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

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

FORM 10-Q/A
AMENDMENT NO. 2

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED MARCH 31, 2002

Commission File Number 1-15663

AMERICAN REALTY INVESTORS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Nevada

75-2847135

(State or Other Jurisdiction of
Incorporation or Organization)

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

1800 Valley View Lane, Suite 300, Dallas, Texas

75234

(Address of Principal Executive Offices)

(Zip Code)

(469) 522-4200

(Registrant's Telephone Number,
Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock, \$.01 par value

11,375,127

(Class)

(Outstanding at April 26, 2002)

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This Form 10-Q/A Amendment No. 2 amends the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002 as follows:

ITEM 1. FINANCIAL STATEMENTS

Consolidated Statements of Operations - pages 4, 5

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

NOTE 10. "OPERATING SEGMENTS" - pages 19, 20

NOTE 11. "DISCONTINUED OPERATIONS" - pages 20, 21

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

"Results of Operations" - pages 28 - 30

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

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2002	December 31, 2001

Assets -----	(dollars in thousands, except per share)	
Real estate held for investment	\$ 473,583	\$ 495,437
Less - accumulated depreciation	(116,003)	(121,777)
	-----	-----
	357,580	373,660
Real estate held for sale	212,626	214,543
Notes and interest receivable		
Performing (\$21,217 in 2002 and \$18,896 in 2001 from affiliates)	23,320	22,612

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Nonperforming (\$6,747 in 2002 and \$6,994 in 2001 from affiliates)	7,764	10,347
	-----	-----
	31,084	32,959
Less--allowance for estimated losses	(2,577)	(2,577)
	-----	-----
	28,507	30,382
Pizza parlor equipment	10,845	10,454
Less - accumulated depreciation	(4,052)	(3,747)
	-----	-----
	6,793	6,707
Leasehold interest - oil and gas properties	4,719	4,719
Less - accumulated depletion	(1)	(1)
	-----	-----
	4,718	4,718
Oilfield equipment	511	511
Less - accumulated depreciation	(21)	(21)
	-----	-----
	490	490
Marketable equity securities, at market value	162	96
Cash and cash equivalents	903	709
Investments in equity investees	76,460	77,933
Intangibles, net of accumulated amortization (\$2,681 in 2002 and \$2,666 in 2001)	15,580	15,594
Other assets	31,996	33,931
	-----	-----
	\$ 735,815	\$ 758,763
	=====	=====

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS - Continued

	March 31, De
	2002

	(dollars in th
	except per
Liabilities and Stockholders' Equity	
Liabilities	
Notes and interest payable (\$14,240 in 2002 and \$1,598 in 2001 to affiliates)	\$ 563,840
Margin borrowings	27,105
Accounts payable and other liabilities (\$6,320 in 2002 and \$11,389 in 2001 to affiliates)	40,951

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	631,896
Minority interest	23,155
Series F Preferred Stock, 3,968.75 shares in 2002 and 2001 (liquidation preference \$3,969)	3,969
Commitments and contingencies	
Stockholders' equity	
Preferred Stock, \$2.00 par value, authorized 50,000,000 shares, issued and outstanding Series A, 2,724,910 shares in 2002 and 2001 (liquidation preference \$27,249)	4,850
Series E, 50,000 shares in 2002 and 2001 (liquidation preference \$5,000)	100
Common Stock, \$.01 par value, authorized 100,000,000 shares; issued 11,375,127 shares in 2002 and 2001	114
Paid-in capital	96,529
Accumulated (deficit)	(25,257)
Accumulated other comprehensive income	459

	76,795

	\$ 735,815
	=====

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

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AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended March 31,	
	2002	2001
	(dollars in thousands except per share)	
Property revenue		
Rents	\$ 28,634	\$ 30,000
Property operations expenses	19,613	20,000
	-----	-----
Operating income	9,021	10,000
Land operations		
Sales	5,580	2,000
Cost of sales	3,381	1,000
	-----	-----
Gain on land sales	2,199	1,000
Pizza parlor operations		

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Sales	8,540	
Cost of sales	6,953	
	-----	-----
Gross margin	1,587	
Income from operations	12,807	1
Other income		
Interest income	612	
Equity in loss of investees	(4,012)	(
Equity in gain on sale of real estate by equity investees	--	
Loss on sale of investments in equity investees	(531)	
Gain on sale of real estate	--	1
Other	184	
	-----	-----
	(3,747)	1
Other expenses		
Interest	18,352	1
Depreciation and amortization	3,499	
General and administrative	3,312	
Advisory fee to affiliate	1,736	
Incentive fee to affiliate	--	
Minority interest	787	
	-----	-----
	27,686	2
	-----	-----
Net income (loss) from continuing operations	(18,626)	
Discontinued operations		
Income (loss) from operations	(57)	
Gain on sale of real estate	5,615	
Equity in gain on sale of real estate by equity investees	4,131	
	-----	-----
Net income from discontinued operations	9,689	
Net income (loss)	(8,937)	
Preferred dividend requirement	(611)	
	-----	-----
Net income (loss) applicable to Common shares	\$ (9,548)	\$
	=====	=====

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

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except per share

Earnings per share

Net income (loss) from continuing operations	\$ (1.69)	\$
Discontinued operations85	
	-----	-----
Net income (loss) applicable to Common shares	\$ (.84)	\$
	=====	=====
Weighted average Common shares used in computing earnings per share	11,375,127	10,10
	=====	=====

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the Three Months Ended March 31, 2002

	Series A Preferred Stock	Series E Preferred Stock	Common Stock	Paid-in Capital	Accumulated (Deficit)
	-----	-----	-----	-----	-----
	(dollars in thousands, except per share)				
Balance, January 1, 2002	\$4,850	\$ 100	\$ 114	\$ 97,140	\$ (16,000)
Comprehensive income					
Foreign currency translation gain	--	--	--	--	
Net loss	--	--	--	--	(8,000)
Preferred dividends					
Series A Preferred Stock (\$.25 per share)	--	--	--	(604)	
Series E Preferred Stock (\$.15 per share)	--	--	--	(7)	
	-----	-----	-----	-----	-----
Balance, March 31, 2002	\$4,850	\$ 100	\$ 114	\$ 96,529	\$ (25,000)
	=====	=====	=====	=====	=====

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

AMERICAN REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

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	For the Three Ended March
	----- 2002 ----- (dollars in tho
Cash Flows From Operating Activities	
Rents collected	\$ 29,045
Pizza parlor sales collected	8,303
Interest collected	666
Payments for property operations	(21,603)
Payments for pizza parlor operations	(7,352)
Interest paid	(15,184)
Advisory fee paid to affiliate	(1,736)
Distributions to minority interest holders	(787)
General and administrative expenses paid	(3,312)
Other	398

Net cash used in operating activities	(11,562)
Cash Flows From Investing Activities	
Collections on notes receivable	3,689
Pizza parlor equipment purchased	(391)
Proceeds from sale of real estate	22,175
Notes receivable funded	(1,868)
Earnest money/escrow deposits	232
Investment in real estate entities	1,071
Acquisition of partnership interest	--
Real estate improvements	(2,063)

Net cash provided by investing activities	22,845
Cash Flows from Financing Activities	
Proceeds from notes payable	26,084
Payments on notes payable	(29,628)
Deferred borrowing costs	(915)
Net (payments to)/advances from affiliates	(5,069)
Margin borrowings, net	(950)
Repurchase of Common Stock	--
Preferred dividends paid	(611)

Net cash (used in) provided by financing activities	(11,089)
Net increase in cash and cash equivalents	194
Cash and cash equivalents, beginning of period	709

Cash and cash equivalents, end of period	\$ 903
	=====

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

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

	For the Three Months Ended March 31,	
	2002	2001
	----- (dollars in thousands)	
Reconciliation of net income to net cash used in operating activities		
Net income (loss)	\$ (8,937)	\$ 2,390
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation, depletion and amortization	3,555	4,079
Gain on sale of real estate	(7,814)	(20,215)
Distributions to minority interest holders	--	1,001
Equity in (income) loss of investees	(119)	5
Loss on sale of investments in equity investees	531	--
(Increase) decrease in accrued interest receivable	54	(153)
Decrease in other assets	2,551	1,187
Increase (decrease) in accrued interest payable	712	(199)
Decrease in accounts payable and other liabilities	(2,095)	(4,018)
	-----	-----
Net cash used in operating activities	\$ (11,562)	\$ (15,923)
	=====	=====
Schedule of noncash investing and financing		
Notes payable assumed by buyer on sale of real estate	\$ 1,389	\$ 12,215
Notes receivable from sale of real estate	--	2,123

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

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AMERICAN REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

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

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

On January 1, 2002, ARI adopted Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). The Statement superceded Statement 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS No. 121") and Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), for segments of a business to be disposed of. SFAS 144 retains the requirements of SFAS No. 121 relating to the recognition and measurement of an impairment loss and resolves certain implementation issues resulting from SFAS No. 121. The adoption of SFAS No. 144 did not have a material impact on the consolidated financial position or results of operations of ARI.

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

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

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

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

NOTE 1. BASIS OF PRESENTATION (Continued)

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

NOTE 2. REAL ESTATE

In 2002, ARI purchased the following property:

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Property	Location	Sq.Ft./Acres	Purchase Price	Net Cash Paid	Debt Incurred	Int R
First Quarter Shopping Center Plaza on Bachman Creek/(1)/	Dallas, TX	80,278 Sq.Ft.	\$3,103	\$ --	\$ --	
Second Quarter Land Willow Springs	Beaumont, CA	20.7 Acres	140	152	--	

(1) Exchanged with Transcontinental Realty Investors, Inc. ("TCI"), a related party, for the Oaktree Village Shopping Center, Rasor land parcel and Lakeshore Villas land parcel.

In 2002, ARI sold the following properties:

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received	De Disch
First Quarter Apartments Mallard Lake/(1)/ Villas	Greensboro, NC Plano, TX	336 Units 208 Units	\$ 14,400 8,525	\$ -- 3,701	\$ 7, 4,
Land Katrina Lakeshore Villas/(2)/ Rasor/(2)/ Thompson II Vista Ridge	Palm Desert, CA Harris County, TX Plano, TX Dallas County, TX Lewisville, TX	2.1 Acres 16.9 Acres 24.5 Acres .2 Acres 10.0 Acres	\$ 1,323 1,499 1,211 21 1,525	\$ (40) 215 174 20 130	\$ 1, 1,
Shopping Center Oaktree Village/(2)/	Lubbock, TX	45,623 Sq.Ft.	2,302	131	1,
Second Quarter Land Mason Goodrich	Houston, TX	7.9 Acres	672	46	

(1) Exchanged for Governor's Square, Grand Lagoon, Park Avenue, Greenbriar, Regency and Westwood Apartments.

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- (2) Exchanged with TCI, a related party, for the Plaza on Bachman Creek Shopping Center.
- (3) Debt assumed by purchaser.

In 2001, ARI sold the following properties:

Property	Location	Units/ Acres/Sq.Ft.	Sales Price	Net Cash Received	Debt Discharged
First Quarter					
Apartments					
Carriage Park	Tampa, FL	46 Units	\$ 2,005	\$ 757	\$ 1,069
Rockborough	Denver, CO	345 Units	16,675	3,654	12,215
Land					
Frisco Bridges	Collin County, TX	27.8 Acres	4,500	4,130	--
Katrina	Palm Desert, CA	20.0 Acres	2,831	(124)	596
Las Colinas	Las Colinas, TX	1.7 Acres	825	233	400
Plano Parkway	Plano, TX	11.3 Acres	1,445	312	950
Scoggins	Tarrant County, TX	232.8 Acres	2,913	892	1,800
Scout	Tarrant County, TX	408.0 Acres	5,087	1,586	3,200
Tree Farm	Dallas County, TX	10.4 Acres	2,888	(87)	2,644
Shopping Center					
Regency Pointe	Jacksonville, FL	67,063 Sq.Ft.	7,350	5,126	1,500

- (1) Debt assumed by purchaser.
- (2) Gain deferred until 2002, when ARI-provided financing was collected.

NOTE 3. NOTES RECEIVABLE

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

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

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

In December 1999, a note with a principal balance of \$1.2 million, secured by a pledge of a partnership interest in a partnership which

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

NOTE 3. NOTES RECEIVABLE (Continued)

owns real estate in Addison, Texas, matured. The maturity date was extended to April 2000 in exchange for an increase in the interest rate to 14.0% per annum. All other terms remained the same. In February 2001, the loan amount was increased to \$1.6 million and the maturity date was extended to June 2001. In February 2002, \$1.5 million in principal and \$87,000 in interest were collected. At May 2002, terms are being negotiated for collection of the remaining \$84,000 in principal plus accrued but unpaid interest.

Related Party. In March 2001, ARI funded \$13.6 million of a \$15.0 million unsecured line of credit to One Realco Corporation ("One Realco"), which owns approximately 14.8% of the outstanding shares of ARI's Common Stock. The line of credit bears interest at 12.0% per annum. All principal and interest were due at maturity in February 2002. The line of credit is guaranteed by Basic Capital Management, Inc. ("BCM"), ARI's advisor. In June 2001, \$394,000 in principal and \$416,000 in interest was collected. In December 2001, \$21,000 in principal and \$804,000 in interest was collected. In February 2002, the maturity date was extended to February 2004. In March 2002, ARI funded an additional \$1.8 million, increasing the outstanding principal balance to \$15.0 million. All principal and interest are due at maturity. Ronald E. Kimbrough, Executive Vice President and Chief Financial Officer of ARI, is a 10% shareholder of One Realco. Mr. Kimbrough does not participate in day-to-day operations or management of One Realco.

In October 1999, ARI funded a \$4.7 million loan to Realty Advisors, Inc., an affiliate. The loan was secured by all of the outstanding shares of common stock of American Reserve Life Insurance Company. The loan bore interest at 10.25% per annum and matured in November 2001. In January 2000, \$100,000 was collected. In November 2001, the maturity date was extended to November 2004. The collateral was changed to a subordinate pledge of 850,000 shares of ARI Common Stock owned by BCM. The shares are also pledged to a lender on ARI's behalf. The interest rate was changed to 2% over the prime rate, currently 6.75% per annum, and the accrued but unpaid interest of \$984,000 was added to the principal. The new principal balance is \$5.6 million. All principal and accrued interest are due at maturity.

In December 2000, an unsecured loan with a principal balance of \$1.8 million to Warwick of Summit, Inc. ("Warwick") matured. All principal and interest were due at maturity. In February 2002, \$275,000 of interest was received. At March 2002, the loan, and \$239,000 of accrued interest, remained unpaid. At May 2002, settlement terms are being negotiated. Richard D. Morgan, a Warwick shareholder, served as a director of ARI until October 2001.

In December 2000, a loan with a principal balance of \$1.6 million to Bordeaux Investments Two, L.L.C. ("Bordeaux"), matured. The loan is secured by (1) a 100% interest in Bordeaux, which owns a shopping center

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

NOTE 3. NOTES RECEIVABLE (Continued)

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in Oklahoma City, Oklahoma; (2) 100% of the stock of Bordeaux Investments One, Inc., which owns 6.5 acres of undeveloped land in Oklahoma City, Oklahoma; and (3) the personal guarantees of the Bordeaux members. At March 2002, the loan, and \$520,000 of accrued interest, remained unpaid. At May 2002, settlement terms are being negotiated. Richard D. Morgan, a Bordeaux member, served as a director of ARI until October 2001.

In March 2000, a loan with a principal balance of \$2.5 million to Lordstown, L.P., matured. The loan is secured by a second lien on land in Ohio and Florida, by 100% of the general and limited partner interest in Partners Capital, Ltd., the limited partner of Lordstown, L.P., and a profits interest in subsequent land sales. At March 2002, the loan, and \$820,000 of accrued interest, remained unpaid. At May 2002, settlement terms are being negotiated. A corporation controlled by Richard D. Morgan is the general partner of Lordstown, L.P. Mr. Morgan served as a director of ARI until October 2001.

NOTE 4. OIL AND GAS OPERATIONS

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

NOTE 5. INVESTMENTS IN EQUITY INVESTEES

Real estate entities. ARI's investment in real estate entities at March 31, 2002, included equity securities of two publicly traded real estate companies, Income Opportunity Realty Investors, Inc. ("IORI") and TCI, and interests in real estate joint venture partnerships. BCM, ARI's advisor, serves as advisor to IORI and TCI.

ARI accounts for its investment in IORI and TCI and the joint venture partnerships using the equity method. The equity securities of IORI and TCI are pledged as collateral for borrowings. See NOTE 8. "MARGIN BORROWINGS."

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AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE 5. INVESTMENTS IN EQUITY INVESTEES (Continued)

ARI's investment in real estate entities, accounted for using the equity method, at March 31, 2002 was as follows:

Investee	Percentage of ARI's Ownership at March 31, 2002	Carrying Value of Investment at March 31, 2002	Equivalent Investee Book Value at March 31, 2002	Market Value of Investment at March 31, 2002
-----	-----	-----	-----	-----

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IORI	28.49%	\$ 8,234	\$ 11,480	\$ 7,440
TCI	49.99%	67,147	107,650	66,745
		-----		-----
		75,381		\$ 74,185
				=====
Other		1,079		

		\$ 76,460		
		=====		

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

Set forth below is summarized results of operations of equity investees for the three months ended March 31, 2002:

Revenues	\$ 35,097
Equity in income of partnerships	(1,778)
Property operating expenses	26,308
Depreciation	5,742
Interest expense	10,218

(Loss) before gains on sale of real estate	(8,949)
Gain on sale of real estate	11,320

Net income	\$ 2,371
	=====

ARI's share of equity investees' loss before gains on the sale of real estate was \$4.0 million for the three months ended March 31, 2002, and its share of equity investees' gains on sale of real estate was \$4.1 million for the three months ended March 31, 2002.

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

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

NOTE 5. INVESTMENTS IN EQUITY INVESTEES (Continued)

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

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NOTE 6. MARKETABLE EQUITY SECURITIES - TRADING PORTFOLIO

Since 1994, ARI has been purchasing equity securities of entities other than those of IORI and TCI to diversify and increase the liquidity of its margin accounts. These equity securities are considered a trading portfolio and are carried at market value. In the first quarter of 2002, ARI did not purchase or sell any such securities. At March 31, 2002, ARI recognized an unrealized increase in the market value of its trading portfolio securities of \$66,000. Unrealized and realized gains and losses on trading portfolio securities are included in other income in the accompanying Consolidated Statements of Operations.

NOTE 7. NOTES PAYABLE

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

Property	Location	Units/ Acres/Sq.Ft.	Debt Incurred	Debt Discharged	Net Cash Received	Int R
-----	-----	-----	-----	-----	-----	-----
First Quarter						
Office Building						
Rosedale Towers	Minneapolis, MN	84,798 Sq.Ft.	\$ 5,109	\$ --	\$ 5,109	12.0
Two Hickory Centre	Farmers Branch, TX	96,127 Sq.Ft.	4,448	--	4,448	12.0
Land						
Walker	Dallas County, TX	90.6 Acres	8,500	8,500	(1,411)	11.2
Shopping Center						
Plaza on Bachman Creek	Dallas, TX	80,278 Sq.Ft.	5,000	--	4,444	6.6
Second Quarter						
Apartments						
Confederate Point	Jacksonville, FL	206 Units	1,929	--	1,929	12.0
Foxwood	Memphis, TN	220 Units	1,093	--	1,093	12.0
Woodsong	Smyrna, GA	190 Units	2,544	--	2,544	12.0
Office Building						
One Hickory Centre	Farmers Branch, TX	102,615 Sq.Ft.	4,468	--	4,468	12.0

- (1) In January 2002, IORI, a related party, purchased 100% of the outstanding common shares of Rosedale Corporation ("Rosedale"), a wholly-owned subsidiary of ARI, for \$5.1 million. Rosedale owns the Rosedale Towers Office Building. ARI has guaranteed that the asset

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will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay IORI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, IORI may require ARI to repurchase the shares of Rosedale for the purchase price. Management has classified this related party transaction as a note payable to IORI.

- (2) In January 2002, TCI, a related party, purchased 100% of the common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, for \$4.4 million. Two Hickory owns the Two Hickory Centre Office Building. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the shares of Two Hickory for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (3) Variable interest rate.
- (4) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Confederate Point, L.P. ("Confederate Point") from ARI for \$1.9 million. Confederate Point owns the Confederate Point Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Confederate Point for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (5) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Foxwood, L.P. ("Foxwood") from ARI for \$1.1 million. Foxwood owns the Foxwood Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Foxwood for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (6) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Woodsong, L.P. ("Woodsong") from ARI for \$2.5 million. Woodsong owns the Woodsong

NOTE 7. NOTES PAYABLE (Continued)

Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Woodsong for the purchase price. Management has classified this related

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party transaction as a note payable to TCI.

- (7) In April 2002, TCI, a related party, purchased 100% of the common shares of ART One Hickory Corporation ("One Hickory"), a wholly-owned subsidiary of ARI, for \$4.5 million. One Hickory owns the One Hickory Centre Office Building. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the shares in One Hickory for the purchase price. Management has classified this related party transaction as a note payable to TCI.

In April 2002, ARI sold nine residential properties to partnerships controlled by Metra Capital, LLC ("Metra"), for a total sales price of \$34.2 million. These properties include: the 12 unit Bay Anchor Apartments in Panama City, Florida; the 168 unit Governor Square Apartments in Tallahassee, Florida; the 54 unit Grand Lagoon Cove Apartments in Panama City, Florida; the 92 unit Oak Hill Apartments in Tallahassee, Florida; the 121 unit Park Avenue Villas Apartments in Tallahassee, Florida; the 62 unit Seville Apartments in Tallahassee, Florida; the 120 unit Westwood Apartments in Mary Ester, Florida; the 64 unit Windsor Tower Apartments in Ocala, Florida and the 546 unit Woodhollow Apartments in San Antonio, Texas. Innovo Group, Inc. ("Innovo"), is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a Director of ARI, controls approximately 11.67% of the outstanding common stock of Innovo. Management has determined to treat this sale as a refinancing transaction. ARI will continue to report the assets and the new debt incurred by Metra on its financial statements. ARI received net cash of \$8.3 million after paying off the existing debt of \$19.3 million and various closing costs, including \$342,000 in brokerage commissions to Third Millennium Partners, LLC. Of the total new debt of \$29.2 million, \$8.8 million bears interest at 5.00% per annum and matures in May 2003, \$17.0 million bears interest at 7.12% per annum and matures in May 2007 and \$3.4 million bears interest at 7.57% per annum and matures in May 2012. ARI also received \$6.3 million of 8% non-recourse, non-convertible Series A Preferred Stock ("Preferred Shares") of Innovo.

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

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

NOTE 7. NOTES PAYABLE (Continued)

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

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

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

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Property	Location	Acres	Debt Incurred	Debt Discharged	Net Cash Received	Inter
First Quarter						
Land						
Mason/Goodrich	Houston, TX	235.0 Acres	\$ 6,750	\$ --	\$ 6,302	14
Pioneer Crossing	Austin, TX	350.1 Acres	7,000	--	6,855	16
Pioneer Crossing	Austin, TX	14.5 Acres	2,500	--	2,350	14

NOTE 8. MARGIN BORROWINGS

ARI has margin arrangements with various financial institutions and brokerage firms which provide for borrowing of up to 50% of the market value of marketable equity securities. The borrowings under such margin arrangements are secured by equity securities of IORI and TCI and ARI's trading portfolio securities and bear interest rates ranging from 5.75% to 24.0%. Margin borrowing totaled \$27.1 million at March 31, 2002.

In April 2000, ARI obtained a security loan in the amount of \$5.0 million from a financial institution. ARI received net cash of \$4.6 million after paying various closing costs. The loan bears interest at 1% over the prime rate, currently 5.75% per annum, requires monthly payments of interest and matures in September 2002. The loan is secured by 1,050,000 shares of ARI Common Stock held by BCM, ARI's advisor.

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

In September 2001, ARI obtained a security loan in the amount of \$20.0 million from a financial institution. ARI received net cash of \$16.1 million after the payment of various closing costs and \$3.4 million

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

NOTE 8. MARGIN BORROWINGS (Continued)

repayment of principal and accrued interest on an existing loan with the same lender. Of the total loan amount, \$19.5 million bears interest at 24% per annum, while the remaining \$500,000 bears interest at 20% per annum. The loan requires monthly payments of interest only and matures in September 2002. The loan is secured by 2,602,608 shares of TCI common stock held by ARI and 920,507 shares of TCI common stock held by BCM, ARI's advisor.

In October 2001, ARI obtained a security loan in the amount of \$1.0 million from a financial institution. ARI received net cash of \$1.0 million after payment of various closing costs. The loan bears interest at 1% over the prime rate, currently 5.75% per annum, requires monthly payments of interest only and matures in October 2003. The loan is callable upon 60 days prior notice, and is

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secured by 200,000 shares of ARI Common Stock held by BCM, ARI's advisor.

NOTE 9. INCOME TAXES

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. ARI had no taxable income or provision for income taxes in the three months ended March 31, 2002 or 2001.

NOTE 10. OPERATING SEGMENTS

Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their net operating income and cash flow. Items of income that are not reflected in the segments are equity in (loss) of investees, equity in gain on sale of real estate by equity investees, loss on sale of investments in equity investees and other income which totaled \$(228,000) for the three months ended March 31, 2002 and \$28,000 for 2001. Expenses that are not reflected in the segments are general and administrative expenses, minority interest, incentive fees, advisory fees and net income fees which totaled \$6.4 million for the three months ended March 31, 2002 and \$7.3 million for 2001. Excluded from operating segment assets are assets of \$116.3 million in 2002 and \$96.2 million in 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses, and ARI conducted all of its business within the United States, with the exception of Hotel Sofia, which is located in Bulgaria.

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

NOTE 10. OPERATING SEGMENTS (Continued)

Presented below are ARI's reportable segments operating income for the three months ended March 31, and segment assets at March 31.

2002	Commercial Properties	Apartments	U.S. Hotels	International Hotels	Land	P Pa
-----	-----	-----	-----	-----	-----	-----
Operating revenue	\$ 10,419	\$ 10,349	\$ 6,558	\$ 1,003	\$ 62	\$
Interest income	--	--	--	--	--	--
Operating expenses	5,458	5,893	5,229	575	2,374	--
Operating income (loss)	\$ 4,961	\$ 4,456	\$ 1,329	\$ 428	\$ (2,312)	\$
	=====	=====	=====	=====	=====	=====
Depreciation	\$ 1,568	\$ 885	\$ 523	\$ 264	\$ --	\$
Interest	4,738	2,957	1,131	30	6,168	--
Capital expenditures	1,289	212	161	--	393	--
Assets	172,354	95,231	67,299	22,696	212,626	--

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Property Sales:	Commercial Properties	Apartments	Land
	-----	-----	-----
Sales price	\$ 2,302	\$ 11,957	\$ 5,580
Cost of sale	2,302	6,342	3,381
	-----	-----	-----
Gain on sale	\$ --	\$ 5,615	\$ 2,199 / (1)
	=====	=====	=====

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

2001	Commercial Properties	Apartments	U.S. Hotels	International Hotels	Land	P Pa
	-----	-----	-----	-----	-----	-----
Operating revenue	\$ 9,022	\$ 15,169	\$ 7,001	\$ 694	\$ 63	\$
Interest income	--	--	--	--	--	--
Operating expenses	5,129	9,353	6,050	534	1,919	--
	-----	-----	-----	-----	-----	-----
Operating income (loss)	\$ 3,893	\$ 5,816	\$ 951	\$ 160	\$ (1,856)	\$
	=====	=====	=====	=====	=====	=====
Depreciation	\$ 1,772	\$ 1,262	\$ 629	\$ --	\$ --	\$
Interest	4,417	4,927	1,267	97	5,290	--
Capital expenditures	2,218	--	152	1,000	65	--
Assets	161,996	141,926	69,016	29,190	245,644	--

Property Sales:	Commercial Properties	Apartments	Land
	-----	-----	-----
Sales price	\$ 7,350	\$ 18,680	\$ 20,490
Cost of sale	5,058	4,546	16,701
	-----	-----	-----
Gain on sale	\$ 2,292	\$ 14,134	\$ 3,789
	=====	=====	=====

NOTE 11. DISCONTINUED OPERATIONS

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

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

NOTE 11. DISCONTINUED OPERATIONS (Continued)

For the three months ended March 31, 2002 and 2001, income from discontinued operations relates to three properties that ARI sold during the first three months of 2002. The following table summarizes revenue and expense information for these properties sold and held-for-sale.

	For the Three Months Ended March 31,	
	2002	2001
Revenue		
Rental	\$ 718	\$ 1,068
Property operations	279	490
	-----	-----
	439	578
Expenses		
Interest	440	328
Depreciation	56	86
	-----	-----
	496	414
	-----	-----
Net income (loss) from discontinued operations	(57)	164
Gain of sale of real estate	5,615	--
Equity in gain on sale of real estate by equity investees	4,131	--
	-----	-----
Net income from discontinued operations	\$ 9,689	\$ 164
	=====	=====

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

NOTE 12. COMMITMENTS AND CONTINGENCIES

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

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

Litigation. ART is involved in various lawsuits arising in the ordinary course of business. In the opinion of ARI's management, the outcome of these lawsuits will not have a material impact on ARI's financial condition, results of

operations or liquidity.

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

Introduction

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

On October 23, 2001, ARI, TCI, and IORI jointly announced a preliminary agreement with the plaintiff's legal counsel of the derivative action entitled Olive et al. V. National Income Realty Trust, et al. for complete settlement of all disputes in the lawsuit. In February 2002, the court granted final approval of the proposed settlement. Under the proposal, ARI will acquire all of the outstanding common shares of IORI and TCI not currently owned by ARI for a cash payment or shares of ARI preferred stock. ARI will pay \$17.50 cash per TCI share and \$19.00 cash per IORI share for the stock held by non-affiliated stockholders. ARI will issue one share of Series G Preferred Stock with a liquidation value of \$20.00 per share for each share of TCI Common Stock for stockholders who affirmatively elect to receive ARI Preferred Stock in lieu of cash. ARI will issue one share of Series H Preferred Stock with a liquidation value of \$21.50 per share for each share of IORI Common Stock for stockholders who affirmatively elect to receive ARI Preferred Stock in lieu of cash. All affiliated stockholders will receive ARI Preferred Stock. Each share of Series G Preferred Stock will be convertible into 2.5 shares of ARI Common Stock, and each share of Series H Preferred Stock will be convertible into 2.25 shares of ARI Common Stock during a 75-day period that commences fifteen days after the date of the first ARI Form 10-Q filing that occurs after the closing of the merger transaction. Upon the acquisition of IORI and TCI shares, TCI and IORI would become wholly-owned subsidiaries of ARI. The transaction is subject to the negotiation of a definitive merger agreement and a vote of the shareholders of all three entities. ARI has the same advisor as TCI and IORI, and TCI and IORI have the same board of directors.

Liquidity and Capital Resources

General. Cash and cash equivalents at March 31, 2002, totaled \$903,000, compared with \$709,000 at December 31, 2001. Although ARI anticipates that during the remainder of 2002 it will generate excess cash from operations, as discussed below, such excess cash is not sufficient to discharge all of ARI's debt obligations as they mature. ARI will therefore again rely on externally generated funds, including aggressive land sales, selected sales of income producing properties, borrowings against its investments in various real estate entities, refinancing of properties, and, to the extent necessary, borrowings to meet its debt service obligations, pay taxes, interest and other non-property related expenses.

At December 31, 2001, notes payable totaling \$267.5 million had either scheduled maturities or required principal reduction payments during 2002. During the first quarter of 2002, ARI either extended,

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

Liquidity and Capital Resources (Continued)

refinanced, paid down, paid off or received commitments from lenders to extend or refinance \$28.5 million of the debt scheduled to mature in 2002.

Net cash used in operating activities decreased to \$11.6 million in the three months ended March 31, 2002, from \$15.9 million in the three months ended March 31, 2001. Fluctuations in the components of cash flow from operations are discussed in the following paragraphs.

Net cash from property operations (rents collected less payments for expenses applicable to rental income) increased to \$7.4 million in the three months ended March 31, 2002 from \$3.9 million in 2001. The increase is primarily attributable to a decline in the payments for operating expenses in 2002 from an elevated level in 2001, when there was a significant paydown of accounts payable. ARI expects a decrease in cash flow from property operations during the remainder of 2002. Such decrease is expected to result from the continued selective sale of income producing properties.

Net cash from pizza operations (sales less cost of sales) decreased to \$1.0 million in the three months ended March 31, 2002, from \$1.5 million in the three months ended March 31, 2001. The decrease is primarily attributable to a decrease in accounts payable and an increase in accounts receivable in 2002.

Interest collected increased to \$666,000 in the three months ended March 31, 2002, from \$231,000 in 2001. The increase was attributable to the collection of \$531,000 in past due interest.

Interest paid decreased to \$15.2 million in the three months ended March 31, 2002, from \$16.0 million in 2001. The decrease is attributable to the paydown and payoff of mortgages on properties sold in 2001.

Advisory fees paid of \$1.7 million in the three months ended March 31, 2002, approximated the \$1.8 million in 2001.

General and administrative expenses paid increased to \$3.3 million in the three months ended March 31, 2002 from \$2.4 million in 2001. The increase is primarily attributable to an increase in legal fees.

ARI's cash flow from its investments in IORI and TCI is dependent on the ability of each of the entities to make distributions. In the fourth quarter of 2000, IORI and TCI suspended distributions. Accordingly, ARI received no distributions in the first quarter of 2002 and 2001.

Other cash from operating activities improved to \$398,000 in the three months ended March 31, 2002, from a use of \$881,000 in 2001. The improvement was primarily attributable to a decrease in property prepaids.

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

Liquidity and Capital Resources (Continued)

In the first quarter of 2002, ARI received a total \$3.7 million on the collection of one mortgage note receivable and partial paydown of two mortgage

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notes receivable.

In 2002, ARI purchased the following property:

Property -----	Location -----	Sq.Ft./Acres -----	Purchase Price -----	Net Cash Paid -----	Debt Incurred -----
First Quarter					
Shopping Center Plaza on Bachman Creek/(1)/	Dallas, TX	80,278 Sq.Ft.	\$3,103	\$ --	\$ --
Second Quarter					
Land Willow Springs	Beaumont, CA	20.7 Acres	140	152	--

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

In 2002, ARI sold the following properties:

Property -----	Location -----	Units/ Acres/Sq.Ft. -----	Sales Price -----	Net Cash Received -----	D Disc -----
First Quarter					
Apartments Mallard Lake/(1)/ Villas	Greensboro, NC Plano, TX	336 Units 208 Units	\$ 14,400 8,525	\$ -- 3,701	\$ 7 4
Land					
Katrina Lakeshore Villas/(2//) Rasor(2) Thompson II Vista Ridge	Palm Desert, CA Harris County, TX Plano, TX Dallas County, TX Lewisville, TX	2.1 Acres 16.9 Acres 24.5 Acres .2 Acres 10.0 Acres	\$ 1,323 1,499 1,211 21 1,525	\$ (40) 215 174 20 130	\$ 1 1
Shopping Center Oaktree Village/(2)//	Lubbock, TX	45,623 Sq.Ft.	2,302	131	1
Second Quarter					
Land Mason Goodrich	Houston, TX	7.9 Acres	672	46	

(1) Exchanged for Governor's Square, Grand Lagoon, Park Avenue, Greenbriar, Regency and Westwood Apartments.

(2) Exchanged with TCI, a related party, for the Plaza on Bachman Creek Shopping Center.

(3) Debt assumed by purchaser.

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

Liquidity and Capital Resources (Continued)

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

Property -----	Location -----	Units/ Acres/Sq.Ft. -----	Debt Incurred -----	Debt Discharged -----	Net Ca Receiv -----
First Quarter					
Office Building					
Rosedale Towers	Minneapolis, MN	84,798 Sq.Ft.	\$ 5,109	\$ --	\$ 5,109
Two Hickory Centre	Farmers Branch, TX	96,127 Sq.Ft.	4,448	--	4,448
Land					
Walker	Dallas County, TX	90.6 Acres	8,500	8,500	(1,400)
Shopping Center					
Plaza on Bachman Creek	Dallas, TX	80,278 Sq.Ft.	5,000	--	4,448
Second Quarter					
Apartments					
Confederate Point	Jacksonville, FL	206 Units	1,929	--	1,929
Foxwood	Memphis, TN	220 Units	1,093	--	1,093
Woodsong	Smyrna, GA	190 Units	2,544	--	2,544
Office Building					
One Hickory Centre	Farmers Branch, TX	102,615 Sq.Ft.	4,468	--	4,468

- (1) In January 2002, IORI, a related party, purchased 100% of the outstanding common shares of Rosedale Corporation ("Rosedale"), a wholly-owned subsidiary of ARI, for \$5.1 million. Rosedale owns the Rosedale Towers Office Building. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay IORI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, IORI may require ARI to repurchase the shares of Rosedale for the purchase price. Management has classified this related party transaction as a note payable to IORI.
- (2) In January 2002, TCI, a related party, purchased 100% of the common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, for \$4.4 million. Two Hickory owns the Two Hickory Centre Office Building. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the shares of

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Two Hickory for the purchase price. Management has classified this related party transaction as a note payable to TCI.

- (3) Variable interest rate.

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

Liquidity and Capital Resources (Continued)

- (4) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Confederate Point, L.P. ("Confederate Point") from ARI for \$1.9 million. Confederate Point owns the Confederate Point Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Confederate Point for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (5) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Foxwood, L.P. ("Foxwood") from ARI for \$1.1 million. Foxwood owns the Foxwood Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Foxwood for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (6) In April 2002, TCI, a related party, purchased all of the general and limited partnership interests in Garden Woodsong, L.P. ("Woodsong") from ARI for \$2.5 million. Woodsong owns the Woodsong Apartments. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the interests in Woodsong for the purchase price. Management has classified this related party transaction as a note payable to TCI.
- (7) In April 2002, TCI, a related party, purchased 100% of the common shares of ART One Hickory Corporation ("One Hickory"), a wholly-owned subsidiary of ARI, for \$4.5 million. One Hickory owns the One Hickory Centre Office Building. ARI has guaranteed that the asset will produce at least a 12% annual return on the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% return, ARI will pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year, TCI may require ARI to repurchase the shares in One Hickory for the purchase price. Management has classified this related party transaction as a note payable to TCI.

In April 2002, ARI sold nine residential properties to partnerships controlled by Metra Capital, LLC ("Metra"), for a total sales price of

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

Liquidity and Capital Resources (Continued)

\$34.2 million. These properties include: the 12 unit Bay Anchor Apartments in Panama City, Florida; the 168 unit Governor Square Apartments in Tallahassee, Florida; the 54 unit Grand Lagoon Cove Apartments in Panama City, Florida; the 92 unit Oak Hill Apartments in Tallahassee, Florida; the 121 unit Park Avenue Villas Apartments in Tallahassee, Florida; the 62 unit Seville Apartments in Tallahassee, Florida; the 120 unit Westwood Apartments in Mary Ester, Florida; the 64 unit Windsor Tower Apartments in Ocala, Florida and the 546 unit Woodhollow Apartments in San Antonio, Texas. Innovo Group, Inc. ("Innovo"), is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a Director of ARI, controls approximately 11.67% of the outstanding common stock of Innovo. Management has determined to treat this sale as a refinancing transaction. ARI will continue to report the assets and the new debt incurred by Metra on its financial statements. ARI received net cash of \$8.3 million after paying off the existing debt of \$19.3 million and various closing costs, including \$342,000 in brokerage commissions to Third Millennium Partners, LLC. Of the total new debt of \$29.2 million, \$8.8 million bears interest at 5.00% per annum and matures in May 2003, \$17.0 million bears interest at 7.12% per annum and matures in May 2007 and \$3.4 million bears interest at 7.57% per annum and matures in May 2012. ARI also received \$6.3 million of 8% non-recourse, non-convertible Series A Preferred Stock ("Preferred Shares") of Innovo.

The dividend on the Preferred Shares will be funded entirely and solely through member distributions from cash flows generated by the operation and subsequent sale of the sold properties. In the event the cash flows for the properties are insufficient to cover the 8% annual dividend, Innovo will have no obligation to cover any shortfall.

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

ARI has margin arrangements with various financial institutions and brokerage firms which provide for borrowing up to 50% of the market value of ARI's marketable equity securities. The borrowings under such margin arrangements are secured by equity securities of IORI and TCI and ARI's trading portfolio and bear interest rates ranging from 5.75% to 24.0%. Margin borrowing totaled \$27.1 million at March 31, 2002.

Management expects that it will be necessary for ARI to sell \$102.0 million, \$34.1 million and \$1.2 million of its land holdings during each of the next three years to satisfy the debt on such land as it matures. If ARI is unable to sell at least the minimum amount of land to satisfy the debt obligations on such land as it matures, or, if it was not able to extend such debt, ARI would either sell other of its assets to pay such debt or transfer the property to the lender.

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

Liquidity and Capital Resources (Continued)

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

Commitments and Contingencies

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

Results of Operations

For the three months ended March 31, 2002, ARI reported net loss of \$8.9 million, compared to net income of \$2.4 million for the three months ended March 31, 2001. The primary factors contributing to ARI's net income are discussed in the following paragraphs.

Rents decreased to \$28.6 million in the three months ended March 31, 2002, from \$32.1 million in 2001. Rents from commercial properties increased to \$10.4 million for the three months ended March 31, 2002, from \$9.0 million in 2001, rent from hotels of \$7.6 million in the three months ended March 31, 2002, approximated the \$7.7 million in 2001 and rents from apartments decreased to \$10.3 million in the three months ended March 31, 2002, from \$15.1 million in 2001. The increase in commercial property rents was primarily attributable to increased occupancy and the decrease in apartment rent was due to the sale of 17 apartments in 2001. Rental income is expected to decrease significantly in the remainder of 2002 as a result of the income producing properties sold in 2001 and 2002.

Property operations expense decreased to \$19.6 million in the three months ended March 31, 2002, from \$23.0 million in 2001. Property operations expense for commercial properties of \$5.5 million in the

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

Results of Operations (Continued)

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three months ended March 31, 2002, approximated the \$5.1 million in 2001. For hotels, property operations expense decreased to \$5.8 million in the three months ended March 31, 2002, from \$6.6 million in 2001. For land, property operations expense increased to \$2.4 million in the three months ended March 31, 2002 from \$1.9 million in 2001. For apartments, property operations expense decreased to \$5.9 million in the three months ended March 31, 2002, from \$9.4 million in 2001. The decrease in hotel operations expense was primarily attributable to reduced utility, personnel and administrative costs. The increase in land operations expense was primarily attributable to increased real estate taxes. The decrease in apartment operations expense was primarily attributable to the sale of 17 apartments in 2001.

Pizza parlor sales and cost of sales increased to \$8.5 million and \$7.0 million, respectively, in the three months ended March 31, 2002 from \$7.8 million and \$6.4 million in 2001. The increase was primarily attributable to the opening of three new stores in 2001, plus an 8.75% increase in same-store sales volume.

Interest income from notes receivable increased to \$612,000 in the three months ended March 31, 2002 from \$384,000 in 2001, due to the funding of \$21.9 million of mortgage notes receivable in 2001.

Equity in loss of investees decreased to \$(4.0) million in the three months ended March 31, 2002 from \$(1.4) million in 2001. The decrease was primarily attributable to increased net losses for IORI and TCI.

Loss on sale of investments in equity investees was \$531,000 for the three months ended March 31, 2002. See NOTE 5. "INVESTMENTS IN EQUITY INVESTEES."

Equity in gain on sale of real estate by equity investees increased to \$4.1 million in the three months ended March 31, 2002 from \$1.4 million in 2001. The 2001 results are reported as a component of net income (loss) from continuing operations, while the 2002 results are reported as a component of net income from discontinued operations.

Interest expense increased to \$18.4 million in the three months ended March 31, 2002 from \$17.7 million in 2001. The increase was primarily attributable to higher balances payable on stock loans, at higher interest rates.

Depreciation and amortization expense decreased to \$3.5 million in the three months ended March 31, 2002 from \$4.0 million in 2001. The decrease is due to the sale of 17 apartments and one commercial property in 2001.

Advisory fees of \$1.7 million in the three months ended March 31, 2002 approximated the \$1.8 million in 2001.

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

Results of Operations (Continued)

There was no incentive fee to affiliate in the three months ended March 31, 2002 compared to \$1.5 million in 2001. The incentive fee is due only if ARI is also subject to the net income fee. At March 2002, the net income fee requirements are not met; therefore, no incentive fee is due. This fee represents 10% of the excess of net capital gains over net capital losses from sales of operating properties. The amount of this fee for the remainder of 2002 will be dependent on the number of operating properties sold, the net capital gains realized and

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whether the net income fee is due.

General and administrative expenses increased to \$3.3 million in the three months ended March 31, 2002 compared to \$2.4 million in 2001. The increase is primarily attributable to increased legal fees.

Minority interest decreased to \$787,000 in the three months ended March 31, 2002 from \$1.6 million in 2001. The decrease is attributable to the repurchase of partnership units by ARI in 2001.

Environmental Matters

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

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

Inflation

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

At March 31, 2002, ARI's exposure to a change in interest rates on its debt is as follows:

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
	-----	-----	-----
Notes payable:			
Variable rate	\$ 130,934	11.224%	\$ 1,309
	=====		=====
Total decrease in ARI's annual net income			\$ 1,309
			=====
Per share			\$.12
			=====

PART II. OTHER INFORMATION

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

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

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

A Current Report on Form 8-K, dated April 26, 2002, was filed with respect to Item 5. "Other Events," which reports the proposal to explore a business combination with Prime Group Realty Trust.

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SIGNATURE PAGE

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

AMERICAN REALTY INVESTORS, INC.

Date: March 4, 2003

By: /s/ Ronald E. Kimbrough

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

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CERTIFICATION

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

1. I have reviewed this quarterly report on Form 10-Q/A/2 of ARI;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial

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information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. I am responsible for establishing and maintaining internal controls and procedures and have:
 - a. designed such internal controls to insure that material information relating to ARI and its consolidated subsidiaries is made known to me by others within those entities, particularly for the periods presented in this quarterly report;
 - b. evaluated the effectiveness of ARI's internal controls as of a date within 90 days prior to the filing date of this quarterly report; and
 - c. presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on a date within 90 days prior to the filing date of this quarterly report;
5. I have disclosed to ARI's auditors and Audit Committee of the Board of Directors (or persons fulfilling the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect ARI's ability to record, process, summarize, and report financial data and have identified for ARI's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in ARI's internal controls; and

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

Date: March 4, 2003

/s/ Ronald E. Kimbrough

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

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AMERICAN REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q/A/2

For the Quarter ended March 31, 2002

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