AMREIT
Form 10-Q
August 10, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2006

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

For the transition period from __________ to __________

Commission File Number: 0-28378

AmREIT

(Name of registrant as specified its charter)

TEXAS	**76-0410050**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
8 GREENWAY PLAZA, SUITE 1000 HOUSTON, TX	**77046**
(Address of Principal Executive Offices)	(Zip Code)

713-850-1400

(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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer þ

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

As of August 7, 2006 there were 6,305,385 class A, 2,091,636 class B, 4,151,948 class C and 11,138,276 class D common shares of beneficial interest of AmREIT, $.01 par value outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AmREIT AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
June 30, 2006 and December 31, 2005
(in thousands, except share data)

	June 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Real estate investments at cost:		
Land	$ 122,055	$ 112,784
Buildings	140,000	127,094
Tenant improvements	8,601	7,366
	270,656	247,244
Less accumulated depreciation and amortization	(8,148)	(5,943)
	262,508	241,301
Real estate held for sale, net		3,569
Net investment in direct financing leases held for investment	19,208	19,212
Intangible lease cost, net	17,644	17,761
Investment in merchant development funds and other affiliates	2,383	2,311
Net real estate investments	301,743	284,154
Cash and cash equivalents	3,140	5,915
Tenant receivables	3,532	3,132
Accounts receivable, net	1,582	1,807
Accounts receivable related party	1,903	4,158
Notes receivable related party	13,762	11,232
Deferred costs	1,916	1,487
Other assets	3,068	3,086
TOTAL ASSETS	$ 330,646	$ 314,971
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes payable	$ 136,741	$ 114,687
Accounts payable and other liabilities	5,973	8,232
Below market leases, net	4,251	2,940
Security deposits	667	651
TOTAL LIABILITIES	147,632	126,510

Minority interest	1,147	1,176
Shareholders equity:		
Preferred shares, $.01 par value, 10,000,000 shares authorized, none issued		
Class A Common shares, $.01 par value, 50,000,000 shares authorized, 6,528,411 and 6,479,278 shares issued, respectively	65	65
Class B Common shares, $.01 par value, 3,000,000 shares authorized, 2,099,516 and 2,148,649 shares issued, respectively	21	22
Class C Common shares, $.01 par value, 4,400,000 shares authorized, 4,161,562 and 4,119,923 shares issued, respectively	42	41
Class D Common shares, $.01 par value, 17,000,000 shares authorized, 11,103,118 and 11,035,482 shares issued, respectively	111	110
Capital in excess of par value	204,977	204,331
Accumulated distributions in excess of earnings	(21,787)	(16,736)
Cost of treasury shares, 214,572 and 77,741 Class A shares, respectively	(1,562)	(548)
TOTAL SHAREHOLDERS EQUITY	181,867	187,285
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 330,646	$ 314,971

See Notes to Consolidated Financial Statements.

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AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Quarter ended June 30, 2006	Quarter ended June 30, 2005	Year to date June 30, 2006	Year to date June 30, 2005
Revenues:				
Rental income from operating leases	$ 7,487	$ 4,482	$ 13,460	$ 8,393
Earned income from direct financing leases	508	508	1,015	1,015
Real estate fee income		58	751	294
Real estate fee income related party	910	957	1,677	1,715
Construction revenues	319	124	940	124
Construction revenues related party	2,623	341	3,796	341
Securities commission income related party	1,227	271	2,618	271
Asset management fee income related party	186	120	344	237
Total revenues	13,260	6,861	24,601	12,390
Expenses:				
General and administrative	2,250	1,346	4,128	2,505
Property expense	2,162	937	3,185	1,630
Construction costs	2,609	302	4,284	302
Legal and professional	278	461	576	891
Real estate commissions		13	540	166
Securities commissions	1,082	236	2,339	236
Depreciation and amortization	2,391	1,324	4,573	2,360
Total expenses	10,772	4,619	19,625	8,090
Operating income	2,488	2,242	4,976	4,300
Other income (expense):				
Interest and other income	232	107	467	156
Income from merchant development funds and other affiliates	208	82	306	113
Federal income tax (expense) benefit for taxable REIT subsidiary	180	(147)	263	(157)
Interest expense	(2,090)	(1,480)	(3,833)	(2,975)
Minority interest in income of consolidated joint ventures	(38)	(34)	(80)	(73)
Income before discontinued operations	980	770	2,099	1,364
Income from discontinued operations	266	96	234	859
Gain on sales of real estate acquired for resale	7	871	12	872

Income from discontinued operations	273	967	246	1,731
Net income	1,253	1,737	2,345	3,095
Distributions paid to class B, C and D shareholders	(2,914)	(2,047)	(5,820)	(3,679)
Net loss available to class A shareholders	$ (1,661)	$ (310)	$ (3,475)	$ (584)
Net (loss) income per class A common share basic and diluted				
Loss before discontinued operations	$ (0.30)	$ (0.29)	$ (0.59)	$ (0.59)
Income from discontinued operations	0.04	0.22	0.04	0.44
Net loss	$ (0.26)	$ (0.07)	$ (0.55)	$ (0.15)
Weighted average class A common shares used to compute net (loss) income per share, basic and diluted	6,348	4,435	6,339	3,956

See Notes to Consolidated Financial Statements.

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AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
For the six months ended June 30, 2006
(in thousands, except share data)
(unaudited)

	Common Shares Amount	Capital in excess of par value	Accumulated distributions in excess of earnings	Cost of treasury shares	Total
Balance at December 31, 2005	$ 238	$ 204,331	$ (16,736)	$ (548)	$ 187,285
Net income			2,345		2,345
Deferred compensation issuance of restricted shares, Class A		(571)		721	150
Repurchase of common shares, Class A		9		(1,735)	(1,726)
Amortization of deferred compensation		279			279
Issuance of common shares, Class C	1	885			886
Retirement of common shares, Class C		(473)			(473)
Issuance of common shares, Class D		2,255			2,255
Retirement of common shares, Class D		(1,738)			(1,738)
Distributions			(7,396)		(7,396)
Balance at June 30, 2006	$ 239	$ 204,977	$ (21,787)	$ (1,562)	$ 181,867

See Notes to Consolidated Financial Statements.

AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, except share data)
(unaudited)

	Year to date ended June 30, 2006	2005
Cash flows from operating activities:		
Net income	$ 2,345	$ 3,095
Adjustments to reconcile net income to net cash provided by operating activities:		
Investment in real estate acquired for resale	(623)	(2,527)
Proceeds from sales of real estate acquired for resale	1,153	3,201
Gain on sales of real estate acquired for resale	(12)	(872)
Gain on sales of real estate acquired for investment	(286)	(595)
Income from merchant development funds and other affiliates	(306)	(113)
Depreciation and amortization	4,463	2,281
Amortization of deferred compensation	279	308
Minority interest in income of consolidated joint ventures	20	438
Increase in tenant receivables	(400)	(598)
Decrease (increase) in accounts receivable	225	(439)
Decrease (increase) in accounts receivable related party	2,255	(478)
Cash receipts from direct financing leases more than income recognized	4	3
Increase in deferred costs	(199)	(287)
Increase in other assets	105	(622)
Decrease in accounts payable and other liabilities	(2,168)	(851)
Increase in security deposits	21	199
Net cash provided by operating activities	6,876	2,143
Cash flows from investing activities:		
Improvements to real estate	(1,523)	(158)
Acquisition of investment properties	(23,967)	(68,952)
Loans to affiliates	(8,415)	(1,190)
Payments from affiliates	5,885	
Additions to furniture, fixtures and equipment	(96)	(132)
Investment in merchant development funds and other affiliates		(929)
Distributions from merchant development funds and other affiliates	93	241
Proceeds from sale of investment property	4,466	2,194
Increase in preacquisition costs	(20)	(6)
Net cash used in investing activities	(23,577)	(68,932)
Cash flows from financing activities:		
Proceeds from notes payable	52,354	52,386
Payments of notes payable	(30,186)	(41,942)
Purchase of treasury shares	(1,726)	(138)
Issuance of common shares		73,726

Retirement of common shares	(2,211)	(859)
Issuance costs	(43)	(7,538)
Common dividends paid	(4,213)	(2,834)
Distributions to minority interests	(49)	(278)
Net cash provided by financing activities	13,926	72,523
Net increase (decrease) in cash and cash equivalents	(2,775)	5,734
Cash and cash equivalents, beginning of period	5,915	2,960
Cash and cash equivalents, end of period	$ 3,140	$ 8,694
Supplemental schedule of cash flow information:		
Cash paid during the year for:		
Interest	$ 3,815	$ 2,944
Income taxes	909	655

Supplemental schedule of noncash investing and financing activities

During 2006 and 2005, the Company converted 49 thousand and 62 thousand B shares to A shares, respectively. Additionally, during 2006 and 2005, the Company issued Class C & D shares with a value of $3.2 million and $1.8 million, respectively, in satisfaction of dividends through the dividend reinvestment program.

In 2006, the Company issued 89 thousand restricted shares to employees and trust managers as part of their compensation arrangements. The restricted shares vest over a four and three year period respectively. The Company recorded $571 thousand in deferred compensation related to the issuance of the restricted shares.

In 2005, the Company issued 151 thousand restricted shares to employees and trust managers as part of their compensation arrangements. The restricted shares vest over a four and three year period respectively. The Company recorded $1.2 million in deferred compensation related to the issuance of the restricted shares.

See Notes to Consolidated Financial Statements.

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AmREIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006

1. DESCRIPTION OF BUSINESS AND NATURE OF OPERATIONS

AmREIT, a Texas real estate investment trust, is a real estate company with three distinct businesses: a real estate development and operating business, an asset advisory business and a portfolio of Irreplaceable Corners . As a real estate development and operating company, AmREIT constructs, develops, acquires, disposes of, brokers, leases and manages properties for its own portfolio as well as for its asset advisory group and third parties. As of June 30, 2006, we had over 1.0 million square feet of shopping centers in various stages of development or in the pipeline for our advisory business or for third parties. Our asset advisory business raises private capital for and generates fees from our merchant development partnership funds. Our portfolio of Irreplaceable Corners provides a steady flow of rental income and it primarily consists of retail properties located in high-traffic, highly populated areas which are held for long-term value. Since listing on the AMEX in July 2002, our total assets have grown from a book value of $48 million to $331 million, and within our asset advisory business, we manage an additional $149 million in assets. Equity within our asset advisory business has grown from $15 million to $85 million over the same period.

AmREIT s direct predecessor, American Asset Advisers Trust, Inc., (AAA) was formed as a Maryland corporation in 1993. Prior to 1998, AAA was externally advised by American Asset Advisors Corp. which was formed in 1985. In June 1998, AAA merged with its advisor and changed its name to AmREIT, Inc. In December 2002, AmREIT, Inc. reorganized as a Texas real estate investment trust and became AmREIT.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

Our financial records are maintained on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when incurred. The consolidated financial statements include the accounts of AmREIT and its wholly or majority owned subsidiaries in which we have a controlling financial interest. Investments in joint ventures and partnerships where we have the ability to exercise significant influence, but do not exercise control, are accounted for using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

REVENUE RECOGNITION

We lease space to tenants under agreements with varying terms. The majority of the leases are accounted for as operating leases with revenue being recognized on a straight-line basis over the terms of the individual leases. Accrued rents are included in tenant receivables. Revenue from tenant reimbursements of taxes, maintenance expenses and insurance is recognized in the period the related expense is recorded. Additionally, certain of the lease agreements contain provisions that grant additional rents based on tenants sales volumes (contingent or percentage rent). Percentage rents are recognized when the tenants achieve the specified targets as defined in their lease agreements. We recognize lease termination fees in the period that the lease is terminated and collection of the fees is reasonably assured. During the six months ended June 30, 2006 and 2005, we recognized lease termination fees of $601 thousand and $0, respectively. The terms of certain leases require that the building/improvement portion of the lease be accounted for under the direct financing method which treats the building as if we had sold it to the lessee and entered into a long-term financing arrangement with such lessee. This accounting method is appropriate when the lessee has all of the benefits and risks of property ownership that they otherwise would if they owned the building versus leasing it from us.

We have been engaged to provide various real estate services, including development, construction, construction management, property management, leasing and brokerage. The fees for these services are recognized as services are provided and are generally calculated as a percentage of revenues earned or to be earned or of property cost, as appropriate. Revenues from fixed-price construction contracts are recognized on the percentage-of-completion method, measured by the physical completion of the structure. Revenues from cost-plus-percentage-fee contracts are recognized on the basis of costs incurred during the period plus the percentage fee earned on those costs. Construction management contracts are recognized only to the extent of the fee revenue.

Construction contract costs include all direct material and labor costs and any indirect costs related to contract performance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from any contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Any profit incentives are included in revenues when their realization is reasonably assured. An amount equal to contract costs attributable to any claims is included in revenues when realization is probable and the amount can be reliably estimated.

Unbilled construction receivables represent reimbursable costs and amounts earned under contracts in progress as of the date of our balance sheet. Such amounts become billable according to contract terms, which usually consider the passage of time, achievement of certain milestones or completion of the project. Advance billings represent billings to or collections from clients on contracts in advance of revenues earned thereon. Unbilled construction receivables are generally billed and collected within the twelve months following the date of our balance sheet, and advance billings are generally earned within the twelve months following the date of our balance sheet. As of June 30, 2006, $244,000 of unbilled receivables has been included in Accounts receivable and $263,000 of unbilled receivables due from related parties has been included in Accounts receivable related party . At December 31, 2005, $700,000 of unbilled receivables has been included in Accounts receivable and $2.3 million of unbilled receivables due from related parties has been included in Accounts receivable related party . We had advance billings of $262,000 and $0 as of June 30, 2006 and December 31, 2005, respectively.

Securities commission income is recognized as units of our merchant development funds are sold through our wholly-owned subsidiary, AmREIT Securities Company (ASC). Securities commission income is earned as the services are performed and pursuant to the corresponding prospectus or private offering memorandum. Generally, it includes a selling commission of between 6.5% and 7.5%, a dealer manager fee of between 2.5% and 3.25% and offering and organizational costs of 1.0% to 1.50%. The selling commission is then paid out to the unaffiliated selling broker dealer and reflected as securities commission expense. During 2005, we began reflecting the revenues and costs generated by our capital-raising activities associated with the sale of class C and D common shares as issuance costs. We have reclassified prior period amounts to conform to this presentation, and these reclassifications had no effect on net income (loss) or shareholder s equity as previously reported. There has been no change in the underlying operations of ASC we will continue to raise capital for AmREIT and affiliated entities as needed and as available on cost-effective terms. ASC s activities for 2006 to date have been limited to capital-raising for our affiliated merchant development funds.

REAL ESTATE INVESTMENTS

Development Properties Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges, acquisition costs and development costs. Carrying charges, primarily interest, real estate taxes and loan acquisition costs, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases at the earlier of one year from the date of completion of major construction or when the property, or any completed portion, becomes available for occupancy. We capitalize acquisition costs once the acquisition of the property becomes probable. Prior to that time, we expense these costs as acquisition expense.

Acquired Properties and Acquired Lease Intangibles We account for real estate acquisitions pursuant to Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS 141). Accordingly, we allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquired out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt. We capitalize acquisition costs once the acquisition of the property becomes probable. Prior to that time, we expense these costs as acquisition expense.

Depreciation Depreciation is computed using the straight-line method over an estimated useful life of up to 50 years for buildings, up to 20 years for site improvements and over the term of lease for tenant improvements. Leasehold estate properties, where we own the building and improvements but not the related ground, are amortized over the life of the lease.

Properties Held for Sale Properties are classified as held for sale if management has decided to market the property for immediate sale in its present condition with the belief that the sale will be completed within one year. Operating properties held for sale are carried at the lower of cost or fair value less cost to sell. Depreciation and amortization are suspended during the held for sale period. At June 30, 2006, we did not have any properties that were classified as real estate held for sale. At December 31, 2005, we owned two

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properties with a combined carrying value of $3.6 million that were classified as real estate held for sale, both of which were disposed of during the quarter ended March 31, 2006.

Our properties generally have operations and cash flows that can be clearly distinguished from the rest of the Company. The operations and gains on sales reported in discontinued operations include those properties that have been sold or are held for sale and for which operations and cash flows have been clearly distinguished. The operations of these properties have been eliminated from ongoing operations, and we will not have continuing involvement after disposition. Prior periods have been restated to reflect the operations of these properties as discontinued operations.

Impairment Management reviews its properties for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. Management determines whether an impairment in value occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the residual value of the property, with the carrying value of the individual property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the asset exceeds its fair value.

RECEIVABLES AND ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

Tenant receivables Included in tenant receivables are base rents, tenant reimbursements and receivables attributable to recording rents on a straight-line basis. An allowance for the uncollectible portion of accrued rents and accounts receivable is determined based upon customer credit-worthiness (including expected recovery of our claim with respect to any tenants in bankruptcy), historical bad debt levels, and current economic trends. As of June 30, 2006 and December 31, 2005, we had an allowance for uncollectible accounts of $84,000 and $163,000, respectively, related to our tenant receivables.

Accounts receivable Included in accounts receivable are amounts due from clients of our construction services business and various other receivables. As of both June 30, 2006 and December 31, 2005, we had an allowance for uncollectible accounts of $264,000 related to our accounts receivable.

Notes receivable related party Included in related party notes receivable are loans made to our affiliated merchant development funds as part of our treasury management function whereby we place excess cash in short-term bridge loans for these affiliates related to the acquisition or development of properties. We typically provide such financing to our affiliates as a way of efficiently deploying our excess cash and earning a higher return than we would in other short term investments or overnight funds. In most cases, the merchant development funds have a construction lender in place, and we simply step in and provide financing on the same terms as the third party lender. In so doing, we are able to access these funds as needed by having our affiliate then draw down on their construction loans. These loans are unsecured, bear interest at the prime rate (8.25% at June 30, 2006) and are due upon demand.

DEFERRED COSTS

Deferred costs include deferred leasing costs and deferred loan costs, net of amortization. Deferred loan costs are incurred in obtaining property financing and are amortized to interest expense over the term of the debt agreements. Deferred leasing costs consist of internal and external commissions associated with leasing our properties and are amortized to expense over the lease term. Accumulated amortization related to deferred loan costs as of June 30, 2006 and December 31, 2005 totaled $337,000 and $268,000, respectively. Accumulated amortization related to leasing costs as of June 30, 2006 and December 31, 2005 totaled $196,000 and $164,000, respectively.

DEFERRED COMPENSATION

Our deferred compensation and long term incentive plan is designed to attract and retain the services of our trust managers and employees that we consider essential to our long-term growth and success. As such, it is designed to provide them with the opportunity to own shares, in the form of restricted shares, in us, and provide key employees the opportunity to participate in the success of our affiliated actively managed merchant development funds through the economic participation in our general partner companies. All long term compensation awards are designed to vest over a period of three to seven years and promote retention of our team.

Restricted Share Issuances Deferred compensation includes grants of restricted shares to our trust managers and employees as a form of long-term compensation. The share grants vest over a period of three to seven years. We determine the fair value of the restricted shares as the number of shares awarded multiplied by the closing price per share of our class A common shares on the grant date. We amortize such fair value ratably over the vesting periods of the respective awards. The following table presents restricted share activity during the six months ended June 30, 2006:

	Non-vested shares	Wtd. avg. grant date fair value
Beginning of period	253,002	$ 7.49
Granted	89,468	7.00
Vested	(32,777)	7.27
Forfeited	(1,306)	7.56
End of period	308,387	7.37

The weighted-average grant date fair value of restricted shares issued during the six months ended June 30, 2006 and 2005 was $7.00 per share and $8.10 per share, respectively. The total fair value of shares vested during the six months ended June 30, 2006 and 2005 was $238 thousand and $237 thousand, respectively. Total compensation cost recognized related to restricted shares during the six months ended June 30, 2006 and 2005 was $279 thousand and $308 thousand, respectively. As of June 30, 2006, total unrecognized compensation cost related to restricted shares was $1.8 million, and the weighted average period over which we expect this cost to be recognized is 4.3 years.

General Partner Profit Participation Interests We have assigned up to 45% of the economic interest in certain of our merchant development funds to certain of our key employees. This economic interest is received, as, if and when we receive economic benefit from our profit participation, after certain preferred returns have been paid to the partnership s limited partners. This assignment of economic interest generally vests over a period of five to seven years. This allows us to align the interest of our employees with the interest of our shareholders. Because the future profits and earnings from the retail limited partnerships cannot be reasonably predicted or estimated, and any employee benefit is contingent upon the benefit received by the general partner of the retail limited partnerships, we recognize expense associated with the assignment of economic interest in our retail limited partnerships as we recognize the

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corresponding income from the associated merchant development funds. No portion of the economic interest in the merchant development funds that have provided profit participation to us to date have been assigned to employees. Therefore, no compensation expense has been recorded to date.

Tax-Deferred Retirement Plan (401k) We maintain a defined contribution 401k retirement plan for our employees. This plan is available for all employees immediately upon employment. The plan allows for contributions to be either invested in an array of large, mid and small cap mutual funds or directly into class A common shares. Employee contributions invested in our stock are limited to 50% of the employee s contributions. We match 50% of the employee s contribution, up to a maximum employee contribution of 4%. None of the employer contribution can be matched in our stock.

Stock Options Additionally, we are authorized to grant options of our class A common stock as either incentive or non-qualified share options, up to an aggregate of 6.0% of the total voting shares outstanding. As of June 30, 2006 and December 31, 2005, none of these options have been granted.

FEDERAL INCOME TAXES

AmREIT has elected to be taxed as a real estate investment trust (REIT) under the Internal Revenue Code of 1986, and is, therefore, not subject to Federal income taxes to the extent of dividends paid, provided it meets all conditions specified by the Internal Revenue Code for retaining its REIT status, including the requirement that at least 90% of its real estate investment trust taxable income be distributed to shareholders.

AmREIT s real estate development and operating business, AmREIT Realty Investment Corporation and subsidiaries (ARIC), is a fully integrated and wholly-owned business consisting of brokers and real estate professionals that provide development, acquisition, brokerage, leasing, construction, asset and property management services to our publicly traded portfolio and merchant development funds as well as to third parties. ARIC and our wholly-owned corporations that serve as the general partners of our merchant development funds are treated for Federal income tax purposes as taxable REIT subsidiaries (collectively, the Taxable REIT Subsidiaries). Federal and state income taxes are accounted for under the asset and liability method.