place lease values are estimated by calculating the estimated time to fill a hypothetically empty apartment complex to its stabilization level (estimated to be 92% occupancy) based on historical observed move-in rates for each property. Carrying costs during these hypothetical expected lease-up periods are estimated, considering current market conditions and include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates. The intangible assets are calculated by estimating the net cash flows of the in-place leases to be realized, as compared to the net cash flows that would have occurred had the property been vacant at the time of acquisition and subject to lease-up. The acquired in-place lease values are amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. The above-market or below-market lease values are recorded as a reduction or increase, respectively, to rental income over the remaining average non-cancelable term of the respective leases. The values of customer relationships are estimated by calculating the product of the avoided hypothetical lost revenue and the average renewal probability and are likewise amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. Acquired intangible assets generally have no residual value.

The Company evaluates its tangible and identifiable intangible real estate assets for impairment annually or when events such as declines in a property's operating performance, deteriorating market conditions, or environmental or legal concerns bring recoverability of the carrying value of one or more assets into question. The total undiscounted cash flows of the asset, including proceeds from disposition, are compared to the net book value of the asset. If this test indicates that impairment exists, an impairment loss is recorded in earnings equal to the shortage of the book value versus the discounted net cash flows of the asset.

Loans Held for Investment

The Company records its investments in real estate loans at cost with assessments made for impairment in the event recoverability of the principal amount becomes doubtful. If, upon testing for impairment, the fair value result is lower than the carrying amount of the loan, a valuation allowance is recorded to lower the carrying amount to fair value, with a loss recorded in earnings. Recoveries of valuation allowances are only recognized in the event of maturity or a sale or disposition in an amount above carrying value. See the 'Revenue Recognition' section of this note for other loan-related policy disclosures required by ASC 310-10-50-6.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Restricted cash includes cash restricted by state law or contractual requirement and, as of September 30, 2012, relates primarily to tax and insurance escrows and resident security deposits.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

Fair Value Measurements

Certain assets and liabilities are required to be carried at fair value, or if they are deemed impaired, to be adjusted to reflect this condition. The Company follows the guidance provided by ASC 820, Fair Value Measurements and Disclosures, in accounting and reporting for real estate assets where appropriate, as well as debt instruments both held for investment and as liabilities. The standard requires disclosure of fair values calculated under each level of inputs within the following hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities at the measurement date.
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs for the asset or liability.

Deferred Loan Costs

Deferred loan costs are amortized using the straight-line method, which approximates the effective interest method, over the terms of the related indebtedness.

Deferred Offering Costs

Deferred offering costs represent costs incurred by the Company related to current equity offerings, excluding costs specifically identifiable to a closing, such as commissions, dealer-manager fees, and other registration fees. For issuances of equity that occur on one specific date, associated offering costs are reclassified as a reduction of proceeds raised on the date of issue. Our ongoing offering of Units, consisting of one share of Series A Redeemable Preferred Stock, or Preferred Stock, and one warrant, or Warrant, to purchase 20 shares of Common Stock, or Units, generally closes on a monthly basis in variable amounts. Deferred offering costs are reclassified to the stockholders' equity section of the consolidated balance sheet as a reduction of proceeds raised on a pro-rata basis equal to the ratio of total Units issued to the maximum number of Units that may be issued.

Non-controlling Interest

Non-controlling interest represents the equity interest of the Operating Partnership that is not owned by the Company. Non-controlling interest is adjusted for contributions, distributions and earnings or loss attributable to the non-controlling interest in the consolidated entity in accordance with the Agreement of Limited Partnership of the Operating Partnership, as amended.

Redeemable Preferred Stock

Shares of the Company's Preferred Stock issued in conjunction with the Company's Unit offering (further described in note 5) are redeemable at the option of the holder, subject to a declining redemption fee schedule. Redemptions are therefore outside the control of the Company. However, the Company retains the right to fund any redemptions of Preferred Stock in either Common Stock or cash at its option, excluding limited holder death rights which expire two years after the applicable issuance date. Therefore, the Company records Preferred Stock as a component of permanent stockholders' equity.

Revenue Recognition

Rental revenue is recognized when earned from residents, which is over the terms of rental agreements, typically of 13 months' duration. Differences from the straight-line method, which recognize the effect of any up-front concessions and other adjustments ratably over the lease term, are not material. The Company evaluates the collectability of amounts due from residents and maintains an allowance for doubtful accounts for estimated losses resulting from the inability of residents to make required payments then due under lease agreements. The balance of amounts due from residents are generally deemed uncollectible 30 days beyond the due date, at which point they are fully reserved.

Interest income on real estate loans and notes receivable is recognized on an accrual basis over the lives of the loans using the effective interest method. Direct loan origination fees and origination or acquisition costs applicable to real estate loans are amortized over the lives of the loans as adjustments to interest income. The accrual of interest on all these instruments is stopped

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

when there is concern as to the ultimate collection of principal or interest, which is generally a delinquency of 30 days in required payments of interest or principal. Any payments received on such non-accrual loans are recorded as interest income when the payments are received. Real estate loan investments are reclassified as accrual-basis once interest and principal payments become current.

Promotional fees received from service providers at the Company's properties are deferred and recognized on a straight-line basis over the term of the agreement.

The PAC Rewards program, implemented in the first quarter of 2012, allows residents to accumulate reward points on a monthly basis for actions such as resident referrals and making rent payments online. A resident must rent a PAC apartment for at least 14 months before reward points may be redeemed for services or upgrades to a resident's unit. The Company accrues a liability for the estimated cost of these future point redemptions, net of a 35% breakage fee, which is the Company's current estimate of rewards points that will not be redeemed. In accordance with Staff Accounting Bulletin 13.A.3c, the Company deems its obligations under PAC Rewards as inconsequential to the delivery of services according to the lease terms. Therefore, the expense related to the PAC Rewards Program is included in property operating and maintenance expense on the consolidated statements of operations.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with guidance provided by ASC 505, Equity-Based Payments to Non-Employees and ASC 718, Stock Compensation. We calculate the fair value of equity compensation instruments at the date of grant based upon estimates of their expected term, the expected volatility of and dividend yield on our Common Stock over this expected term period and the market risk-free rate of return. We will also estimate forfeitures of these instruments and accrue the compensation expense, net of estimated forfeitures, over the vesting period(s). We record the fair value of restricted stock awards based upon the closing stock price on the trading day immediately preceding the date of grant.

Acquisition Costs

The Company expenses property acquisition costs as incurred, which include costs such as due diligence, legal, environmental and consulting.

Capitalization and Depreciation

The Company capitalizes replacements of furniture, fixtures and equipment, as well as carpet, appliances, air conditioning units, certain common area items, and other assets. Significant repair and renovation costs that improve the usefulness or extend the useful life of the properties are also capitalized. These assets are then depreciated on a straight-line basis over their estimated useful lives, as follows:

•Buildings	40 years	
•Furniture, fixtures & equipment	5 - 10 years	
•Improvements to buildings and land	5 - 10 years	
•Acquired customer intangibles	average remaining lease term	

Operating expenses related to unit turnover costs, such as carpet cleaning, mini-blind replacements, and minor repairs are expensed as incurred.

Income Taxes

The Company has elected to be taxed as a REIT under the Code. To continue to qualify as a REIT, the Company must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of the Company's annual REIT taxable income to its stockholders (which is computed without regard to the dividends paid deduction or net capital gain which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Company generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income tax on its taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

following the year during which qualification is lost unless the Internal Revenue Service grants the Company relief under certain statutory provisions. Such an event could materially adversely affect the Company's net income and net cash available for distribution to stockholders. The Company intends to operate in such a manner as to maintain its election for treatment as a REIT.

Since the Company made its REIT election effective as of January 1, 2011 (See Note 10), it was subject to U.S. federal and state income taxes for the period prior to that date. The provision for income taxes is based on income before taxes reported for financial statement purposes after adjustment for transactions that do not have tax consequences. Deferred tax assets and liabilities are realized according to the estimated future tax consequences attributable to differences between the carrying value of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates as of the date of the balance sheet. The effect of a change in tax rates on deferred tax assets and liabilities is reflected in the period that includes the statutory enactment date. A deferred tax asset valuation allowance is recorded when it has been determined that it is more likely than not that deferred tax assets will not be realized. If a valuation allowance is needed, a subsequent change in circumstances in future periods that causes a change in judgment about the realization of the related deferred tax amount could result in the reversal of the deferred tax valuation allowance.

The Company recognizes a liability for uncertain tax positions. An uncertain tax position is defined as a position taken or expected to be taken in a tax return that is not based on clear and unambiguous tax law and which is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company measures the tax benefits recognized based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income or loss available to common stockholders by the weighted average number of shares of Common Stock outstanding for the period. Diluted earnings (loss) per share is computed by dividing earnings or net loss available to common stockholders by the weighted average number of shares of Common Stock outstanding adjusted for the effect of dilutive securities such as share grants or warrants. No adjustment is made for potential Common Stock equivalents that are anti-dilutive during the period.

Recent Adoption of Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The substantive changes in this new guidance require the application of a premium or discount in valuing an instrument that is absent Level 1 inputs, when a market participant would apply such a factor in valuing an instrument. The guidance also enhances disclosure requirements: (i) for fair values of Level 3 assets, the valuation process used for those assets and the sensitivity of those calculations to changes in the amount of unobservable inputs; (ii) a reporting entity's use of a nonfinancial asset in a way that differs from the asset's highest and best use when that asset is measured at fair value in the statement of financial position; and (iii) the categorization by level within the fair value hierarchy of items that are not measured at fair value in the statement of financial position but for which the fair value is required to be disclosed.

This guidance is effective for interim and annual periods beginning after December 15, 2011. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This new guidance removes the option of presenting elements of other comprehensive income within the statements of changes to stockholders' equity. Instead, the total of comprehensive income, the components of net income, and the components of other comprehensive income may be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance is effective for interim and annual periods beginning after December 15, 2011, with retrospective application required. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

In December 2011, the FASB issued ASU 2011-10, Property, Plant and Equipment (Topic 360): Derecognition of in Substance Real Estate – a Scope Clarification. This new standard clarifies the guidance concerning deconsolidation of a subsidiary that is

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

in substance real estate upon the event of default of that subsidiary's nonrecourse debt. Generally, deconsolidation of a subsidiary in this circumstance is not appropriate until the collateral is legally transferred to the lender and the indebtedness is extinguished. This guidance is effective for annual and interim periods beginning after June 15, 2012. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

3. Real Estate Assets

The Company acquired the following three properties which were either partly or wholly owned by parties related to the Company. The acquisition price for each property was based on the appraisals of two independent real estate appraisers and was approved by the Company's conflicts committee.

On April 15, 2011, the Company acquired 100% of the membership interests in Stone Rise Apartments, LLC, a Delaware limited liability company (f/k/a Oxford Rise JV LLC), the fee-simple owner of a 216-unit multifamily community located in suburban Philadelphia, Pennsylvania, or Stone Rise, for a total purchase price of \$30.15 million, exclusive of acquisition-related and financing-related transaction costs. The membership interests in Oxford Rise JV LLC were owned by WOF.

On April 21, 2011, the Company acquired 100% of the membership interests in PAC Summit Crossing, LLC, a Georgia limited liability company (f/k/a Oxford Summit Partners, LLC), the fee-simple owner of a 345-unit multifamily community located in suburban Atlanta, Georgia, or Summit Crossing, for a total purchase price of \$33.2 million, exclusive of acquisition-related and financing-related transaction costs. Williams Realty Fund I, LLC, or WRF (see note 6), owned a majority of the membership interests in PAC Summit Crossing, LLC.

On April 29, 2011, the Company, through its wholly owned subsidiary Trail Creek Apartments, LLC, acquired Oxford Trail, a 204-unit multifamily community located in Hampton, Virginia, or Trail Creek, for a total purchase price of \$23.5 million, exclusive of acquisition-related and financing-related transaction costs. The Company purchased a fee-simple interest in the property from Oxford Trail JV LLC. WRF owned indirectly an approximately 10% membership interest in Oxford Trail JV LLC.

The Company allocated the purchase prices of the three properties to the acquired assets and liabilities based upon their fair values, as follows:

	Trail Creek	Stone Rise	Summit Crossing	Total
Land	\$2,652,000	\$6,950,000	\$3,450,000	\$13,052,000
Buildings and Improvements	17,257,845	18,637,356	24,112,767	60,007,968
Furniture, fixtures and equipment	1,841,990	2,819,094	3,591,881	8,252,965
Intangibles	1,748,165	1,743,550	2,045,352	5,537,067
Cash	9,301	16,101	486	25,888
Deposits	28,160	61,276	41,525	130,961
Prepays and reserves	93,967	439,041	154,744	687,752
Accounts payable and accrued expenses	(48,374)	(81,677)	(89,321)	(219,372)
Net assets acquired	\$23,583,054	\$30,584,741	\$33,307,434	\$87,475,229
Net assets excluding cash	\$23,573,753	\$30,568,640	\$33,306,948	\$87,449,341

The Company recorded depreciation and amortization of tangible and intangible assets as follows:

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	Three months ended		Nine months ended	
	9/30/2012	9/30/2011	9/30/2012	9/30/2011
Depreciation:				
Buildings and improvements	\$412,091	\$406,754	\$1,235,725	\$718,352
Furniture, fixtures, and equipment	492,746	559,474	1,561,225	1,007,394
	904,837	966,228	2,796,950	1,725,746
Amortization:				
Acquired intangible assets	—	2,656,352	—	4,698,175
Website development costs	1,151	1,152	3,454	1,920
Total depreciation and amortization	\$905,988	\$3,623,732	\$2,800,404	\$6,425,841

All depreciation and amortization of acquired intangible assets for the nine-month period ended September 30, 2011 commenced with the dates of acquisition of the three properties. The intangible assets recognized in conjunction with the acquisitions of the three properties were amortized in full during 2011.

4. Real Estate Loans, Notes Receivable, and Line of Credit

Madison-Rome

On September 28, 2012, the Company made a land acquisition bridge loan in the amount of \$5,360,042 to Madison Retail - Rome LLC, or Madison-Rome, a Delaware limited liability company, to partially finance the construction of a 88,000 square foot retail complex located in Rome, Georgia. At September 30, 2012, Madison had drawn \$4,740,408 of the loan amount.

The Madison-Rome loan matures on September 20, 2015, with no option to extend and pays current monthly interest of 8% per annum. An additional exit fee equal to the difference between the 8% interest paid and a 14% cumulative annual simple interest return will be due and payable to the Company if Madison-Rome refinances the loan with a third party or when the loan balance is repaid.

The Madison-Rome loan is secured by a first priority lien in the land and the project, and by unconditional guaranties of payment and performance by Stephen H. Whisenant and Charles N. Worthen, unaffiliated third parties and principals of the borrower. In connection with the closing of the Madison-Rome loan, the Company received a loan fee of 2% of the aggregate loan amount, or \$107,201 and paid an acquisition fee of \$53,600 to the Manager out of these funds. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

City Park

On September 6, 2012, the Company made a mezzanine loan of up to \$10,000,000 to Oxford City Park Development LLC, or City Park, a Georgia limited liability company, to partially finance the construction of a 284-unit multifamily community located in Charlotte, North Carolina. At September 30, 2012, City Park had drawn \$5,070,511 of the loan amount.

The City Park mezzanine loan matures on September 5, 2017, with no option to extend and pays current monthly interest of 8% per annum. The loan accrues an additional 6% interest which will be due at maturity or if the property is sold to, or refinanced by, a third party. The Company also has an option (but not an obligation) to purchase the property between and including November 1, 2015 and March 31, 2016 for a pre-negotiated purchase price of

\$30,945,845. If the Company exercises the purchase option and acquires the property, the additional accrued interest will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of City Park. Prepayment of the mezzanine loan is permitted in whole, but not in part, without the Company's consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of approximately \$18.6 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny have guaranteed the completion of the project in accordance with the plans and specifications. In addition, Messrs. Faulk and Denny have entered into joint and several repayment guaranties of the mezzanine loan. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement.

In connection with the closing of the City Park mezzanine loan, the Company received a loan fee of 2% of the amount drawn on

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

the loan, or \$101,430, and paid an acquisition fee of \$50,715 to the Manager out of these funds. Additional loan fees will be recorded on subsequent drawn amounts up to the full aggregate amount of the loan. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

City Vista

On August 31, 2012, the Company made a mezzanine loan of up to \$12,153,000 to Oxford City Vista Development LLC, or City Vista, a Georgia limited liability company, to partially finance the construction of a 272-unit multifamily community located in Pittsburgh, Pennsylvania. At September 30, 2012, City Vista had drawn \$5,640,266 of the loan amount.

The City Vista mezzanine loan matures on June 1, 2016, with an option to extend until July 1, 2017 and pays current monthly interest of 8% per annum. The loan accrues an additional 6% interest which will be due at maturity or if the property is sold to, or refinanced by, a third party. The Company also has an option (but not an obligation) to purchase the property between and including February 1, 2016 and May 31, 2016 for a pre-negotiated purchase price of \$43,560,271. If the Company exercises the purchase option and acquires the property, the additional accrued interest will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of City Vista. Prepayment of the mezzanine loan is permitted in whole, but not in part, without the Company's consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of approximately \$28.4 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny have guaranteed the completion of the project in accordance with the plans and specifications. In addition, Messrs. Faulk and Denny have entered into joint and several repayment guaranties of the mezzanine loan. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement.

In connection with the closing of the City Vista mezzanine loan, the Company received a loan fee of 2% of the amount drawn on the loan, or \$112,825 and paid an acquisition fee of \$56,412 to the Manager out of these funds. Additional loan fees will be recorded on subsequent drawn amounts up to the full aggregate amount of the loan. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Crosstown Walk

On August 28, 2012, the Company amended the real estate acquisition bridge loan it made on June 29, 2012 to Iris Crosstown Apartments LLC, or Crosstown Walk, a Florida limited liability company, for Crosstown Walk to acquire a parcel of land located in suburban Tampa, Florida, upon which a multifamily community is to be constructed. The amendment increased the aggregate amount of the loan to \$3,693,471. The amount drawn under the loan at September 30, 2012 was \$3,636,496, with the balance scheduled to be drawn at a later date. The bridge loan matures on December 31, 2012, with no option to extend and pays current monthly interest of 8% per annum. If Iris sells the property to a third party or if a third party refinances the bridge loan at any time during its term, an additional 6% per annum exit fee will be due and payable to the Company.

The bridge loan is secured by a mortgage, an assignment of project documents and by unconditional guaranties of payment and performance by W. Daniel Faulk, Jr., Richard A. Denny, and J. Michael Morris, unaffiliated third parties and principals of the borrower. In connection with the closing of the bridge loan and the subsequent amendment, the Company received a total loan fee of 2% of the amount drawn on the loan, or \$73,540 and paid an acquisition fee of \$36,770 to the Manager out of these funds. Additional loan fees will be recorded on subsequent drawn amounts up to the full aggregate amount of the loan. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Summit II

On May 7, 2012, the Company made a mezzanine loan in the amount of \$6,103,027 to Oxford Summit Apartments II LLC, or Summit II, a Georgia limited liability company, to partially finance the construction of a 140-unit multifamily community located adjacent to the Company's existing Summit Crossing multifamily community in suburban Atlanta, Georgia.

The Summit II mezzanine loan matures on May 8, 2017, with no option to extend and pays current monthly interest of 8% per annum. The loan accrues an additional 6% interest which will be due at maturity or if the property is sold to, or refinanced by, a third party. Under the terms of a purchase option agreement entered into in connection with the closing of the mezzanine loan, we have an option (but not an obligation) to purchase the property for a period of five months following completion of construction,

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

lease up and stabilization for \$19,254,155. If the property is sold to, or refinanced by, a third party before or after the option period, we will be entitled to receive an exit fee equal to the amount required to provide us with a 14% simple interest return on the loan, in addition to loan fees received at closing, which totaled 2% of the loan amount. Since the minimum exit fee, assuming the purchase option is not exercised, is the amount needed to provide a 14% simple interest return, the Company will accrue each period the additional exit fee earned based on the 14% rate assuming the loan was paid off at period end. The accrued exit fee will be recorded as interest income in the consolidated statements of operations. If the Company exercises the purchase option and acquires the property, the additional accrued interest will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of Oxford Summit II. Prepayment of the mezzanine loan is permitted in whole, but not in part, without the Company's consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of \$12,384,000 that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny have guaranteed the completion of the project in accordance with the plans and specifications. In addition, Messrs. Faulk and Denny have entered into joint and several repayment guaranties of the mezzanine loan. The repayment guaranties expire at the completion of construction of the property. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement.

In connection with the closing of the Summit II mezzanine loan, the Company received a loan fee of 2% of the loan amount, or \$122,061 and paid an acquisition fee of \$61,030 to the Manager out of these funds. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Trail II

On June 30, 2011, the Company made a mezzanine loan of \$6.0 million to Oxford Hampton Partners LLC, or Hampton Partners, a Georgia limited liability company and a related party, to partially finance the construction of a 96-unit multifamily community located adjacent to the Company's existing Trail Creek multifamily community in Hampton, Virginia, or Trail II. Hampton Partners was required to fully draw down the mezzanine loan on the closing date. Approximately 100% of the membership interest in Hampton Partners is owned by WRF.

The Trail II mezzanine loan matures on June 29, 2016, with no option to extend and pays interest at a fixed rate of 8.0% per annum. Interest will be paid monthly with principal and any accrued but unpaid interest due at maturity. Under the terms of a purchase option agreement entered into in connection with the closing of the mezzanine loan, the Company has an option (but not an obligation) to purchase the property between and including April 1, 2014 and June 30, 2014 for \$17,825,600, which is the amount of the aggregate project costs as set forth in the approved construction budget on the closing date. If the property is sold to, or refinanced by, a third party before July 1, 2014, the Company will be entitled to receive an exit fee equal to the amount required to provide it with a 14% cumulative internal rate of return on the loan. If the property is sold to, or refinanced by, a third party on or after July 1, 2014, then the Company will be entitled to receive an exit fee equal to the amount required to provide it with a 12% cumulative internal rate of return on the loan. The calculation of the cumulative internal rate of return will include the loan's fees received at closing. Since the minimum exit fee, assuming the purchase option is not exercised, is the amount needed to provide a 12% cumulative internal rate of return, the Company will accrue each period the additional exit fee earned based on the 12% rate assuming the loan was paid off at period end as the borrower cannot control whether the option is exercised. The accrued exit fee will be recorded as interest income in the consolidated statements of operations.

If the Company exercises the purchase option and acquires the property, any accrued and unpaid exit fee will be treated as additional basis in the acquired project.

The Trail II mezzanine loan is secured by a pledge of 100% of the membership interests of Hampton Partners. Partial prepayment of the mezzanine loan is not permitted without the Company's consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of \$10 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny, both unaffiliated third parties, have guaranteed the completion of the project in accordance with the plans and specifications. This guaranty is subject to the rights held by the senior lender pursuant to a standard intercreditor agreement with the senior lender.

In connection with the closing of the Trail II mezzanine loan, the Company received a loan fee of 2% of the loan amount, or \$120,000, and a loan commitment fee of \$14,333. The Company paid an acquisition fee of \$60,000 to its Manager out of these funds. The net fees received by the Company are recognized as an adjustment of yield over the term of the loan using the effective interest method.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

Notes Receivable

On September 14, 2012, the Company made a loan in the amount of \$500,000 to Newport Development, LLC, or Newport, a Georgia limited liability company and unaffiliated third party, in the form of a promissory note. The full amount of the loan was drawn as of September 30, 2012. The loan bears interest at 15% per annum and interest only payments are due on a monthly basis until the maturity date of March 17, 2013. The loan may be prepaid at any time, in whole or in part, without penalty. The amounts payable under the terms of the loan are backed by personal guaranties of repayment issued by Robert F. Krause, Jr., and J. Richard Stephens, Jr., principals of Newport and who are unaffiliated third parties.

On May 21, 2012, the Company made a loan in the amount of \$575,000 to Madison Retail, LLC, or Madison Retail, a Georgia limited liability company and unaffiliated third party, in the form of a promissory note. The amount drawn by Madison Retail as of September 30, 2012 was \$430,544. The loan bore interest at 15% per annum and interest only payments were due on a monthly basis until the maturity date of September 30, 2012. The loan was paid off at maturity. The amounts payable under the terms of the loan were backed by a personal guaranty of repayment issued by Stephen H. Whisenant, the principal of Madison Retail and an unaffiliated third party.

On March 26, 2012, the Company made a loan in the amount of \$650,000 to Oxford Properties, LLC, a Georgia limited liability company, or Oxford, in the form of a promissory note. The loan bore interest at 15% per annum and interest only payments were due beginning May 1, 2012, and continued on a monthly basis until the repayment of the loan, which occurred on September 6, 2012.

Line of Credit

On August 21, 2012, the Company extended a revolving line of credit to its Manager in an aggregate amount of up to \$1.0 million, in order to provide liquidity to the Manager in support of its ongoing business operations. The credit line bears interest at 8.0% per annum, with interest payable monthly, and matures on July 31, 2013. The loan is secured by a collateral assignment of the Manager's right to fees under the Management Agreement. At September 30, 2012, the amount drawn on the line of credit by the Manager was \$345,200.

The Company recorded interest income and other revenue from these instruments as follows:

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	Three months ended		Nine months ended	
	9/30/2012	9/30/2011	9/30/2012	9/30/2011
Interest income:				
Real estate loans:				
Summit II	\$ 122,061	\$—	\$ 196,189	\$—
Trail II	120,000	120,000	360,000	120,000
Crosstown Walk	62,335	—	63,567	—
City Park	27,784	—	27,784	—
City Vista	38,838	—	38,838	—
Madison-Rome	3,117	—	3,117	—
Total	374,135	120,000	689,495	120,000
Accrued exit fees	198,449	—	318,296	—
Net loan fee revenue recognized	27,765	4,495	39,194	5,828
Total interest income on real estate loans	600,349	124,495	1,046,985	125,828
Notes receivable:				
Newport	3,493	—	3,493	—
Oxford	16,793	—	42,770	—
Madison Retail	13,589	—	17,253	—
PAA line of credit	1,925	—	1,925	—
Total interest income on notes and lines of credit	35,800	—	65,441	—
Total interest income	\$ 636,149	\$ 124,495	\$ 1,112,426	\$ 125,828

The Company extends loans for purposes such as to partially finance the development of multifamily residential communities, to acquire land in anticipation of developing and constructing multifamily residential communities, and for other real estate or real estate related projects. Certain of these loans include characteristics such as exclusive options to purchase the project at a fixed price within a specific time window following project completion and stabilization, the rights to incremental exit fees over and above the amount of periodic interest paid during the life of the loans, or both. These characteristics can cause the loans to create variable interests to the Company and require further evaluation as to whether the variable interest creates a variable interest entity, or VIE, which would necessitate consolidation of the project. The Company considers the facts and circumstances pertinent to each entity borrowing under the loan, including the relative amount of financing the Company is contributing to the overall project cost, decision making rights or control held by the Company, and rights to expected residual gains or obligations to absorb expected residual losses that could be significant from the project. If the Company is deemed to be the primary beneficiary of a VIE, consolidation treatment would be required.

The Company has evaluated its real estate loans, where appropriate, for accounting treatment as loans versus real estate development projects, as required by ASC 310. For each loan, the majority of the characteristics and the facts and circumstances indicate that loan accounting treatment is appropriate.

The Company's real estate loans partially finance the development activities of the borrowers' associated legal entities. Each of these loans create variable interests in each of these entities, and according to the Company's analysis, are deemed to be VIEs. Due to the combined factors of the sufficiency of the borrowers' investment at risk, the existence of payment and performance guaranties provided by the borrowers, as well as the limitations on the fixed-price purchase options on the Trail II, Summit II, City Park and City Vista loans, the Company has concluded that it is not the primary beneficiary of the borrowing entities. It has no decision making authority or power to direct activity, except normal lender rights, which are subordinate to the senior loans on the projects. Therefore, since the Company has concluded it is not the primary beneficiary, it has not consolidated these entities

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements – (continued)
September 30, 2012
(unaudited)

in its consolidated financial statements. The Company's maximum exposure to loss from these loans is their carrying value as of September 30, 2012 of approximately \$31.2 million. The maximum aggregate amount of loans to be funded as of September 30, 2012 was approximately \$43.3 million.

The Company is subject to a concentration of credit risk that could be considered significant with regard to the Trail II, Summit II, Crosstown Walk, City Park and City Vista real estate loans, as identified specifically by the two named principals of the borrowers, W. Daniel Faulk, Jr. and Richard A. Denny, and as evidenced by repayment guaranties offered in support of these loans. These loans total approximately \$26.5 million and in the event of a total failure to perform by the borrowers and guarantors, would subject the Company to a total possible loss of that amount. The Company generally requires secured interests in one or a combination of the membership interests of the borrowing entity, guaranties of loan repayment, and project completion performance guaranties as credit protection with regard to its real estate loans, as is customary in the mezzanine loan industry. The Company has performed assessments of the guaranties with regard to the obligors' ability to perform according to the terms of the guaranties if needed and has concluded that the guaranties reduce the Company's risk and exposure to the above-described credit risk in place as of September 30, 2012.

The borrowers and guarantors behind these real estate loans (excluding the Madison-Rome loan) collectively qualify as a major customer as defined in ASC 280-10-50, as the revenue recorded from this customer exceeded ten percent of the Company's total revenues. The Company recorded revenue from transactions with this major customer for the three-month and nine-month periods ended September 30, 2012 of approximately \$611 thousand and \$1.1 million, respectively.

5. Redeemable Preferred Stock

On November 18, 2011, the Securities and Exchange Commission declared effective our registration statement on Form S-11 (registration number 333-176604) for our offering of up to a maximum of 150,000 Units, with each Unit consisting of one share of our Preferred Stock and one Warrant to purchase 20 shares of our Common Stock. We refer to such offering as the Primary Series A Offering. Each share of Preferred Stock ranks senior to the Company's Common Stock and carries a cumulative annual 6% dividend of the stated per share value of \$1,000, payable monthly as declared by the Company's board of directors. Dividends begin accruing on the date of issuance. The Preferred Stock is redeemable at the option of the holder beginning two years following the date of issue subject to a 10% redemption fee. After year three the redemption fee decreases to 5%, after year four it decreases to 3%, and after year five there is no redemption fee. Any redeemed shares of Preferred Stock are entitled to any accrued but unpaid dividends at the time of redemption and any redemptions may be in cash or Common Stock, at the Company's discretion. The Warrant is exercisable by the holder at an exercise price of 120% of the current market price per share of the Common Stock on the date of issuance of such warrant with a minimum exercise price of \$9.00 per share. The current market price per share is determined using the volume weighted average closing market price for the 20 trading days prior to the date of issuance of the Warrant. The Warrants are not exercisable until one year following the date of issuance and expire four years following the date of issuance.

On August 16, 2012, we filed a registration statement on Form S-11 (registration number 333-183355) for a follow-on offering of an additional 850,000 Units, bringing the maximum number of Units to be issued to one million. The terms of the follow-on offering and features of the Units are substantially the same as the Primary Series A Offering. The registration statement has not yet been declared effective by the Securities and Exchange Commission.

As of September 30, 2012, offering costs specifically identifiable to Unit offering closing transactions, such as commissions, dealer manager fees, and other registration fees, totaled approximately \$1.2 million. These costs are

reflected as a reduction of stockholders' equity at the time of closing. In addition, the costs related to the offering not related to a specific closing transaction totaled approximately \$2.7 million. As of September 30, 2012 the Company had issued 12,178 Units and collected net proceeds of approximately \$11.0 million from the Primary Series A Offering. The number of Units issued was approximately 1.2% of the maximum number of Units to be issued under the Primary Series A Offering and the follow-on offering. Consequently, the Company cumulatively recognized approximately 1.2% of the approximate \$2.7 million deferred to date, or approximately \$33 thousand as a reduction of stockholders' equity. The remaining balance of offering costs not yet reflected as a reduction of stockholder's equity, approximately \$2.7 million, are reflected in the asset section of the consolidated balance sheet as deferred offering costs. The remainder of current and future deferred offering costs will likewise be recognized as a reduction of stockholders' equity in the proportion of the number of Units issued to the maximum number of Units available to be issued. Offering costs not related to a specific closing transaction are subject to an overall cap of 1.5% of the total gross proceeds raised during the Unit offering.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

6. Related Party Transactions

John A. Williams, the Company's Chief Executive Officer and Chairman of the Board and Leonard A. Silverstein, the Company's President and Chief Operating Officer and a member of the Board, are also executive officers and directors of NELL Partners, Inc., which controls the Manager. Mr. Williams is the Chief Executive Officer and President and Mr. Silverstein is the President and Chief Operating Officer of the Manager.

Mr. Williams, Mr. Silverstein and Michael J. Cronin, the Company's Executive Vice President, Chief Accounting Officer and Treasurer are executive officers of Williams Realty Advisors, LLC, or WRA, which is the manager of the day-to-day operations of WOF. WRA is also the manager of the day-to-day operations of WRF.

The third amended and restated management agreement, or Management Agreement, between the Company and its Manager entitles the Manager to receive compensation for various services it performs related to acquiring assets and managing properties on the Company's behalf:

Type of Compensation	Basis of Compensation	Three months ended September 30, 2012	September 30, 2011	Nine months ended September 30, 2012	September 30, 2011
Acquisition fees	1% of the gross purchase price of real estate assets acquired or loans advanced	\$ 168,813	\$—	\$ 258,528	\$ 928,500
Asset management fees	Monthly fee equal to one-twelfth of 0.50% of the total book value of assets, as adjusted	148,573	127,292	409,964	235,019
Property management fees	Monthly fee equal to 4% of the monthly gross revenues of the properties managed	104,320	100,519	304,827	175,572
General and administrative expense fees	Monthly fee equal to 2% of the monthly gross revenues of the Company	66,111	50,183	173,696	87,722
		\$ 487,817	\$ 277,994	\$ 1,147,015	\$ 1,426,813

In addition to property management fees, the Company incurred reimbursable on-site personnel salary and related benefits expenses at the properties as follows:

Three months ended		Nine months ended	
September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
\$ 247,165	\$ 255,847	\$ 738,643	\$ 435,902

The Company's Manager utilizes certain personnel of its affiliates to accomplish certain tasks related to raising capital that would typically be performed by third parties, including, but not limited to, legal and marketing functions. As permitted under the Management Agreement, the Manager has requested reimbursement of \$43,747 and \$120,618 for

the three-month and nine-month periods ended September 30, 2012, respectively. These costs are recorded as deferred offering costs until such time as additional closings occur on the Unit offering, at which time they are reclassified on a pro-rata basis as a reduction of offering proceeds within stockholders' equity.

In addition to the fees described above, the Management Agreement also entitles the Manager to other potential fees, as follows:

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

Disposition fees - Based on the lesser of (A) one-half of the commission that would be reasonable and customary; and (B) 1% of the sale price of the asset

Construction, development, and landscaping fees - Customary and competitive market rates in light of the size, type and location of the asset

Special limited partnership interest in the Operating Partnership - distributions from the Operating Partnership equal to 15% of any net proceeds from the sale of an asset and prior operations that are remaining after the payment of (i) the capital and expenses allocable to all realized investments (including the sold asset), and (ii) a 7% priority annual return on such capital and expense; provided that all accrued and unpaid dividends on the Preferred Stock have been paid in full

The Company did not incur any of these other potential fees during the three or nine-month periods ended September 30, 2012 or 2011.

7. Dividends

The Company declares and pays monthly cash dividend distributions on its Preferred Stock in the amount of \$5.00 per share, prorated for partial months at issuance as necessary. In addition to \$718 of accrued dividends applicable to the three-month period

ended March 31, 2012, the Company's dividend activity on its Preferred Stock for the nine-month period ended September 30, 2012 was:

Declaration date	Record date	Payment date	Dividend distributions
4/13/2012	4/30/2012	5/21/2012	\$ 11,486
5/10/2012	5/31/2012	6/20/2012	25,406
6/22/2012	6/29/2012	7/20/2012	42,793
7/22/2012	7/31/2012	8/20/2012	50,878
8/2/2012	8/31/2012	9/20/2012	54,119
9/18/2012	9/28/2012	10/22/2012	58,062
			\$242,744

On February 2, 2012, the Company declared a quarterly dividend on its Common Stock of \$0.13 per share. The dividend totaled \$673,181 and was paid on April 16, 2012 to all holders of Common Stock of record as of March 30, 2012.

On May 10, 2012, the Company declared a quarterly dividend on its Common Stock of \$0.13 per share. The dividend totaled \$677,477 and was paid on July 16, 2012 to all holders of Common Stock of record as of June 29, 2012.

On August 2, 2012, the Company declared a quarterly dividend on its Common Stock of \$0.14 per share. The dividend totaled \$729,699 and was paid on October 15, 2012 to all holders of Common Stock of record as of September 28, 2012.

8. Equity Compensation

Stock Incentive Plan

On February 25, 2011, the Company's board of directors adopted, and the Company's stockholders approved, the Preferred Apartment Communities, Inc. 2011 Stock Incentive Plan, or, as amended, the 2011 Plan, to incentivize, compensate and retain eligible employees, consultants, and non-employee directors. A maximum of 567,500 shares of Common Stock may be issued under the 2011 Plan. Awards may be made in the form of issuances of Common Stock, restricted stock, stock appreciation rights ("SARs"), performance shares, incentive stock options, non-qualified stock options, or other forms. Eligibility for receipt of, amounts, and all terms governing awards pursuant to the 2011 Plan, such as vesting periods and voting and dividend rights on

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements – (continued)
September 30, 2012
(unaudited)

unvested awards, are determined by the Compensation Committee of the Company's Board of Directors.

Restricted Stock Grants

On April 5, 2011, the Company granted a total of 26,000 shares of restricted Common Stock to its non-employee board members, in payment of their annual retainer fees. The Company records the fair value of restricted stock awards based upon the closing stock price on the trading day immediately preceding the date of grant. The fair value per share was deemed to be \$10.00 per share (the IPO offering price) by Board resolution. Compensation cost in the amount of \$260,000 was recognized on a straight-line basis over the period ending on the first anniversary of the grant date and all 26,000 shares vested on April 5, 2012. For the nine-month period ended September 30, 2012, stock compensation expense for these grants was \$66,867. For the three-month and nine-month periods ended September 30, 2011, stock compensation expense for these grants was \$65,534 and \$127,507, respectively.

On May 10, 2012, the Company granted a total of 33,046 shares of restricted Common Stock to its non-employee board members, in payment of their annual retainer fees. The per-share fair value was \$7.83 and total compensation cost in the amount of \$258,750 will be recognized on a straight-line basis over the period ending on the earlier of first anniversary of the grant date or the next annual meeting of the Company's stockholders. For the three-month and nine-month periods ended September 30, 2012, stock compensation expense was \$64,480 and \$107,813 for these grants, respectively. Unrecognized compensation expense was \$150,937 and all 33,046 unvested shares were outstanding at September 30, 2012.

Directors' Stock Grants

On August 2, 2012, the Company granted 780 shares of Common Stock to its independent board members, in payment of their meeting fees. The per-share fair value of this immediate-vesting award was \$7.88, which was the closing price of the Common Stock on the prior business day. The total compensation cost of \$6,146 was recorded in full at the grant date.

On February 2, 2012, the Company granted 2,988 shares of Common Stock to its independent board members, in payment of their meeting fees. The per-share fair value of this immediate-vesting award was \$6.12, which was the closing price of the Common Stock on the prior business day. The total compensation cost of \$18,287 was recorded in full at the grant date.

On August 4, 2011, the Company granted 1,500 shares of Common Stock to its independent board members, in payment of their meeting fees. The per-share fair value of this immediate-vesting award was \$7.99, which was the closing price of the Common Stock on the prior business day. The total compensation cost of \$11,985 was recorded in full at the grant date.

On May 5, 2011, the Company granted 1,872 shares of Common Stock to its independent board members, in payment of their meeting fees. The per-share fair value of this immediate-vesting award was \$9.62, which was the closing price of the Common Stock on the prior business day. The total compensation cost of \$18,009 was recorded in full at the grant date.

Class B Units

On December 30, 2011, pursuant to its Third Amended and Restated Agreement of Limited Partnership of the Partnership, the Company granted 107,164 Class B Units, representing ownership interests in the Operating Partnership, to certain of its executive officers as compensation for service in 2011. On January 3, 2012, the Company granted 106,988 Class B Units for service to be rendered during 2012.

The Class B Units become Vested Class B Units at the Initial Valuation Date, which is one year from the date of grant. For each grant, on the Initial Valuation Date, the market capitalization of the number of shares of Common Stock at the date of grant is compared to the market capitalization of the same number of shares of Common Stock at the Initial Valuation Date. If the market capitalization measure results in an increase of at least \$650,000, the Vested Class B Units become Earned Class B Units and automatically convert into Class A Units of the Operating Partnership, which are henceforth entitled to distributions from the Operating Partnership and become exchangeable for Common Stock of the Company on a one-to-one basis at the option of the holder. Vested Class B Units may become Earned Class B Units on a pro-rata basis should the result of the market capitalization test be an increase of less than \$650,000. Any Vested Class B Units that do not become Earned Class B Units on the Initial Valuation Date are subsequently remeasured on a quarterly basis until such time as all Vested Class B Units become Earned Class

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

B Units or are forfeited due to termination of continuous service as an officer of the Company due to an event other than as a result of a qualified event, which is generally the death or disability of the holder. Continuous service through the final valuation date is required for the Vested Class B Units to qualify to become fully Earned Class B Units.

On August 15, 2012, the Company granted 6,128 Class B Units to its Vice Chairman of the Company's Board of Directors, as additional compensation for acting in an expanded capacity related to board oversight of the Company's capital raising efforts. The vesting conditions, conversion rights and other features are identical to the Class B Unit grants described above, except the market capitalization hurdle is \$50,000.

Because of the market condition determining the transition of the Vested Class B Units to Earned Class B Units, a Monte Carlo simulation was utilized to calculate the total fair values, which will be amortized as compensation expense over the one-year periods beginning on the grant dates through the Initial Valuation Dates. For the three-month and nine-month periods ended September 30, 2012, stock compensation expense for these three grants was \$244,974 and \$722,094, respectively. Unrecognized compensation expense for these awards was \$278,302 and all unvested Class B Units were outstanding at September 30, 2012.

The underlying valuation assumptions and results for the Class B Unit awards were:

Grant dates	12/30/2011		1/3/2012		8/15/2012	
Stock price	\$5.98		\$6.05		\$8.30	
Dividend yield	8.7	%	8.6	%	6.75	%
Expected volatility	35.29	%	35.23	%	31.35	%
Risk-free interest rate	2.73	%	2.83	%	2.72	%
Derived service period (years)	1.0		1.0		1.0	
Number of Units granted	107,164		106,988		6,128	
Calculated fair value per Unit, assuming:						
50% vesting	\$4.49		\$4.50		\$6.69	
100% vesting	\$4.46		\$4.47		\$6.68	
Total fair value of Units	\$479,559		\$479,841		\$40,996	

The expected dividend yield assumptions were derived from the Company's closing price of its Common Stock on the grant date and its projected future quarterly dividend payments of \$0.13 per share for the 2011 and 2012 awards and \$0.14 per share for the August 15, 2012 award.

Since the Company has a limited amount of operating history in the public equity market, the expected volatility assumption was derived from the observed historical volatility of the common stock prices of a select group of peer companies within the REIT industry that most closely approximate the Company's size, capitalization, leverage, line of business and geographic focus markets.

The risk-free rate assumptions were obtained from the Federal Reserve yield table and were calculated as the interpolated rate between the 20 and 30 years year yield percentages on U. S. Treasury securities on the grant dates.

Since the likelihood of attainment of the market condition for each of the Class B Units to become earned is believed to be high and the vesting period is one year, the forfeiture rate assumption for these Class B Units was set to 0%.

Since the Class B Units have no expiration date, a derived service period of one year was utilized, which equals the period of time from the grant date to the initial valuation date.

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements – (continued)
September 30, 2012
(unaudited)

Warrant

On March 31, 2011, as partial compensation for services rendered for the IPO, the Company issued to International Assets Advisory, LLC, or IAA, a warrant to purchase up to 150,000 shares of Common Stock. The exercise price is \$12.50 per share, which is 125% of the gross IPO price of \$10.00 per share. The warrant is currently exercisable and expires on March 31, 2015. The Company calculated the per-share fair value of the warrant using the Black-Scholes method. The underlying valuation assumptions were:

Dividend yield	5.0%
Expected volatility	62.69%
Risk-free interest rate	1.765%
Expected option term (years)	4

The expected dividend yield assumption was derived from the Company's gross IPO price per share of \$10.00 and its then-projected future quarterly dividend payments of \$0.125 per share.

Since the Company has a limited amount of operating history in the public equity market, the expected volatility assumption was derived from the observed historical volatility of the common stock prices of a select group of peer companies within the REIT industry that most closely approximate the Company's size, capitalization, leverage, line of business and geographic focus markets.

The risk-free rate assumption was obtained from the treasury constant maturities nominal yield table obtained from the Federal Reserve, interpolated between the three-year and five-year yield percentages on U. S. Treasury securities on March 31, 2011.

The expected term assumption of 4 years was equal to the contractual term of the instrument. The fair value of the warrant was calculated to be \$462,330, or \$3.08 per share and, since all service conditions had been met as of the date of issuance, was recorded in full at March 31, 2011 as an increase in the deferred offering costs on the consolidated balance sheet and an increase in additional paid-in capital. Subsequent to the closing of the IPO, these deferred offering costs were removed from the consolidated balance sheet and charged against stockholders' equity.

The warrant is exercisable, at IAA's option, in whole or in part, by either payment of the aggregate exercise price for the number of shares exercised, plus applicable transfer taxes, or by a cashless net share settlement. Upon exercise of the warrant, shares of Common Stock will be issued from authorized but unissued Common Stock.

9. Indebtedness

Note Payable

On September 2, 2010, the Company borrowed \$465,050 from WOF through the issuance of a promissory note. The note had an interest rate of 4.25% per annum and had a maturity date of April 30, 2011. The proceeds were used to reimburse for organizational, offering, acquisition and due diligence expenses. On April 5, 2011, the Company paid off this note in conjunction with the closing of the IPO and the private placement with WOF. The Company incurred interest on this note of \$5,090 for the nine-month period ended September 30, 2011.

Mortgage Notes Payable

The Company partially financed the acquisitions of Stone Rise, Summit Crossing and Trail Creek with non-recourse mortgage notes collateralized only by the associated real estate assets for each community with no cross-collateralization of any of our other properties. Each mortgage requires payments of interest only from the dates of closing through May 1, 2014, then principal and interest are due on a 30-year amortization schedule through May 1, 2018, the date of maturity of each instrument. Interest expense on the mortgages for the three acquired properties was:

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	Acquisition date	Principal balance as of September 30, 2012	Interest rate	Three months ended		Nine months ended	
				September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Stone Rise	4/15/2011	\$ 19,500,000	1 month LIBOR + 2.77%	\$ 150,036	\$ 147,962	\$ 448,126	\$ 270,309
Summit Crossing	4/21/2011	20,862,000	Fixed 4.71%	251,109	251,109	747,868	444,900
Trail Creek	4/29/2011	15,275,000	1 month LIBOR + 2.8%	118,700	117,075	354,521	197,291
Total		\$55,637,000		\$ 519,845	\$ 516,146	\$ 1,550,515	\$ 912,500

In addition, the Company recorded amortization of deferred loan costs related to these mortgages of \$21,492 and \$64,479 for the three-month and nine-month periods ended September 30, 2012 and \$21,445 and \$42,986 for the three-month and nine-month periods ended September 30, 2011, respectively. The interest expense and deferred loan cost amortization for the nine-month period ended September 30, 2011 began with the closing dates of the acquisition of the three multifamily properties and so do not reflect a full period of activity.

Variable monthly interest rates are capped at 7.25% and 6.85% for Stone Rise and Trail Creek, respectively. LIBOR was 0.210% on September 30, 2012. Based upon this current rate, the Company's estimated future principal payments due on its debt instruments as of September 30, 2012 were:

Period	Future principal payments
Remainder of 2012	\$—
2013	15,000,000
2014	608,635
2015	1,072,884
2016	1,111,367
thereafter	52,844,114
Total	\$ 70,637,000

Lines of Credit

On October 12, 2010, the Company entered into a \$1.0 million unsecured non-revolving line of credit arrangement with WOF, which matured on March 31, 2011. On March 25, 2011, the line of credit was increased to \$1.25 million and the maturity date was extended to April 30, 2011. The line was to be used to fund approved expenses incurred by the Company such as organization, offering and property acquisition expenses. The line had an interest rate of 4.25% per annum. For the nine-month period ended September 30, 2011, the Company incurred interest on this line of credit of \$10,758. On April 5, 2011, the Company paid off and terminated this line of credit in conjunction with the closing

of the IPO and the private placement with WOF.

On October 12, 2010, the Company entered into a \$1.0 million unsecured revolving line of credit arrangement with WOF, which matured on March 31, 2011. On March 25, 2011, the line of credit was reduced to \$750,000 and the maturity date was extended to April 30, 2011. The line was only to be used to fund certain approved deposits and escrows related to the acquisition of real

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

estate projects and related financings. The line had an interest rate of 4.25% per annum. For the nine month period ended September 30, 2011, the Company incurred interest on this line of credit of \$880. On April 5, 2011, the Company paid off and terminated this line of credit in conjunction with the closing of the IPO and the private placement with WOF.

Credit Facility

On August 31, 2012, the Company and the Operating Partnership entered into a credit agreement with Key Bank National Association, or Key Bank, to obtain a \$15.0 million senior secured revolving credit facility, or the Credit Facility. The intended uses of the Credit Facility are to fund investments, capital expenditures, dividends (with consent), working capital and other general corporate purposes on an as needed basis. Amounts drawn under the Credit Facility bear interest at a variable rate of the 1 month LIBOR index plus 500 basis points, or approximately 5.2% per annum at September 30, 2012 as well as a commitment fee on the average daily unused portion of the Credit Facility of 0.50% per annum. Accrued interest and commitment fees are payable monthly and principal amounts owed may be repaid in whole or in part without penalty. The Credit Facility has a maturity date of August 31, 2013.

Borrowings under the Credit Facility are secured by, among other things, pledges of 100% of the ownership of each of the current and future mezzanine loan subsidiaries, and 49% of the ownership of each of the current and future real estate subsidiaries, as well as by joint and several repayment guaranties.

The Credit Facility contains certain affirmative and negative covenants including negative covenants that limit or restrict secured and unsecured indebtedness, mergers and fundamental changes, investments and acquisitions, liens and encumbrances, dividends, transactions with affiliates, burdensome agreements, changes in fiscal year and other matters customarily restricted in such agreements. As of September 30, 2012, the Company was in compliance with all covenants related to the Credit Facility, as follows:

Covenant	Requirement	Result
Senior leverage ratio	Maximum 65%	46%
Net worth	Minimum \$38,230,562	\$43,587,623
Debt yield	Minimum 7.75%	8.72%
Payout ratio	Maximum 95%	77.7%
Total leverage ratio	Maximum 70%	58.3%
Debt service coverage ratio	Minimum 1.50x	2.77x

At September 30, 2012, the Company and the Operating Partnership had drawn the full \$15.0 million available under the Credit Facility to finance the closings of the City Vista and City Park mezzanine loans and the Madison-Rome loan, as well as associated legal expenses and a loan fee and closing costs of \$323,918 for the establishment of the Credit Facility, of which \$26,993 was amortized for the three-month and nine-month periods ended September 30, 2012. Interest expense for the Credit Facility was \$46,970 and the weighted average interest rate was 5.24% for the three-month and nine-month periods ended September 30, 2012 (commencing with the first draw upon the Credit Facility on August 31, 2012).

10. Income Taxes

The Company elected to be taxed as a REIT effective with its tax year beginning January 1, 2011, and therefore, the Company will not be subject to federal and state income taxes after this effective date. For the period preceding this

election date, the Company's operations resulted in a tax loss. As of December 31, 2010, the Company had deferred federal and state tax assets totaling approximately \$298,100, none of which were based upon tax positions deemed to be uncertain. These deferred tax assets will most likely not be used since the Company elected REIT status, therefore, management has determined that a 100% valuation allowance is appropriate for the period ended September 30, 2012.

11. Commitments and Contingencies

The Company is not currently subject to any known material commitments or contingencies from its business operations, nor any

material known or threatened litigation.

12. Segment Information

The Company evaluates the performance of its business operations and allocates financial and other resources by assessing the financial results and outlook for future performance across two distinct segments: multifamily communities and real estate related financing.

Multifamily Communities - consists of owned residential multifamily communities.

Financing - consists of the Company's portfolio of mezzanine loans, bridge loans, and other instruments deployed by the Company to partially finance the development, construction, and prestabilization carrying costs of new multifamily communities and other real estate and real estate related assets.

The primary financial operating measure utilized internally by the Company's chief operating decision maker, or CODM, is Adjusted Funds from Operations, or AFFO. The Company defines and calculates AFFO as:

Net income/loss, excluding the effects of:

- impairment charges on and gains/losses from sales of depreciable property;
- depreciation and amortization charges;
- acquisition costs;
- organization costs;
- non-cash equity compensation to directors and executives;
- amortization of loan closing costs;
- REIT establishment costs;
- net loan origination fees received;
- non-cash mezzanine loan interest income;
- cash paid for loan closing costs; and
- normally recurring capital expenditures

The Company's reported AFFO results are not generally comparable to those reported by other companies. Investors are cautioned that AFFO is a non-GAAP measure which excludes acquisition costs which are generally recorded in the periods in which the properties are acquired (and often preceding periods). The CODM utilizes AFFO to gauge the results of the operating performance of the Company's portfolio of real estate-related assets. As a widely accepted industry financial measure, the Company believes AFFO is useful to investors as a supplemental gauge of its operating performance and is useful in comparing its operating performance with other real estate companies that are not as involved in ongoing acquisition activities. AFFO is a useful supplement to, but not a substitute for, its closest GAAP-compliant measure, which the Company believes to be net income/loss available to common stockholders.

The following table presents the Company's AFFO results by reportable segment. The amounts on the line entitled 'Other' consist of expense attributable to equity compensation awards, asset management fees and general and administrative expense fees incurred at the Operating Partnership level, professional fees, and other miscellaneous costs not allocable to either reportable segment. Assets by reporting segment are not reviewed by, nor reported to, the CODM and are therefore not presented.

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	Three months ended:		Nine months ended:	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenues				
Multifamily communities	\$2,607,102	\$2,509,133	\$7,626,707	\$4,386,071
Financing	636,149	124,495	1,112,426	125,828
Consolidated revenues	\$3,243,251	\$2,633,628	\$8,739,133	\$4,511,899
Adjusted funds from operations attributable to common stockholders (AFFO):				
Multifamily communities	\$1,140,231	\$976,585	\$3,091,436	\$3,351,776
Financing	578,976	119,976	1,013,645	195,642
Other	(901,211)	(326,088)	(1,691,461)	(2,460,645)
Consolidated AFFO	817,996	770,473	2,413,620	1,086,773
Depreciation of real estate assets	(900,307)	(961,446)	(2,782,052)	(1,715,674)
Amortization of acquired intangible assets	—	(2,656,351)	—	(4,698,174)
Acquisition costs	—	(18,272)	(912)	(1,680,432)
Organization costs	—	—	(1,593)	(94,372)
Non-cash equity compensation to directors and executives	(315,600)	(77,519)	(921,207)	(157,501)
Amortization of loan closing costs	(48,487)	(21,445)	(91,473)	(42,986)
REIT establishment costs	—	—	—	(25,849)
Depreciation/amortization of non-real estate assets	(5,681)	(5,935)	(18,352)	(11,993)
Net mezzanine loan fees received	(168,813)	—	(258,528)	(74,333)
Non-cash mezzanine loan interest income	225,970	4,489	357,219	4,489
Cash paid for loan closing costs	323,918	—	323,918	—
Normally recurring capital expenditures	52,240	62,052	162,009	89,000
Net loss attributable to common stockholders	\$(18,764)	\$(2,903,954)	\$(817,351)	\$(7,321,052)

13. Loss Per Share

The following is a reconciliation of weighted average basic and diluted shares outstanding used in the calculation of loss per share of Common Stock:

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	QTD September 30, 2012	September 30, 2011	YTD September 30, 2012	September 30, 2011
Numerator:				
Net income (loss)	\$ 148,921	\$ (2,900,704)	\$ (562,305)	\$ (7,314,552)
Net loss attributable to non-controlling interests	—	—	—	—
Net income (loss) attributable to the Company	148,921	(2,900,704)	(562,305)	(7,314,552)
Dividends on Series A Redeemable Preferred Stock (See Note A below)	(163,059)	—	(242,744)	—
Earnings attributable to unvested restricted shares (See Note B below)	(4,626)	(3,250)	(12,302)	(6,500)
Net loss attributable to common stockholders	\$ (18,764)	\$ (2,903,954)	\$ (817,351)	\$ (7,321,052)
Denominator:				
Weighted average number of shares of Common Stock - basic	5,178,822	5,146,845	5,169,467	3,375,384
Effect of dilutive securities (See Note C below):				
Warrants	—	—	—	—
Class B Units	—	—	—	—
Weighted average number of shares of Common Stock - diluted	5,178,822	5,146,845	5,169,467	3,375,384
Loss per weighted average share - basic and diluted	\$ 0.00	\$ (0.56)	\$ (0.16)	\$ (2.17)

(A) The Company's issuances totaling 12,178 shares of Preferred Stock which accrue dividends at an annual rate of 6% of the stated value of \$1,000 per share, payable monthly.

(B) The Company's unvested restricted share awards (33,046 and 26,000 shares of Common Stock at September 30, 2012 and September 30, 2011, respectively) contain non-forfeitable rights to distributions or distribution equivalents. The impact of the unvested restricted share awards on earnings per share has been calculated using the two-class method whereby earnings are allocated to the unvested restricted share awards based on dividends declared and the unvested restricted shares' participation rights in undistributed earnings. Given the Company has incurred net losses to date, the cumulative dividends declared as of September 30, 2012 are adjusted in determining the calculation of loss per share of Common Stock since the unvested restricted share awards are defined as participating securities.

(C) Potential dilution from 150,000 shares of Common Stock that would be outstanding due to the hypothetical exercise of a warrant issued by the Company on March 31, 2011 and warrants outstanding from issuances of Units from our Primary Series A Offering that are potentially exercisable into 243,560 shares of Common Stock, as well as

a total of 220,280 unvested Class B Units issued on December 30, 2011, January 3, 2012 and August 15, 2012 were excluded from the diluted shares calculation because the effect was antidilutive.

14. Pro Forma Financial Information

The Company's condensed pro forma financial results, assuming the acquisitions of Stone Rise, Summit Crossing, and Trail Creek were hypothetically completed on January 1, 2011 were:

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Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

	Three months ended September 30, 2011	Nine months ended September 30, 2011
Pro forma:		
Revenue	\$2,633,628	\$7,442,678
Amortization of intangibles	—	(5,537,067)
Depreciation expense	(1,007,756)	(2,972,115)
Acquisition costs	(18,272)	(1,662,160)
Organization costs	—	(94,372)
Property operating expenses	(1,060,675)	(3,036,288)
Other expenses	(831,653)	(2,388,676)
Net income (loss)	\$(284,728)	\$(8,248,000)
Pro forma basic and diluted earnings (loss) per share	\$(0.06)	\$(1.67)
Pro forma weighted average outstanding shares, basic and diluted	4,935,429	4,933,943

Since the Company commenced operations with its IPO on April 5, 2011, pro forma adjustments have been made to corporate general and administrative expenses for the three-month and nine-month periods ended September 30, 2011. These pro forma results are not necessarily indicative of what historical performance would have been had these business combinations been effective January 1, 2011, nor should they be interpreted as expectations of future results.

15. Fair Values of Financial Instruments

Fair value is defined as the price at which an asset or liability is exchanged between market participants in an orderly transaction at the reporting date. The Company's cash equivalents, notes receivable, accounts receivable and payables and accrued expenses all approximate fair value due to their short term nature. The Company does not have any assets or liabilities measured at fair value on a recurring basis.

The following tables provide estimated fair values based upon unobservable (Level 3) assumption inputs of the Company's other financial instruments, which include mortgage notes collateralized only by the Company's three acquired apartment communities and its real estate loans and bridge loan assets:

As of September 30, 2012			Fair value measurements using fair value hierarchy		
	Carrying value	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Real estate loans	\$31,190,708	\$35,505,102	\$—	\$3,636,496	\$31,868,606
Notes receivable	930,544	930,544	—	930,544	—
Line of Credit receivable	345,200	345,200	—	345,200	—
	\$32,466,452	\$36,780,846	\$—	\$4,912,240	\$31,868,606
Financial Liabilities:					
Mortgage notes payable	\$55,637,000	\$57,097,796	\$—	\$—	\$57,097,796

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Revolving line of credit	15,000,000	15,000,000	—	15,000,000	—
	\$70,637,000	\$72,097,796	\$—	\$15,000,000	\$57,097,796

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

September 30, 2012

(unaudited)

As of December 31, 2011		Fair value measurements using fair value hierarchy			
	Carrying value	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Real estate loans	\$ 6,000,000	\$ 6,490,022	\$ —	\$ —	\$ 6,490,022
Financial Liabilities:					
Mortgage notes payable	\$ 55,637,000	\$ 56,728,053	\$ —	\$ —	\$ 56,728,053

The fair value of the real estate loans are comprised of estimates of the fair value of the notes, which were developed utilizing a discounted cash flow model over the remaining terms of the notes until their maturity dates and utilizing discount rates believed to approximate the market risk factor for notes of similar type and duration. The fair values also contain separately-calculated estimates of the fair value of the Company's purchase options on the to-be-developed properties for those instruments which contain purchase option features. These estimates were developed utilizing internal estimates of the properties' net operating income once stabilized and internal estimates of projected capitalization rates at the midpoint of the Company's option windows. These factors were used to estimate the future fair market value of the stabilized property. The difference between this result and the Company's purchase price per the option was discounted to the reporting date utilizing a discount rate believed to be appropriate for multifamily development projects.

The fair values of the Company's two variable rate mortgages are believed to approximate their carrying values, as long as market interest rates remain below the levels of the interest rate caps in place on these two notes. The fair value of the fixed rate mortgage on the Company's Summit Crossing property was developed using market quotes of the fixed rate yield index and spread for seven year notes as of the reporting date. Consideration is taken of the current margin rates and spreads relative to the interest rate caps in performing this analysis. The present value of the cash flows were calculated using the original interest rate in place on the Summit mortgage and again at the current market rate. The difference between the two results was applied as a fair market adjustment to the carrying value of the mortgage.

16. Subsequent Events

On October 17, 2012, the Company issued 418 Units and collected net proceeds of \$379,023.

On October 20, 2012, the Company declared a monthly dividend of \$5.00 per share of its Preferred Stock (plus a prorated amount for September with respect to certain shares that were issued on September 14, 2012, and September 28, 2012), which will total \$61,553 and is payable on November 20, 2012 to applicable preferred stockholders of record as of October 31, 2012.

On October 31, 2012, the Company issued 506 Units and collected net proceeds of \$459,195.

On November 1, 2012, the Company declared a monthly dividend of \$5.00 per share of its Preferred Stock (plus a prorated amount for October with respect to certain shares that were issued on October 17, 2012 and October 31, 2012), which is payable on December 20, 2012 to applicable preferred stockholders of record as of November 30, 2012.

On November 1, 2012, the Company declared a quarterly dividend on its Common Stock of \$0.145 per share, payable on January 15, 2013 to all holders of Common Stock of record as of December 31, 2012.

On November 1, 2012, the Company granted 2,187 shares of Common Stock to its independent board members, in payment of their meeting fees. The per-share fair value of this immediate-vesting award was \$8.06, which was the closing price of the Common Stock on the prior business day. The total compensation cost of \$17,627 was recorded in full at the grant date.

On October 17, 2012, the borrower drew an additional \$439,844 on the City Park loan, bringing the total loan balance to \$5,510,355.

On October 17, 2012, the borrower drew an additional \$634,711 on the City Vista loan, bringing the total loan balance to \$6,274,977.

On October 26, 2012, the Company amended the Crosstown Walk loan by increasing the aggregate amount of the loan to \$4,685,000 and extended the maturity date to March 31, 2013.

On November 13, 2012, the Company amended the Madison-Rome loan from a land acquisition bridge loan to a mezzanine loan, to partially finance the construction of a 88,000 square foot retail complex located in Rome, Georgia. In connection with the amendment, the Company released its existing first priority lien on the property. The loan is subordinate to a senior loan of approximately \$11.5 million held by an unrelated third party and is secured by unconditional guaranties of payment and performance by Stephen H. Whisenant and Charles N. Worthen, unaffiliated third parties and principals of the borrower as well as by a standard intercreditor agreement. Also on November 13, 2012, the Company funded an additional amount of approximately \$236 thousand of the loan.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Significant Developments

During the third quarter of 2012, we increased our loan portfolio by \$15.5 million to \$31.2 million, adding two new loans which are partially financing the construction of new multifamily communities in Charlotte, North Carolina and Pittsburgh, Pennsylvania. In addition, we added a land acquisition bridge loan in the amount of approximately \$5.4 million. This loan is partially financing a retail development project in Rome, Georgia which is anchored by a major grocery chain and which was 92% preleased at September 30, 2012. The two multifamily mezzanine loans also include exclusive options to purchase the properties once stabilized. Our total aggregate loan commitments totaled approximately \$43.3 million at September 30, 2012, and is discussed in detail in the Results of Operations section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

As of September 30, 2012, we had cumulatively issued 12,178 Units and collected net proceeds of approximately \$11.0 million from our continuous public offering of a minimum of 2,000 and a maximum of 1,000,000 Units, with each Unit consisting of one share of our series A redeemable preferred stock, or Preferred Stock, and one warrant, or Warrant, to purchase 20 shares of our common stock, par value \$.01 per share, or Common Stock. We refer to such offering as the Primary Series A Offering, which is discussed in detail in the Liquidity and Capital Resources section of this Management's Discussion and Analysis of Financial Condition and Results of Operations. On August 16, 2012, we filed a registration statement on Form S-11 (registration number 333-183355) for a follow-on offering of an additional 850,000 Units, bringing the maximum number of Units to be issued to one million. The terms of the follow-on offering and features of the Units are substantially the same as the Primary Series A Offering. The registration statement has not yet been declared effective by the Securities and Exchange Commission.

On August 31, 2012, we entered into a \$15.0 million revolving credit facility with an unrelated third party lender. The intended uses of the line of credit are to fund investments, capital expenditures, dividends (with consent) and working capital and other general corporate purposes on an as needed basis. Amounts drawn under the line of credit bear interest at a variable rate which was approximately 5.2% per annum at September 30, 2012. More details on the line of credit are discussed in the Liquidity and Capital Resources section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

We declare and pay monthly cash dividend distributions on the outstanding shares of our Preferred Stock, in the amount of \$5.00 per share, prorated for partial months at issuance as necessary. We declared and paid dividends on these shares totaling \$184,682 through September 30, 2012 and an additional \$58,062 which was paid on October 22, 2012.

On August 2, 2012, we declared a quarterly dividend on our Common Stock of \$0.14 per share. The dividend totaled \$729,699 and was paid on October 15, 2012 to all holders of Common Stock of record as of September 28, 2012.

For the three-month period ended September 30, 2012, we recorded Adjusted Funds From Operations Attributable to Common Stockholders, or AFFO, of \$817,996, an increase of 6.2% over the third quarter 2011 AFFO result. Net cash

provided by operating activities was approximately \$1.2 million for the third quarter of 2012 and was more than sufficient to fund our third quarter dividend distributions on our Preferred Stock and our Common Stock.

Forward-looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes," "anticipates," "intends," "expects," "assumes," "trends" and similar expressions, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based upon our current plans, expectations and projections about future events. However, such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among

others, the following:

- our business and investment strategy;
- our projected operating results;
- actions and initiatives of the U.S. Government and changes to U.S. Government policies and the execution and impact of these actions, initiatives and policies;
- the state of the U.S. economy generally or in specific geographic areas;
- economic trends and economic recoveries;
- our ability to obtain and maintain financing arrangements, including through the Federal National Mortgage Association, or Fannie Mae, and the Federal Home Loan Mortgage Corporation, or Freddie Mac;
- financing and advance rates for our target assets;
- our expected leverage;
- general volatility of the securities markets in which we invest;
- changes in the values of our assets;
- our expected portfolio of assets;
- our expected investments;
- interest rate mismatches between our target assets and our borrowings used to fund such investments;
- changes in interest rates and the market value of our target assets;
- changes in prepayment rates on our target assets;
- effects of hedging instruments on our target assets;
- rates of default or decreased recovery rates on our target assets;
- the degree to which our hedging strategies may or may not protect us from interest rate volatility;
- impact of and changes in governmental regulations, tax law and rates, accounting guidance and similar matters;
- our ability to maintain our qualification as a real estate investment trust, or REIT, for U.S. federal income tax purposes;
- our ability to maintain our exemption from registration under the Investment Company Act of 1940, as amended;
- availability of investment opportunities in mortgage-related and real estate-related investments and securities;
- availability of qualified personnel;
- estimates relating to our ability to make distributions to our stockholders in the future;
- our understanding of our competition; and
- market trends in our industry, interest rates, real estate values, the debt securities markets or the general economy.

Forward-looking statements are found throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Quarterly Report on Form 10-Q. The reader should not place undue reliance on forward-looking statements, which speak only as of the date of this report. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission, or SEC, we do not have any intention or obligation to publicly release any revisions to forward-looking statements to reflect unforeseen or other events after the date of this report. The forward-looking statements should be read in light of the risk factors indicated in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the twelve months ended December 31, 2011 that was filed with the SEC on March 15, 2012, and as may be supplemented by any amendments to our risk factors in our quarterly reports on Form 10-Q, which are accessible on the SEC's website at www.sec.gov.

General

The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our results of operations and financial position. This discussion and analysis should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this quarterly report.

Overview

We are an externally managed Maryland corporation incorporated on September 18, 2009 formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As a secondary strategy,

we also may acquire or originate senior mortgage loans, subordinate loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets and invest not more than 10% of our total assets in other real estate related investments, as determined by our manager as appropriate for us. We collectively refer to these asset classes as our target assets. Our manager is Preferred Apartment Advisors, LLC, or our Manager.

In addition, while we currently do not anticipate investing in unimproved property, developing new construction properties or acquiring new construction, as part of our business strategy, we may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and we may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the construction of multifamily communities and other properties.

We expect to seek to generate returns for our stockholders by taking advantage of the current environment in the real estate market and the United States economy by acquiring multifamily assets in our targeted markets. The current economic environment still provides many challenges for new development, which provides opportunity for current multifamily product to potentially enjoy stable occupancy rates and rising rental rates as the overall economy continues to grow. As the real estate market and economy stabilize, we intend to employ efficient management techniques to grow income and create asset value.

As market conditions change over time, we intend to adjust our investment strategy to adapt to such changes as appropriate. We continue to believe there are abundant opportunities among our target assets that currently present attractive risk-return profiles. However, in order to capitalize on the investment opportunities that may be present in the various other points of an economic cycle, we may expand or change our investment strategy and target assets. We believe that the diversification of the portfolio of assets that we intend to acquire, our ability to acquire and manage our target assets, and the flexibility of our strategy will position us to generate attractive total returns for our stockholders in a variety of market conditions.

We elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the "Code") effective with our tax year ended December 31, 2011. We also intend to operate our business in a manner that will permit us to maintain our status as a REIT and our exemption from registration under the Investment Company Act of 1940, as amended. We will conduct substantially all of our operations through Preferred Apartment Communities Operating Partnership, L.P., or our Operating Partnership, in which we owned an approximate 100% interest as of September 30, 2012.

We commenced revenue-generating operations in April 2011.

Industry Outlook

We believe gradual, albeit potentially sporadic, improvement in the United States' economy will continue over the coming quarters, which should translate into more stable job growth and improvements in consumer confidence. We believe a growing economy, improved job market and increased consumer confidence should help sustain the current upward momentum in the multifamily sector. We expect current occupancy rates to generally remain stable, on an annual basis, as net absorption of available unit inventory and the new product coming on-line continues over the near term. The pipeline of new multifamily construction, although increasing, is currently below historical levels due to a difficult construction financing environment, which, we believe, should help to keep occupancies stable.

Historically low U.S. Treasury yields and competitive lender spreads have created a favorable borrowing environment for multifamily owners. Given the uncertainty around the world's financial markets, investors have been willing to accept lower yields on U.S. Government backed securities, providing Freddie Mac and Fannie Mae with excellent access to investor capital. We expect the market to continue to remain favorable for borrowing as the equity and debt markets continue to view the U.S. multifamily sector as a desirable investment. We expect the supply of multifamily housing units to eventually grow as market rent increases overcome financing, commodity, and other cost challenges, boosting revenue projections and making more construction projects viable for builders and developers.

We believe the combination of a more sustainable current and future lending approach from the banking industry, coupled with continued hesitance and reluctance among prospective homebuyers concerning the net benefits of home ownership versus renting will continue to work in the multifamily sector's favor, resulting in gradual increases in market rents, lower concessions, and opportunities for increases in ancillary fee income. In addition, we believe immigration rates to the U.S. may be lower than in recent years, driven by fewer available jobs due to the economic downturn and legislation in place in certain states aiming to curb illegal immigration. As new residents of the U.S. are believed to be primarily renters rather than home buyers, we expect a marginal softening of market conditions due to this factor. More than offsetting this effect, we believe, will be a firming effect on market conditions by the ongoing

migration of the domestic echo-boomer generation into the workforce, resulting in a net increase in demand for rental housing.

Critical Accounting Policies

Below is a discussion of the accounting policies that management believes are critical. We consider these policies critical because they involve significant management judgments, assumptions, and estimates about matters that are inherently uncertain and because they are important for understanding and evaluating our reported financial results. These judgments affect the reported amounts of assets and liabilities and our disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. With different estimates or assumptions, materially different amounts could be reported in our financial statements. Additionally, other companies may utilize different estimates that may impact the comparability of our results of operations to those of companies in similar businesses.

Real Estate

Cost Capitalization. Investments in real estate properties are carried at cost and depreciated using the straight-line method over the estimated useful lives of 40 years for buildings, 5 to 10 years for building and land improvements and 5 to 10 years for computers, furniture, fixtures and equipment. Third-party acquisition costs are generally expensed as incurred. Repairs, maintenance and resident turnover costs are charged to expense as incurred and significant replacements and betterments are capitalized and depreciated over the items' estimated useful lives. Repairs, maintenance and resident turnover costs include all costs that do not extend the useful life of the real estate property. We consider the period of future benefit of an asset to determine its appropriate useful life.

Real Estate Acquisition Valuation. We generally record the acquisition of income-producing real estate as a business combination. All assets acquired and liabilities assumed in a business combination are measured at their acquisition-date fair values. Acquisition costs generally are expensed as incurred and restructuring costs that do not meet the definition of a liability at the acquisition date are expensed in periods subsequent to the acquisition date. We assess the acquisition-date fair values of all tangible assets, identifiable intangibles and assumed liabilities using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis) and that utilize appropriate discount and/or capitalization rates and available market information. Estimates of future cash flows are based on a number of factors, including historical operating results, known and anticipated trends, and market and economic conditions. The fair value of tangible assets of an acquired property considers the value of the property as if it were vacant.

We record above-market and below-market in-place lease values for acquired properties based on the difference between (i) the contractual amounts to be paid pursuant to the in-place leases, and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining average non-cancelable term of the leases. We amortize any recorded above-market or below-market lease values as a reduction or increase, respectively, to rental income over the remaining average non-cancelable term of the respective leases.

Intangible assets include the value of in-place leases, which represents the estimated value of the net cash flows of the in-place leases to be realized, as compared to the net cash flows that would have occurred had the property been vacant at the time of acquisition and subject to lease-up. These estimates include estimated carrying costs, such as real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the hypothetical expected lease-up periods. Acquired in-place lease value are amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases.

Estimating the fair values of the tangible assets, identifiable intangibles and assumed liabilities require us to make significant assumptions to estimate market lease rates, property-operating expenses, carrying costs during lease-up periods, discount rates, market absorption periods, the number of years the property will be held for investment, and market interest rates. The use of different assumptions would result in variations of the values of our acquired tangible assets, identifiable intangibles and assumed liabilities, which would impact the amount of our net income.

Impairment of Real Estate, Loans and Related Intangible Assets. We monitor events and changes in circumstances that could indicate that the carrying amounts of our real estate, loans and related intangible assets may not be recoverable or realized. When conditions suggest that our tangible and intangible assets may be impaired, we compare their carrying value to their estimated undiscounted future cash flows, including proceeds from their eventual disposition. If, based on this analysis, we do not believe that we will be able to recover the carrying value of our tangible and intangible assets, we record an impairment loss to the extent that the carrying value exceeds the estimated fair value of the real estate and related intangible assets. Fair market value is determined based on a discounted cash flow analysis. This analysis requires us to use future estimates of net operating income, expected hold period, capitalization rates and discount rates. The use of different assumptions would result in variations of the values of the assets which could impact the amount of our net income and our assets on our balance sheet.

Real Estate Loans

We extend loans for purposes such as to provide partial financing for the development of multifamily residential communities, to acquire land in anticipation of developing and constructing multifamily residential communities, and for other real estate or real estate related projects. Certain of these loans we extend include characteristics such as

exclusive options to purchase the project within a specific time window following project completion and stabilization, the rights to incremental exit fees over and above the amount of periodic interest paid during the life of the loans, or both. These characteristics can cause the loans to fall under the definition of a variable interest entity, or VIE, and thus trigger consolidation consideration. We consider the facts and circumstances pertinent to each loan, including the relative amount of financing we are contributing to the overall project cost, decision making rights or control we hold, and our rights to expected residual gains or our obligations to absorb expected

residual losses from the project. If we are deemed to be the primary beneficiary of a VIE due to holding a controlling financial interest, the majority of decision making control, or by other means, consolidation treatment would be required. Arriving at these conclusions requires us to make significant assumptions and judgments concerning each project, especially with regard to our estimates of future market capitalization rates and property net operating income projections. Additionally, we analyze each loan arrangement and utilize these same assumptions and judgments for consideration of whether the loan qualifies for accounting as a loan or as an investment in a real estate development project.

Rents and Other Receivables

We periodically evaluate the collectability of amounts due from residents and maintain an allowance for doubtful accounts for estimated losses resulting from the inability of residents to make required payments then due under lease agreements. The balance of amounts due from residents are written off when we deem the amounts to be uncollectible.

Revenue Recognition

We expect to lease apartment units under operating leases with terms generally of thirteen months or less. Rental revenue, net of concessions, is recognized on a straight-line basis over the term of the lease. Differences from the straight-line method, which recognize the effect of any up-front concessions and other adjustments ratably over the lease term, are not material.

We recognize gains on sales of real estate either in total or deferred for a period of time, depending on whether a sale has been consummated, the extent of the buyer's investment in the property being sold, whether our receivable, if any, is subject to future subordination, and the degree of our continuing involvement with the property after the sale, if any. If the criteria for profit recognition under the full-accrual method are not met, we defer gain recognition and account for the continued operations of the property by applying the reduced profit, deposit, installment or cost recovery method, as appropriate, until the appropriate criteria are met.

Other income, including interest earned on our cash, is recognized as it is earned. We recognize interest income on real estate loans on an accrual basis over the life of the loan using the effective interest method. Direct loan origination fees and origination or acquisition costs, is amortized over the life of the loan as an adjustment to interest income. We stop accruing interest on loans when there is concern as to the ultimate collection of principal or interest of the loan, which is generally a delinquency of 30 days in required payments of interest or principal. Any payments received on such non-accrual loans are recorded as interest income when the payments are received. Interest accrual on real estate loan investments is resumed once interest and principal payments become current.

Promotional fees received from service providers at our properties are deferred and recognized on a straight-line basis over the term of the agreement.

Income Taxes

We elected to be taxed as a REIT, under the Code effective with our tax year ended December 31, 2011. We had no taxable income prior to that date. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our annual REIT taxable income to our stockholders (which is computed without regard to the dividends paid deduction or net capital gain and which does not equal net income as calculated in accordance with United States generally accepted accounting principles, or GAAP). As a REIT, we generally will not be subject to U.S. federal income tax to the extent we distribute qualifying dividends to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to U.S. federal income tax on our taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for the four taxable years following the year during which qualification is lost unless the Internal Revenue Service, or IRS, grants us relief under certain statutory provisions. Such an event could materially

adversely affect our net income and net cash available for distribution to stockholders. However, we intend to operate in such a manner as to maintain our election for treatment as a REIT.

Equity Compensation

We calculate the fair value of equity compensation instruments such as warrants and stock options based upon estimates of their expected term, the expected volatility of and dividend yield on our Common Stock over this expected term period and the market risk-free rate of return. When appropriate, we will also estimate forfeitures of these instruments and accrue the compensation

expense, net of estimated forfeitures, over the vesting period(s).

Recent Adoption of Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The substantive changes in this new guidance require the application of a premium or discount in valuing an instrument that is absent Level 1 inputs, when a market participant would apply such a factor in valuing an instrument. The guidance also enhances disclosure requirements: (i) for fair values of Level 3 assets, the valuation process used for those assets and the sensitivity of those calculations to changes in the amount of unobservable inputs; (ii) a reporting entity's use of a nonfinancial asset in a way that differs from the asset's highest and best use when that asset is measured at fair value in the statement of financial position; and (iii) the categorization by level within the fair value hierarchy of items that are not measured at fair value in the statement of financial position but for which the fair value is required to be disclosed. This guidance is effective for interim and annual periods beginning after December 15, 2011. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This new guidance removes the option of presenting elements of other comprehensive income within the statements of changes to stockholders' equity. Instead, the total of comprehensive income, the components of net income, and the components of other comprehensive income may be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance is effective for interim and annual periods beginning after December 15, 2011, with retrospective application required. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

In December 2011, the FASB issued ASU 2011-10, Property, Plant and Equipment (Topic 360): Derecognition of in Substance Real Estate – a Scope Clarification. This new standard clarifies the guidance concerning deconsolidation of a subsidiary that is in substance real estate upon the event of default of that subsidiary's nonrecourse debt. Generally, deconsolidation of a subsidiary in this circumstance is not appropriate until the collateral is legally transferred to the lender and the indebtedness is extinguished. This guidance is effective for annual and interim periods beginning after June 15, 2012. Our adoption of this guidance did not have a material effect on our financial position or results of operations.

Results of Operations

Overview

We commenced business operations in the second quarter of 2011 with the acquisitions of the Stone Rise, Summit Crossing, and Trail Creek multifamily communities (each as defined below) on April 15, 21, and 29, 2011, respectively. Our portfolio, as of September 30, 2012, also includes four mezzanine real estate construction loans, totaling approximately \$22.8 million, each with exclusive options to purchase the properties once developed, and two real estate acquisition bridge loans totaling approximately \$8.4 million.

We recorded net losses attributable to common stockholders of approximately \$19 thousand and \$2.9 million for the three-month periods ended September 30, 2012, and 2011, respectively.

The highlights of our third quarter 2012 operating results include:

• We closed on and partially funded two mezzanine construction loans and a land acquisition bridge loan totaling a maximum aggregate amount of approximately \$27.5 million. At September 30, 2012, the funded amounts of these

loans totaled approximately \$15.5 million. The two mezzanine loans each include an option to purchase the property once developed and stabilized.

We continue to hold no debt at the Company or Operating Partnership levels, except with regard to our \$15.0 million Credit Facility. We have no cross-collateralization of our real estate assets, and have no contingent liabilities at the Company or Operating Partnership levels with regard to our secured mortgage debt on our communities.

Through September 30, 2012, we have cumulatively issued 12,178 Units and collected net proceeds of approximately

\$11.0 million from our Primary Series A Offering.

Declared a quarterly dividend on our Common Stock of \$729,699, or \$0.14 per common share, which was paid on October 15, 2012 to all common stockholders of record as of September 28, 2012. This represents a 12% overall increase in our Common Stock dividend since our IPO and an annualized dividend growth rate of 9.6%.

Declared and paid monthly dividends of \$5.00 per share of our Series A Redeemable Preferred Stock, which totaled \$163,059 for the three-month period ended September 30, 2012 and represents a 6% annual yield.

AFFO for the three-month period ended September 30, 2012 was \$817,996 and cash provided by operating activities was approximately \$1.2 million for the same period, which was more than sufficient to fund our third quarter Common Stock and Preferred Stock dividends. See the Adjusted Funds From Operations Attributable to Common Stockholders section within this Management's Discussion and Analysis of Financial Condition and Results of Operations for the definition of this non-GAAP measure and a reconciliation to net loss attributable to the Company, which we believe is the most comparable GAAP measure.

Acquired properties

On April 15, 2011, we acquired 100% of the membership interests in Stone Rise Apartments, LLC, a Delaware limited liability company (f/k/a Oxford Rise JV LLC), or Stone Rise, the fee-simple owner of a multifamily community located in suburban Philadelphia, Pennsylvania. Williams Opportunity Fund, LLC, or WOF, owned the membership interests in Stone Rise Apartments, LLC. The Stone Rise Apartments membership interests were acquired from Oxford Rise Partners LLC, a Georgia limited liability company, and WOF. As of April 15, 2011, WOF owned approximately 19.75% of our outstanding Common Stock. As of September 30, 2012, WOF owned approximately 2.75% of our Common Stock. In addition, John A. Williams, our Chief Executive Officer and Chairman of the Board, indirectly owns an approximate 1.0% membership interest in WOF. In connection with the acquisition, we paid an acquisition fee of \$301,500, or 1.0% of the contract purchase price, to our Manager, of which WOF received \$3,015 through its special limited liability company interest in our Manager which entitles WOF to receive 1% of our Manager's gross revenues.

On April 21, 2011, we acquired 100% of the membership interests in PAC Summit Crossing, LLC, a Georgia limited liability company (f/k/a Oxford Summit Partners, LLC), or Summit Crossing, the fee-simple owner of a multifamily community located in suburban Atlanta, Georgia. The PAC Summit Crossing membership interests were acquired from Oxford Summit Development LLC, a Georgia limited liability company, and Williams Realty Fund I, LLC, or WRF. As of April 21, 2011, WRF owned approximately 13.62% of our outstanding Common Stock. As of September 30, 2012, WRF owned approximately 0.15% of our Common Stock. In addition, Mr. Williams indirectly owns an approximate 7.0% membership interest in WRF. In connection with the acquisition, we paid an acquisition fee of \$332,000, or 1.0% of the contract purchase price, to our Manager, of which WOF received \$3,220 through its special limited liability company interest in our Manager.

On April 29, 2011, we acquired Oxford Trail, a multifamily community located in Hampton, Virginia from Oxford Trail JV LLC, or Trail Creek. WRF owned an approximately 10% membership interest in Oxford Trail JV LLC. Separate from Mr. Williams' membership interest in WRF, Mr. Williams received approximately \$62,600 from Oxford Trail JV as a promoted interest in connection with the sale of Oxford Trail. Leonard A. Silverstein, the Company's President and Chief Operating Officer received \$20,375 from Oxford Trail JV as a promoted interest in connection with the sale of Oxford Trail. In connection with the acquisition, we paid an acquisition fee of \$235,000, or 1.0% of the contract purchase price, to our Manager of which WOF received \$2,350 through its special limited liability company interest in our Manager.

Community	Purchase Price (millions)	Mortgage Amount (millions)	Debt / Purchase Price	
Summit Crossing	\$33.20	\$20.86	62.8	%
Trail Creek	23.50	15.28	65.0	%

Stone Rise	30.15	19.50	64.7	%
Total	\$86.85	\$55.64	64.1	%

36

Property	Year Completed	Number of Units	Average Unit Size (sq. ft.)	As of:	Three months ended:
				September 30, 2012	September 30, 2012
				Physical Occupancy (1)	Average Economic Occupancy (2)
Summit Crossing	2007	345	1,034	95.1%	95.0%
Trail Creek	2006	204	988	97.1%	91.3%
Stone Rise	2008	216	1,078	98.6%	93.9%
Total		765	1,033	96.6%	93.6%

- (1) Count of occupied units (including models) divided by total units at reporting date.
- (2) Gross potential rent less vacancy losses, model expenses, bad debt expenses and concessions divided by gross potential rent.

Real estate loans, Notes Receivable, and Line of Credit

Madison-Rome

On September 28, 2012, we made a land acquisition bridge loan in the amount of \$5,360,042 to Madison Retail - Rome LLC, or Madison-Rome, a Delaware limited liability company, to partially finance the construction of an 88,000 square foot retail complex located in Rome, Georgia. At September 30, 2012, Madison had drawn \$4,740,408 of the loan amount.

The Madison-Rome loan matures on September 20, 2015, with no option to extend and pays current monthly interest of 8% per annum. An additional exit fee equal to the difference between a 14% cumulative annual simple interest return and the 8% current interest will be due and payable to the Company if Madison-Rome refinances the loan with a third party or when the loan balance is repaid.

The Madison-Rome loan is secured by a first priority lien in the land and the project, and by unconditional guaranties of payment and performance by Stephen H. Whisenant and Charles N. Worthen, unaffiliated third parties and principals of the borrower. In connection with the closing of the Madison-Rome loan, the Company received a loan fee of 2% of the aggregate loan amount, or \$107,201 and paid an acquisition fee of \$53,600 to the Manager out of these funds. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

City Park

On September 6, 2012, we made a mezzanine loan of up to \$10,000,000 to Oxford City Park Development LLC, or City Park, a Georgia limited liability company, to partially finance the construction of a 284-unit multifamily community located in Charlotte, North Carolina. At September 30, 2012, City Park had drawn \$5,070,511 of the loan amount.

The City Park mezzanine loan matures on September 5, 2017, with no option to extend and pays current monthly interest of 8% per annum. We will accrue an additional 6% interest which will be due at maturity or if the property is sold to, or refinanced by, a third party. We also have an option (but not an obligation) to purchase the property

between and including November 1, 2015 and March 31, 2016 for a pre-negotiated purchase price of \$30,945,845. If we exercise the purchase option and acquire the property, the additional accrued interest will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of City Park. Prepayment of the mezzanine loan is permitted in whole, but not in part, without our consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of approximately \$18.6 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A.

Denny have guaranteed the completion of the project in accordance with the plans and specifications. In addition, Messrs. Faulk and Denny have entered into joint and several repayment guaranties of the mezzanine loan. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement.

In connection with the closing of the City Park mezzanine loan, we received a loan fee of 2% of the amount drawn on the loan, or \$101,430 and paid an acquisition fee of \$50,715 to the Manager out of these funds. We will also receive 2% of any future draws on the loan and pay a 1% acquisition fee to the Manager. The net fees received by us will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

City Vista

On August 31, 2012, we made a mezzanine loan of up to \$12,153,000 to Oxford City Vista Development LLC, or City Vista, a Georgia limited liability company, to partially finance the construction of a 272-unit multifamily community located in Pittsburgh, Pennsylvania. At September 30, 2012, City Vista had drawn \$5,640,266 of the loan amount.

The City Vista mezzanine loan matures on June 1, 2016, with an option to extend until July 1, 2017 and pays current monthly interest of 8% per annum. We will accrue an additional 6% interest which will be due at maturity or if the property is sold to, or refinanced by, a third party. We also have an option (but not an obligation) to purchase the property between and including February 1, 2016 and May 31, 2016 for a pre-negotiated purchase price of \$43,560,271. If we exercise the purchase option and acquire the property, the additional accrued interest will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of City Vista. Prepayment of the mezzanine loan is permitted in whole, but not in part, without our consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of approximately \$28.4 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny have guaranteed the completion of the project in accordance with the plans and specifications. In addition, Messrs. Faulk and Denny have entered into joint and several repayment guaranties of the mezzanine loan. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement.

In connection with the closing of the City Vista mezzanine loan, we received a loan fee of 2% of the amount drawn on the loan, or \$112,825 and paid an acquisition fee of \$56,412 to the Manager out of these funds. We will also receive 2% of any future draws on the loan and pay a 1% acquisition fee to the Manager. The net fees received by us will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Crosstown Walk

On June 29, 2012, we made a real estate acquisition bridge loan in the amount of \$2,868,471, of which \$2,811,101 had been drawn at June 30, 2012, to Iris Crosstown Apartments LLC, or Crosstown Walk, a Florida limited liability company, to acquire a parcel of land located in suburban Tampa, Florida, upon which a multifamily community is to be constructed. On August 28, 2012, we amended the loan by increasing the aggregate amount of the loan to \$3,693,471 and the borrower increased its amount drawn to \$3,636,496 as of September 30, 2012. The bridge loan matures on December 31, 2012, with no option to extend and pays current monthly interest of 8.0% per annum. We will receive an additional 6.0% interest as an exit fee, which will be due and payable if Crosstown Walk sells the property to a third party or refinances the bridge loan at any time during its term. On October 26, 2012, we amended the loan again by increasing the aggregate amount of the loan to \$4,685,000 and extended the maturity date to March 31, 2013.

Summit II

On May 7, 2012, we made a mezzanine loan of approximately \$6.1 million to Oxford Summit Apartments II LLC, or Summit II, to partially finance the construction of a 140-unit multifamily townhome community located adjacent to our existing Summit Crossing multifamily community in metro Atlanta, Georgia.

The Summit II mezzanine loan matures on May 8, 2017, with no option to extend and pays interest at a fixed rate of 8.0% per annum. Interest will be paid monthly with principal and any accrued but unpaid interest (including the exit fee) due at maturity. Under the terms of a purchase option agreement entered into in connection with the closing of the mezzanine loan, we have an option (but not an obligation) to purchase the property for a period of four months following completion of construction, lease up and stabilization for \$19,254,155. If the property is sold to, or refinanced by, a third party before or after the option period, we will be entitled to receive an exit fee equal to the amount required to provide us with a 14% simple interest return on the loan, in

addition to loan fees received at closing, which totaled 2% of the loan amount. Since the minimum exit fee, assuming the purchase option is not exercised, is the amount needed to provide a 14% simple interest return, we will accrue each period the additional exit fee earned based on the 14% rate assuming the loan was paid off at period end. The accrued exit fee will be recorded as interest income in the consolidated statements of operations.

If we exercise the purchase option and acquire the property, any accrued and unpaid exit fee will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of Oxford Summit II, as well as by personal guaranties of repayment by the principals of Oxford Summit II. The guaranties are to remain in effect until a certificate of occupancy is obtained for the property. Prepayment of the mezzanine loan is permitted in whole, but not in part, without the Company's consent.

In connection with the closing of the mezzanine loan, we received a loan fee of 2% of the loan amount, or \$122,061 and we paid an acquisition fee of \$61,030 to our Manager out of these funds, of which WOF received \$610 through its special limited liability company interest in our Manager. The net fees received by us will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Trail II

On June 30, 2011, we made a mezzanine loan of \$6.0 million to Oxford Hampton Partners LLC, or Hampton Partners, a Georgia limited liability company and a related party, to partially finance the construction of a 96-unit multifamily community located adjacent to our existing Trail Creek multifamily community in Hampton, Virginia, or Trail II. Hampton Partners was required to fully draw down the mezzanine loan on the closing date. Hampton Partners paid \$302,300 to WRF from the proceeds of the mezzanine loan to retire an outstanding short term loan that matured on the closing date of the Trail II mezzanine loan.

The Trail II mezzanine loan matures on June 29, 2016, with no option to extend and pays interest at a fixed rate of 8.0% per annum. Interest will be paid monthly with principal and any accrued but unpaid interest (including the exit fee) due at maturity. Under the terms of a purchase option agreement entered into in connection with the closing of the mezzanine loan, we have an option (but not an obligation) to purchase the property between and including April 1, 2014 and June 30, 2014 for \$17,825,600, which is the amount of the aggregate project costs as set forth in the approved construction budget on the closing date. If the property is sold to, or refinanced by, a third party before July 1, 2014, we will be entitled to receive an exit fee equal to the amount required to provide it with a 14% cumulative internal rate of return on the loan. If the property is sold to, or refinanced by, a third party on or after July 1, 2014, then we will be entitled to receive an exit fee equal to the amount required to provide us with a 12% cumulative internal rate of return on the loan. The calculation of the cumulative internal rate of return will include the loan's fees received at closing. Since the minimum exit fee, assuming the purchase option is not exercised, is the amount needed to provide a 12% cumulative internal rate of return, we will accrue each period the additional exit fee earned based on the 12% rate assuming the loan was paid off at period end. The accrued exit fee will be recorded as interest income in the consolidated statements of operations. If we exercise the purchase option and acquire the property, any accrued and unpaid exit fee will be treated as additional basis in the acquired project.

The Trail II mezzanine loan is secured by a pledge of 100% of the membership interests of Hampton Partners, of which WRF is an approximately 100% indirect owner. Partial prepayment of the mezzanine loan is not permitted without our consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of \$10 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny, both unaffiliated third parties, have guaranteed to us the completion of the project in accordance with the plans and specifications. This guaranty is subject to the rights held by the senior lender pursuant to a standard intercreditor agreement with the senior lender.

In connection with the closing of the Trail II mezzanine loan, we received a loan fee of 2% of the loan amount, or \$120,000, and a loan commitment fee of \$14,333. We paid an acquisition fee of \$60,000 to our Manager out of these

funds, of which WOF received \$600 through its special limited liability company interest in our Manager. The net fees received by us will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

Notes Receivable

On September 14, 2012, we made a loan in the amount of \$500,000 to Newport Development, LLC, or Newport, a Georgia limited liability company and unaffiliated third party, in the form of a promissory note. The full amount was drawn as of

September 30, 2012. The loan bears interest at 15% per annum and interest only payments are due on a monthly basis until the maturity date of March 17, 2013. The loan may be prepaid at any time, in whole or in part, without penalty. The amounts payable under the terms of the loan are backed by personal guaranties of repayment issued by Robert F. Krause, Jr. and J. Richard Stephens, Jr., the principals of Newport and unaffiliated third parties.

On May 21, 2012, we made a loan in the amount of \$575,000 to Madison Retail, LLC, or Madison Retail, a Georgia limited liability company and unaffiliated third party, in the form of a promissory note. The amount drawn by Madison Retail as of September 30, 2012 was \$430,544. The loan bore interest at 15% per annum and interest only payments were due on a monthly basis until the maturity date of September 30, 2012. Although the loan matured on that date, payment of principal and interest was received by the Company on October 2, 2012. The amounts payable under the terms of the loan were backed by a personal guaranty of repayment issued by Stephen H. Whisenant, the principal of Madison Retail and an unaffiliated third party.

On March 26, 2012, the Company made a loan in the amount of \$650,000 to Oxford Properties, LLC, a Georgia limited liability company, or Oxford, in the form of a promissory note. The loan bore interest at 15% per annum and interest only payments were due beginning May 1, 2012, and continued on a monthly basis until the repayment of the loan, which occurred on September 6, 2012.

Line of Credit

On August 21, 2012, we extended a revolving line of credit to our Manager in an aggregate amount of up to \$1.0 million, in order to provide liquidity to our Manager in support of its ongoing business operations. The credit line bears interest at 8.0% per annum, with interest payable monthly and matures on July 31, 2013. At September 30, 2012, the amount drawn by our Manager was \$345,200, and for the three-month and nine-month periods ended September 30, 2012, interest revenue was \$1,925.

Three Months and Nine Months Ended September 30, 2012 and 2011

Revenues

We recorded total rental revenue of approximately \$2.3 million, or 71.2% of total revenues, for the three-month period ended September 30, 2012, versus approximately \$2.3 million, or 85.5% of total revenues for the three-month period ended September 30, 2011. We recorded total rental revenue of approximately \$6.8 million, or 77.6% of total revenues for the nine-month period ended September 30, 2012, versus approximately \$3.9 million, or 87.4% of total revenues for the nine-month period ended September 30, 2011.

The increase in rental revenue in the nine-month period was primarily due to the acquisitions of our three multifamily communities in April of 2011 and consequently, full periods of activity were not recorded for the nine-month period ended September 30, 2011. Occupancy rates and rent growth are the primary drivers of increases in rental revenue from acquired multifamily communities. At September 30, 2012, the combined properties had physical occupancy rates, including model units, of 96.6% of the total units available for rent, including model units, versus 95.6% at September 30, 2011.

Factors which we believe affect market rents include vacant unit inventory in local markets, local and national economic growth and resultant employment stability, income levels and growth, the ease of obtaining credit for home purchases, and changes in demand due to consumer confidence in the above factors.

We also collect revenue from residents for items such as utilities, application fees, lease termination fees, and late charges. The increase in other property revenues for the nine-month period ended September 30, 2012 was primarily due to the acquisitions of the three communities in April 2011 and consequently, we did not record a full nine months of activity.

Interest income from our real estate loans increased substantially for both the three-month and nine-month periods ended September 30, 2012 versus September 30, 2011 due to (i) recording a full quarter of interest income from our Summit II loan during the three-month period ended September 30, 2012, (ii) the closing of our City Park and City Vista loans during the third quarter of 2012, and (iii) the closing of our Crosstown Walk loan on June 29, 2012 and recognition of a full quarter of income.

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	Three months ended		Nine months ended	
	9/30/2012	9/30/2011	9/30/2012	9/30/2011
Interest income:				
Summit II	\$ 122,061	\$ —	\$ 196,189	\$ —
Trail II	120,000	120,000	360,000	120,000
Crosstown Walk	62,335	—	63,567	—
City Park	27,784	—	27,784	—
City Vista	38,838	—	38,838	—
Madison-Rome	3,117	—	3,117	—
Total	374,135	120,000	689,495	120,000
Accrued exit fees	198,449	—	318,296	—
Net loan fee revenue recognized	27,765	4,495	39,194	5,828
Total interest income on real estate loans	600,349	124,495	1,046,985	125,828
Notes receivable:				
Newport	3,493	—	3,493	—
Oxford	16,793	—	42,770	—
Madison Retail	13,589	—	17,253	—
PAA line of credit	1,925	—	1,925	—
Total interest income on notes and lines of credit	35,800	—	65,441	—
Total interest income	\$ 636,149	\$ 124,495	\$ 1,112,426	\$ 125,828

Property operating and maintenance expense

We recorded expenses for the operations and maintenance of our multifamily communities of approximately \$598 thousand and \$580 thousand for the three-month periods ended September 30, 2012 and 2011, respectively. We recorded these same expenses of approximately \$1.8 million and \$1.0 million for the nine-month periods ended September 30, 2012 and 2011, respectively. The increase for the nine-month period ended September 30, 2012 was driven by the ownership and operation of the three acquired multifamily properties for a full period in 2012 versus 2011. The primary components of operating and maintenance expense are salary and benefits expense of property personnel, utilities, property repairs, and landscaping costs. The number of employees assigned by our property manager to our three multifamily communities at September 30, 2012 is not expected to change materially over the foreseeable future. The expenses incurred for property repairs and, to a lesser extent, utilities could generally be expected to increase gradually over time as the buildings and properties age. Utility costs may generally be expected to increase in future periods as rate increases from providing carriers are passed on to our residents.

Management fees

We pay a fee for property management services to our Manager in an amount of 4% of gross property revenues as compensation for services such as rental, leasing, operation and management of our communities and the supervision of any subcontractors. These costs were approximately \$104 thousand and \$101 thousand for the three-month periods ended September 30, 2012 and 2011, respectively, and approximately \$305 thousand and \$176 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. We also paid general and administrative

expense fees and asset management fees to our Manager which totaled approximately \$215 thousand and \$177 thousand for the three-month periods ended September 30, 2012 and 2011, respectively, and approximately \$584 thousand and \$323 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. General and administrative expense fees are calculated as 2% of gross property revenues and asset management fees are calculated as one-twelfth of 0.5% of the total value of assets per month, as adjusted. The percentage of these costs charged is governed by the Third Amended and Restated Management Agreement with our Manager.

The increase for the three-month period was primarily due to the increases in asset management fees from additional assets acquired and owned in the 2012 period. The nine-month period increase was also attributable to the ownership and operation of the three acquired multifamily communities for the full nine-month period in 2012 versus 2011.

Real estate taxes

We are liable for property taxes due to the various counties and municipalities that levy such taxes on real property for each of our three multifamily communities. The current assessed values of our communities, the estimated annual effective tax rates and expected total property taxes for 2012, as of September 30, 2012 were:

Property	Assessed Value	Expected Property Tax Rate		Expected Property Taxes, FYE 2012	Property Taxes, FYE 2011
Stone Rise	\$ 11,130,000	3.24	%	\$ 361,067	\$ 358,581
Summit Crossing	5,937,815	2.66	%	157,791	153,449
Trail Creek	21,546,200	1.06	%	227,400	224,728
Total	\$38,614,015	1.93	%	\$746,259	\$736,758

We generally expect the assessed values of our multifamily communities to rise over time, owing to our expectation of improving market conditions, pressure on municipalities to raise revenues and increased activity in the transactional market. However, we have some insurance against any potential rise in assessments at Stone Rise because its assessed value is frozen through 2015, unless there is a county wide reassessment. The assessed value of the Stone Rise community did not increase from 2011. Summit Crossing's initial 2012 tax valuation was increased by the municipality in which it resides during the second quarter to \$6,250,332, however, we successfully appealed the valuation and were able to reduce it to \$5,937,815 for an increase of 3% from 2011. Trail Creek's assessed value for 2012 was increased 3.6% to \$21,546,200.

Depreciation and amortization

We recorded expenses for depreciation and amortization of tangible and identifiable intangible assets of approximately \$906 thousand and \$3.6 million for the three-month periods ended September 30, 2012 and 2011, respectively, and approximately \$2.8 million and \$6.4 million for the nine-month periods ended September 30, 2012 and 2011, respectively. The 2011 three-month and nine-month periods both included amortization of acquired intangible assets related to our three multifamily communities of approximately \$2.7 million and \$4.7 million, respectively. These intangible assets were amortized in full during 2011 and there were no such expenses for the 2012 periods.

Acquisition costs

We recorded acquisition costs for our three multifamily communities of approximately \$1.7 million for the nine-month period ended September 30, 2011, primarily related to due diligence, purchase negotiation, appraisals, and other costs related to the three acquired multifamily communities, which were all acquired in April 2011.

Professional fees

We recorded professional fee expenses of approximately \$242 thousand and \$305 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. These costs consist principally of fees for audit, tax and legal work performed and the decreases were due to higher accounting and legal costs incurred in the 2011 periods.

related to audits of our initial financial statements as a publicly held company and fees for tax consulting services.

Interest expense

We recorded interest expense of approximately \$615 thousand and \$538 thousand for the three-month periods ended September 30, 2012 and 2011, respectively, and approximately \$1.7 million and \$972 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. Interest expense on mortgage indebtedness from the three acquired communities was approximately \$520 thousand and \$516 thousand and amortization of deferred loan costs on the mortgage indebtedness was approximately \$21 thousand for both the three-month periods ended September 30, 2012 and 2011, respectively. Interest expense on mortgage indebtedness from the three acquired communities was approximately \$1.6 million and \$913 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. Amortization of deferred loan costs on the mortgage indebtedness was approximately \$64 thousand and \$43 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively.

The increases in interest expense for the 2012 periods were due to the acquisitions of the three multifamily properties in April of 2011 and consequently, less than full periods of interest were accrued and paid for the corresponding 2011 period. Interest expense for the prior year periods also included a nominal amount of interest on the note payable and on the two lines of credit due to WOF, all of which were paid and retired in April 2011 with proceeds from the IPO.

Equity compensation to directors and executives

We recorded amortization expense related to equity compensation to our directors and executives of approximately \$316 thousand and \$78 thousand for the three-month periods ended September 30, 2012 and 2011, respectively, and approximately \$921 thousand and \$158 thousand for the nine-month periods ended September 30, 2012 and 2011, respectively. The primary factor driving these increases in the 2012 periods was the inclusion of amortization expense for the 2012 and 2011 Class B Unit awards to our four principal executives of approximately \$245 thousand and \$722 thousand for the three-month and nine-month 2012 periods, respectively.

Other income

For the three-month and nine-month periods ended September 30, 2012, we recorded other income of approximately \$81 thousand and \$82 thousand, respectively. Included in the amounts was \$80,720, which was a cost reimbursement from the local water utility servicing our Stone Rise property. This reimbursement related to the construction of a water main by Oxford Rise JV, LLC prior to the date we acquired the entity and community.

Funds From Operations Attributable to Common Stockholders ("FFO")

Analysts, managers, and investors have, since the first real estate investment trusts were created, made certain adjustments to reported net income amounts under U.S. GAAP in order to better assess these vehicles' liquidity and cash flows. FFO is one of the most commonly utilized Non-GAAP measures currently in practice. In its 2002 "White Paper on Funds From Operations", which was revised in 2004, the National Association of Real Estate Investment Trusts, or NAREIT, standardized the definition of how Net income/loss should be adjusted to arrive at FFO, in the interests of uniformity and comparability. The NAREIT definition of FFO (and the one we report) is:

Net income/loss:

- ✶ Excluding impairment charges on and gains/losses from sales of depreciable property;
- ✶ Plus depreciation and amortization of real estate assets; and
- ✶ After adjustments for unconsolidated partnerships and joint ventures

Not all companies necessarily utilize the standardized NAREIT definition of FFO, and so caution should be taken in comparing our reported FFO results to those of other companies. Our FFO results are comparable to the FFO results of other companies that follow the NAREIT definition of FFO and report these figures on that basis. We believe FFO

is useful to investors as a supplemental gauge of our operating results. FFO is a non-GAAP measure that is reconciled to its most comparable GAAP measure, which the Company believes to be net income/loss available to common stockholders.

Adjusted Funds From Operations Attributable to Common Stockholders (“AFFO”)

AFFO makes further adjustments to FFO results in order to arrive at a more refined measure of operating and financial performance. There is no industry standard definition of AFFO and practice is divergent across the industry. We calculate AFFO

as:

FFO, plus:

• Acquisition costs;

• Organization costs;

• Non-cash equity compensation to directors and executives;

• Amortization of loan closing costs;

• REIT establishment costs;

• Depreciation and amortization of non-real estate assets; and

• Net loan origination fees received;

Less:

• Non-cash mezzanine loan interest income;

• Cash paid for loan closing costs; and

• Normally recurring capital expenditures

AFFO figures reported by us are not generally comparable to those reported by other companies. Investors are cautioned that AFFO excludes acquisition costs which are recorded as incurred, which generally occur in the periods in which the properties are acquired (and often preceding periods). We utilize AFFO to gauge the results of the operating performance of our portfolio of real estate assets. We believe AFFO is useful to investors as a supplemental gauge of our operating performance and is useful in comparing our operating performance with other real estate companies that are not as involved in ongoing acquisition activities. AFFO is a useful supplement to, but not a substitute for, its closest GAAP-compliant measure, which we believe to be net income/loss available to common stockholders.

Reconciliation of Funds From Operations Attributable to Common Stockholders and
Adjusted Funds From Operations Attributable to Common Stockholders
to Net Loss Attributable to Common Stockholders

	Three months ended:		Nine months ended:	
	9/30/2012	9/30/2011	9/30/2012	9/30/2011
Net income (loss) attributable to the Company	\$ 148,921	\$(2,900,704)	\$(562,305)	\$(7,314,552)
Less: Preferred stock dividends	(163,059)	—	(242,744)	—
Earnings attributable to unvested restricted stock	(4,626)	(3,250)	(12,302)	(6,500)
Net loss attributable to common stockholders	(18,764)	(2,903,954)	(817,351)	(7,321,052)
Add: Depreciation of real estate assets	900,307	961,446	2,782,052	1,715,674
Amortization of acquired intangible assets	—	2,656,351	—	4,698,174
Funds from operations attributable to common stockholders	881,543	713,843	1,964,701	(907,204)
Add: Acquisition costs	—	18,272	912	1,680,432
Organization costs	—	—	1,593	94,372
Non-cash equity compensation to directors and executives	315,600	77,519	921,207	157,501
Amortization of loan closing costs	48,487	21,445	91,473	42,986
REIT establishment costs	—	—	—	25,849
Depreciation/amortization of non-real estate assets	5,681	5,935	18,352	11,993
Net mezzanine loan fees received	168,813	—	258,528	74,333
Less: Non-cash mezzanine loan interest income	(225,970)	(4,489)	(357,219)	(4,489)
Cash paid for loan closing costs	(323,918)	—	(323,918)	—
Normally recurring capital expenditures	(52,240)	(62,052)	(162,009)	(89,000)
Adjusted funds from operations attributable to common stockholders	\$ 817,996	\$ 770,473	\$ 2,413,620	\$ 1,086,773
Common Stock dividends:				
Declared	\$ 729,699	\$ 646,675	\$ 2,080,357	\$ 1,293,162
Per share	\$ 0.14	\$ 0.125	\$ 0.40	\$ 0.25
Weighted average shares outstanding - basic	5,178,822	5,146,845	5,169,467	3,375,384
Weighted average shares outstanding - diluted (A)	5,428,752	5,172,845	5,410,539	3,392,432
Actual shares outstanding at September 30, 2012 and 2011, including 33,046 and 26,000 unvested shares of restricted Common Stock at September 30, 2012 and 2011, respectively	5,212,139	5,173,399	5,212,139	5,173,399

(A) Since our AFFO results are positive for the periods reflected above, we are presenting recalculated diluted weighted average shares for these periods for purposes of this table, which includes the dilutive effect of potential common stock equivalents from grants of the Company's Class B Units granted in the Operating Partnership, issued on December 30, 2011, January 3, 2012, and August 15, 2012, as well as 33,046 shares of restricted Common Stock issued May 10, 2012. The weighted average shares outstanding presented on the Consolidated Statements of Operations are the same for basic and diluted since we recorded a net loss available to common stockholders for the periods presented.

Liquidity and Capital Resources

Short-Term Liquidity

We believe our principal short-term liquidity needs are to fund:

- operating expenses directly related to our portfolio of multifamily communities (including regular maintenance items);
- capital expenditures incurred to lease our multifamily communities;
- interest expense on our outstanding property level debt;
- amounts due on our Credit Facility;
- monthly distributions that we pay to our preferred stockholders; and
- quarterly distributions that we pay to our common stockholders.

On August 31, 2012, we, in conjunction with the Operating Partnership, entered into a credit agreement with Key Bank National Association, or the Lender, to obtain a \$15.0 million senior secured revolving credit facility, or Credit Facility. The intended uses of the Credit Facility are to fund our investments, capital expenditures, dividends (with consent) and working capital and other general corporate purposes on an as needed basis. Amounts drawn under the Credit Facility bear interest at a variable rate of the 1 month LIBOR index plus 500 basis points, which was approximately 5.2% per annum at September 30, 2012 as well as a commitment fee on the average daily unused portion of the Credit Facility of 0.50% per annum. Accrued interest and commitment fees are payable monthly and principal amounts owed may be repaid in whole or in part without penalty. The Credit Facility has a maturity date of August 31, 2013.

Borrowings under the Credit Facility are secured by, among other things, pledges of 100% of the ownership of each of our current and future mezzanine loan subsidiaries, and 49% of the ownership of each of our current and future real estate subsidiaries, as well as by joint and several repayment guaranties.

The Credit Facility contains certain affirmative and negative covenants including negative covenants that limit or restrict secured and unsecured indebtedness, mergers and fundamental changes, investments and acquisitions, liens and encumbrances, dividends, transactions with affiliates, burdensome agreements, changes in fiscal year and other matters customarily restricted in such agreements. The material financial covenants include minimum net worth and debt service coverage ratios and maximum leverage and dividend payout ratios. As of September 30, 2012, we were in compliance with all covenants related to the Credit Facility.

At September 30, 2012, we had drawn the full \$15.0 million available under the Credit Facility to finance the closings of the City Vista and City Park mezzanine loans and the Madison-Rome loan, as well as associated legal expenses and a loan fee and closing costs of \$323,918 for the establishment of the line of credit. Interest expense was \$46,970 and the weighted average interest rate was 5.24% for the three-month and nine-month periods ended September 30, 2012 (commencing with the first draw upon the Credit Facility on August 31, 2012).

Our net cash provided by operating activities for the nine-month period ended September 30, 2012 was approximately \$3.0 million and net cash used in operating activities for the nine-month period ended September 30, 2011 was approximately \$266 thousand. We had net cash used in operating activities in the prior year period, rather than net cash provided by operating activities, since we commenced business operations following our IPO in the second quarter of 2011 and also incurred approximately \$1.7 million of acquisition costs in that period. The net cash provided by operating activities in the 2012 period reflects a full period of operational results from our multifamily communities, interest income from our real estate loans and an immaterial amount of acquisition costs.

The majority of our revenue is derived from residents under existing leases at our multifamily communities. Therefore, our operating cash flow is principally dependent on: (1) the number of multifamily communities in our portfolio; (2) rental rates; (3) occupancy rates; (4) operating expenses associated with these multifamily communities; and (5) the ability of our residents to make their rental payments. We believe we are well positioned to take advantage of the recent improvements in multifamily fundamentals, such as higher occupancy rates, positive new and renewal rates over expiring leases, a declining home ownership rate and a decline in turnover, which we believe are all positive developments in the multifamily industry.

We also earn interest revenue from the issuance of real estate-related loans and may receive fees at the inception of these loans for originating them and setting aside funds to procure them. Interest revenue we record on these loans is influenced by (1)

market interest rates on similar loans; (2) the availability of credit from alternative financing sources; (3) the desire of borrowers to finance new real estate projects; and (4) unique characteristics attached to these loans, such as exclusive purchase options.

Our net cash used in investing activities was approximately \$26.6 million and \$93.6 million for the nine-month periods ended September 30, 2012 and September 30, 2011, respectively. The 2012 period included disbursements for three mezzanine loans and two real estate acquisition bridge loans totaling approximately \$25.2 million and the issuance of three promissory notes totaling approximately \$1.6 million, partially offset by the repayment of one note in the amount of \$650 thousand. During the 2011 period, we disbursed approximately \$87.4 million to acquire our three multifamily properties and \$6.0 million for the Trail II real estate loan.

Cash used in or provided by investing activities is primarily driven by acquisitions and dispositions of multifamily properties and acquisitions and maturities or other dispositions of real estate loans and other real estate and real estate-related assets, and secondarily by capital expenditures related to our owned properties. We have no current plans to dispose of any of our communities and will seek to acquire more communities at costs that we expect will be accretive to our financial results. Capital expenditures may be nonrecurring and discretionary, as part of a strategic plan intended to increase a property's value and corresponding revenue-generating power, or may be normally recurring and necessary to maintain the income streams and present value of a property. Certain capital expenditures may be budgeted and reserved for upon acquiring a property as initial expenditures necessary to bring a property up to our standards or to add features or amenities that we believe make the property a compelling value to prospective residents in its individual market. These budgeted nonrecurring capital expenditures in connection with an acquisition are funded from the capital source(s) for the acquisition and are not dependent upon subsequent property operational cash flows for funding.

For the nine-month period ended September 30, 2012, our capital expenditures were:

	Summit	Trail	Rise	Total
Nonrecurring capital expenditures:				
Budgeted at property acquisition	\$6,681	\$160,552	\$10,799	\$178,032
Other nonrecurring capital expenditures	—	5,850	4,166	10,016
Total nonrecurring capital expenditures	6,681	166,402	14,965	188,048
Normally recurring capital expenditures	59,492	60,833	41,684	162,009
Total capital expenditures	\$66,173	\$227,235	\$56,649	\$350,057

For the nine-month period ended September 30, 2011, our capital expenditures were:

	Summit	Trail	Rise	Total
Nonrecurring capital expenditures:				
Budgeted at property acquisition	\$86,699	\$142,600	\$8,880	\$238,179
Other nonrecurring capital expenditures	—	—	—	—
Total nonrecurring capital expenditures	86,699	142,600	8,880	238,179
Normally recurring capital expenditures	34,538	34,194	20,268	89,000
Total capital expenditures	\$121,237	\$176,794	\$29,148	\$327,179

Net cash provided by financing activities was approximately \$21.5 million and \$98.9 million for the nine-month periods ended September 30, 2012 and September 30, 2011, respectively. During the 2012 period, we drew \$15.0 million from our revolving credit facility in order to fund the closing transactions on our City Vista, City Park, and Madison-Rome loans and received approximately \$11.0 million from the issuance of 12,178 Units. Partially offsetting these cash inflows were the payments of our Preferred Stock and Common Stock dividends totaling approximately

\$2.2 million and deferred offering costs of approximately \$1.9 million. The financing cash inflows during the 2011 period consisted primarily of proceeds from sales of Common Stock of approximately \$46.1 million and proceeds from mortgage notes payable on our three acquired multifamily communities of approximately \$55.6 million.

Distributions

47

In order to obtain and maintain our status as a REIT for U.S. federal income tax purposes, we must comply with a number of organizational and operating requirements, including a requirement to distribute 90% of our annual REIT taxable income to our stockholders. As a REIT, we generally will not be subject to federal income taxes on the taxable income we distribute to our stockholders. Generally, our objective is to meet our short-term liquidity requirement of funding the payment of our quarterly Common Stock dividends to stockholders, as well as monthly dividends to holders of our Preferred Stock, through net cash generated from operating results.

For each of the three-month periods within the nine-month periods ended September 30, 2012 and September 30, 2011, our dividend and cash-generating activity was:

Three-month period ended	Dividend per share of Common Stock	Dividends declared			Cash flow (used in) provided by operating activities
		Common	Preferred	Total	
3/31/2011	\$—	\$—	\$—	\$—	\$(122,686)
6/30/2011	\$0.125	\$646,487	\$—	\$646,487	\$(697,122)
9/30/2011	\$0.125	\$646,675	\$—	\$646,675	\$553,596
3/31/2012	\$0.13	\$673,181	\$718	\$673,899	\$927,394
6/30/2012	\$0.13	\$677,477	\$79,685	\$757,162	\$869,992
9/30/2012	\$0.14	\$729,699	\$163,059	\$892,758	\$1,225,510

We commenced business operations on April 5, 2011 and acquired three multifamily communities and a real estate loan during the second quarter of 2011. As shown above, our cash flow provided by operating activities for the three-month period ended September 30, 2012 was \$1,225,510 versus \$553,596 for the three-month period ended September 30, 2011, and was attributable to the increase in interest income from our expanded portfolio of loans and notes receivable in the 2012 period. Our cash flow from operations for both the three-month and nine-month periods ended September 30, 2012 were sufficient to fund both our quarterly Common Stock dividend(s) and our monthly Preferred Stock dividends for the respective periods.

On August 2, 2012, we declared a quarterly dividend on our Common Stock of \$0.14 per share, an increase of 12% from our initial dividend per share of \$0.125 following our IPO, or an annualized dividend growth rate of 9.6%. Our board of directors reviews the proposed Common Stock dividend declarations quarterly, and there can be no assurance that the current dividend level will be maintained.

In addition to \$718 of accrued dividends payable for the three-month period ended March 31, 2012, for the nine-month period ended September 30, 2012, our Preferred Stock dividend activity consisted of:

Declaration date	Record date	Payment date	Dividend distributions	(1)
4/13/2012	4/30/2012	5/21/2012	\$11,486	
5/10/2012	5/31/2012	6/20/2012	25,406	
6/22/2012	6/29/2012	7/20/2012	42,793	
7/22/2012	7/31/2012	8/20/2012	50,878	
8/2/2012	8/31/2012	9/20/2012	54,119	
9/18/2012	9/28/2012	10/22/2012	58,062	
			\$242,744	

(1)

The Preferred Stock receives dividend distributions of \$5.00 per share for each full month and, for shares outstanding for less than a full month, a prorated amount based on such monthly rate.

Our board of directors reviews the Preferred Stock dividend monthly to determine whether we have funds legally available

for payment of such dividends in cash, and there can be no assurance that the Preferred Stock dividends will consistently be paid in cash. Dividends may be paid as a combination of cash and stock in order to satisfy the annual distribution requirements applicable to REITs. We expect the aggregate dollar amount of monthly Preferred Stock dividend payments to increase at a rate that approximates the rate at which we issue new Units from our Unit offering.

Long-Term Liquidity Needs

We believe our principal long-term liquidity needs are to fund:

- the principal amount of our long-term debt as it becomes due or matures;
- capital expenditures needed for our multifamily communities;
- costs associated with current and future capital raising activities;
- costs to acquire additional multifamily communities and enter into lending opportunities; and
- our minimum distributions necessary to maintain our REIT status.

We intend to finance our future investments with the net proceeds from additional issuances of our securities, including our Unit offering (described below), Common Stock, preferred stock, units of limited partnership interest in our Operating Partnership, and/or borrowings. The success of our acquisition strategy may depend, in part, on our ability to access further capital through issuances of additional securities, especially our Unit offering during 2012 and beyond. If we are unsuccessful in raising additional funds, we may not be able to obtain any assets in addition to those we have acquired.

On November 18, 2011, the SEC declared effective our registration statement on Form S-11 (registration number 333-176604), or the Registration Statement, for our offering of up to a maximum of 150,000 Units, with each Unit consisting of one share of our Preferred Stock and one Warrant to purchase 20 shares of our Common Stock and are immediately separable and will be issued separately. We refer to such offering as the Primary Series A Offering. The price per Unit is \$1,000. The Preferred Stock ranks senior to the Common Stock with respect to payment of dividends and distribution of amounts upon liquidation, dissolution and winding up. Holders of the Preferred Stock are entitled to receive, when and as authorized by our board of directors and declared by us out of legally available funds, cumulative cash dividends on each share of Preferred Stock at an annual rate of six percent (6%) of the Stated Value, which is \$1,000. Dividends on each share of Preferred Stock will begin accruing on the date of issuance. The Preferred Stock is redeemable at the option of the holder beginning two years following the date of issuance, subject to a 10% redemption fee. After year three the redemption fee decreases to 5%, after year four it decreases to 3%, and after year five there is no redemption fee. Any redemptions are entitled to any accrued but unpaid dividends. The Warrant is exercisable by the holder at an exercise price of 120% of the current market price per share of the Common Stock on the date of issuance of such Warrant with a minimum exercise price of \$9.00 per share. The current market price per share is determined using the volume weighted average closing market price for the 20 trading days prior to the date of issuance of the Warrant. The Warrants are not exercisable until one year following the date of issuance and expire four years following the date of issuance. As of September 30, 2012, we had issued an aggregate of 12,178 Units from our Primary Series A Offering, leaving 137,822 Units available to be issued.

On August 16, 2012, we filed a registration statement on Form S-11 (registration number 333-183355) for a follow-on offering of an additional 850,000 Units, bringing the maximum number of Units to be issued to one million. The terms of the follow-on offering and features of the Units are substantially the same as the Primary Series A Offering. The registration statement has not yet been declared effective by the Securities and Exchange Commission.

Our ability to raise funds through the issuance of our securities is dependent on, among other things, general market conditions for REITs, market perceptions about us, and the current trading price of our Common Stock. We will continue to analyze which source of capital is most advantageous to us at any particular point in time, but the equity and credit markets may not consistently be available on terms that are attractive to us or at all.

The sources to fulfill our long-term liquidity in the future may include borrowings from a number of sources, including repurchase agreements, securitizations, resecuritizations, warehouse facilities and credit facilities (including term loans and revolving facilities), in addition to our \$15.0 million revolving line of credit. We have utilized, and we intend to continue to utilize, leverage in making our investments in multifamily communities. The number of different multifamily communities and other investments we will acquire will be affected by numerous factors, including the amount of funds available to us. By operating on a leveraged basis, we will have more funds available for our investments. This will allow us to make more investments than would otherwise be possible, resulting in a larger and more diversified portfolio. See the section entitled "Risk Factors" in Item 1.A of our Annual Report on Form 10-K for more information about the risks related to operating on a leveraged basis.

We intend to target leverage levels (secured and unsecured) between 50% and 65% of the value of our tangible assets (including our real estate assets, real estate loan investments, accounts receivable and cash and cash equivalents) on a portfolio basis based on fair market value. As of September 30, 2012, our outstanding debt (including the balance on our line of credit) was approximately 48.2% of the value of our tangible assets on a portfolio basis based on our current estimate of fair market value. Neither our charter nor our by-laws contain any limitation on the amount of leverage we may use. Our investment guidelines, which can be amended by our board without stockholder approval, limit our borrowings (secured and unsecured) to 75% of the cost of our tangible assets at the time of any new borrowing. These targets, however, will not apply to individual real estate assets or investments. At the date of acquisition of each asset, we anticipate that the cost of investment for such asset will be substantially similar to its fair market value. However, subsequent events, including changes in the fair market value of our assets, could result in our exceeding these limits. In addition, we have acquired, and we intend to acquire, all of our multifamily communities through separate single purpose entities and we have financed, and we intend to finance, each of these multifamily communities using financing techniques for that property alone without any cross-collateralization to our other multifamily communities or guarantees by us or our Operating Partnership. We intend to have no long-term unsecured debt at the Company or Operating Partnership levels, except for our \$15.0 million line of credit.

Our secured and unsecured aggregate borrowings are intended by us to be reasonable in relation to our tangible assets and will be reviewed by our board of directors at least quarterly. In determining whether our borrowings are reasonable in relation to our tangible assets, we expect that our board of directors will consider many factors, including without limitation the lending standards of government-sponsored enterprises, such as Fannie Mae and Freddie Mac, for loans in connection with the financing of multifamily properties, the leverage ratios of publicly traded and non-traded REITs with similar investment strategies, and general market conditions. There is no limitation on the amount that we may borrow for any single investment.

Our ability to incur additional debt is dependent on a number of factors, including our credit ratings (if any), the value of our assets, our degree of leverage and borrowing restrictions imposed by lenders. We will continue to monitor the debt markets, including Fannie Mae and/or Freddie Mac (from both of whom we have obtained single asset secured financing on all of our multifamily communities in 2011), and as market conditions permit, access borrowings that are advantageous to us.

If we are unable to obtain financing on favorable terms or at all, we may have to curtail our investment activities, including acquisitions and improvements to real properties, which could limit our growth prospects. This, in turn, could reduce cash available for distribution to our stockholders and may hinder our ability to raise capital by issuing more securities or borrowing more money. We may be forced to dispose of assets at inopportune times in order to maintain our REIT qualification and Investment Company Act exemption. Our ability to generate cash from asset sales is limited by market conditions and certain rules applicable to REITs. We may not be able to sell a property or properties as quickly as we would like or on terms as favorable as we would like.

Furthermore, if interest rates or other factors at the time of financing result in higher costs of financing, then the interest expense relating to that financed indebtedness would be higher. Higher interest rates on newly incurred debt may negatively impact us as well. If interest rates increase, our interest costs and overall costs of capital will increase, which could adversely affect our transaction and development activity, financial condition, results of operations, cash flow, our ability to pay principal and interest on our debt and our ability to pay distributions to our stockholders. Finally, sellers may be less inclined to offer to sell to us if they believe we may be unable to obtain financing.

As of September 30, 2012, we had long term mortgage indebtedness of approximately \$55.6 million, all of which was incurred by us in connection with the acquisition of our three multifamily communities in 2011. The outstanding balance includes fixed-rate debt of approximately \$20.9 million, or 37.5% of the total mortgage debt balance, and floating-rate debt of approximately \$34.8 million, or 62.5% of the total mortgage debt balance.

As of September 30, 2012, we had approximately \$2.5 million in unrestricted cash and cash equivalents available to meet our short-term and long-term liquidity needs. As of September 30, 2012, we earmarked approximately \$1.7 million of cash and cash equivalents to fund our working capital and dividend requirements and approximately \$82 thousand for planned capital expenditures that were identified at acquisition for our acquired multifamily communities. The remaining balance of approximately \$718 thousand was available for general operating purposes.

Off-Balance Sheet Arrangements

As of September 30, 2012, we had an outstanding warrant to purchase up to 150,000 shares of our Common Stock, or

50

the IPO Warrant, to International Assets Advisory, LLC, or IAA, for financial advisory services performed in connection with our IPO. The IPO Warrant was issued on March 31, 2011. If IAA exercises the IPO Warrant, the purchase price for each share is \$12.50 per share and expires on March 31, 2015. Neither the IPO Warrant nor the underlying shares of Common Stock to be issued upon the exercise of the IPO Warrant were or will be registered. Under certain circumstances, the IPO Warrant also may be exercised on a “cashless” basis, which allows IAA to elect to pay the exercise price by surrendering the IPO Warrant for that number of shares of our Common Stock equal to the quotient obtained by dividing (x) the product of the number of shares of our Common Stock underlying the IPO Warrant, multiplied by the difference between the exercise price of the IPO Warrant and the “fair market value” (defined below) of the Common Stock by (y) the fair market value of the Common Stock. The “fair market value” shall mean the average reported last sale price of our Common Stock for the five trading days immediately preceding the date as of which the fair market value is being determined.

As of September 30, 2012, we had 12,178 outstanding Units, each containing one warrant to purchase 20 shares of our Common Stock. The Warrants are exercisable by the holder at an exercise price of 120% of the current market price per share of the Common Stock on the date of issuance of such warrant with a minimum exercise price of \$9.00 per share. The current market price per share is determined using the volume weighted average closing market price for the 20 trading days prior to the date of issuance of the Warrant. The Warrants are not exercisable until one year following the date of issuance and expire four years following the date of issuance. The Warrants outstanding at September 30, 2012 become exercisable between March 30, 2013 and September 28, 2013 and have exercise prices that range between \$9.00 and \$10.08 per share. If all the outstanding warrants at September 30, 2012 become exercisable and are exercised, gross proceeds to us would be approximately \$2.1 million and we would as a result issue an additional 243,560 shares of Common Stock.

Contractual Obligations

As of September 30, 2012, our contractual obligations consisted of the three mortgage notes secured by our three acquired properties and the revolving line of credit. Based on the 1 Month London Interbank Offered Rate, or LIBOR, at September 30, 2012 of 0.210%, our estimated future required payments on these instruments were:

	Total	Less than one year (1)	1-3 years	3-5 years	More than five years
Long-term debt obligations:					
Interest	\$ 11,747,520	\$ 504,483	\$ 4,622,274	\$ 3,931,157	\$ 2,689,606
Principal	55,637,000	—	608,635	2,184,251	52,844,114
Line of credit:					
Interest	781,500	194,840	586,660	—	—
Principal	15,000,000	—	15,000,000	—	—
Total	\$83,166,020	\$ 699,323	\$ 20,817,569	\$ 6,115,408	\$ 55,533,720

(1) Represents obligations due for the remainder of 2012

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our primary market risk exposure is interest rate risk. All our floating-rate debt is tied to the 30-day LIBOR. \$19.5 million of our floating-rate debt has LIBOR effectively capped at 4.48% (all-in rate of 7.25%) and approximately \$15.3 million of our floating rate debt has LIBOR effectively capped at 4.05% (all-in rate of 6.85%), both through caps on the maximum interest rate on our debt under Freddie Mac's capped adjustable-rate mortgage program. We have limited market risk associated with debt maturity as all of our floating rate debt financing our communities was incurred in April 2011 and does not mature until May 2018. Our \$15.0 million line of credit is uncapped and bears interest at a spread over LIBOR of 5.0%, and because of the short term nature of this loan, we believe our interest rate

risk is minimal. We have no business operations which subject us to trading risk.

We have and will continue to manage interest rate risk as follows:

- maintain a reasonable ratio of fixed-rate, long-term debt to total debt so that floating-rate exposure is kept at an acceptable level;
- place interest rate caps on floating-rate debt; and

take advantage of favorable market conditions for long-term debt and/or equity.
We use various financial models and advisors to achieve our objectives.

If interest rates under our floating-rate LIBOR-based indebtedness fluctuated by 100 basis points, our interest costs, based on outstanding borrowings at September 30, 2012, would increase by approximately \$498 thousand on an annualized basis, or decrease by approximately \$105 thousand on an annualized basis. The difference between the interest expense amounts related to an increase or decrease in our floating-rate interest cost is because LIBOR was 0.21% at September 30, 2012, therefore we have limited the estimate of how much our interest costs may decrease because we use a floor of 0% for LIBOR.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

Our Chief Executive Officer and Chief Accounting Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, or Exchange Act, Rule 13a-15(e)) as of September 30, 2012. Based on that evaluation, our Chief Executive Officer and Chief Accounting Officer have concluded that our disclosure controls and procedures are effective as of the end of such period to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in internal control over financial reporting

As required by Exchange Act Rule 13a-15(d), our Chief Executive Officer and Chief Accounting Officer evaluated our internal controls over financial reporting to determine whether any change occurred during the quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting. Based on that evaluation, there has been no such change during such quarter.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We and our subsidiaries are not currently subject to any legal proceedings that we consider material.

Item 1A. Risk Factors

There have been no material changes to our potential risks and uncertainties presented in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the twelve months ended December 31, 2011 that was filed with the SEC on March 15, 2012, as supplemented by our Quarterly Report on Form 10-Q for the three months ended March 31, 2012 that was filed with the SEC on May 11, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

See the Exhibit Index.

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.

PREFERRED APARTMENT COMMUNITIES, INC.
(Registrant)

Date: November 13, 2012

/s/ John A. Williams

John A. Williams
Chief Executive Officer

Date: November 13, 2012

/s/ Michael J. Cronin

Michael J. Cronin
Executive Vice President, Chief Accounting Officer and
Treasurer

EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of John A. Williams, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Michael J. Cronin, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	XBRL (eXtensible Business Reporting Language). The following materials from Preferred Apartment Communities, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2012, formatted in XBRL: (i) Consolidated balance sheets at September 30, 2012 and December 31, 2011, (ii) consolidated statements of operations for the three months and nine months ended September 30, 2012 and 2011, (iii) consolidated statement of equity and accumulated deficit, (iv) consolidated statement of cash flows and (v) notes to consolidated financial statements. As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purpose of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.