

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

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

FORM 10-Q/A
AMENDMENT NO. 1

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

Commission File Number 1-9240

TRANSCONTINENTAL REALTY INVESTORS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Nevada

94-6565852

(State or Other Jurisdiction of
Incorporation or Organization)

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

1800 Valley View Lane, Suite 300, Dallas, Texas

75234

(Address of Principal Executive Office)

(Zip Code)

(469) 522-4200

(Registrant's Telephone Number,
Including Area Code)

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

Yes . No .

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock, \$.01 par value

8,042,594

(Class)

(Outstanding at April 26, 2002)

This Form 10-Q/A Amendment No. 1 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 7. "OPERATING SEGMENTS" - page 15, 16

NOTE 8. "DISCONTINUED OPERATIONS" - page 16, 17

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

"Results of Operations" - pages 20 - 22

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 Transcontinental Realty Investors, Inc. ("TCI"), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of TCI's consolidated financial position, consolidated results of operations and consolidated cash flows at the dates and for the periods indicated, have been included.

TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS

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| | March 31, 2002 | December 31, 2001 |
|--|---|----------------------|
| | (dollars in thousands, except per share) | |
| Assets | | |
| Real estate held for investment | \$ 714,706 | \$ 712,832 |
| Less - accumulated depreciation | (95,922) | (90,661) |
| | ----- | ----- |
| | 618,784 | 622,171 |
| Real estate held for sale | 14,831 | 516 |
| Notes and interest receivable | | |
| Performing (including \$6,372 in 2002 and \$1,970 in 2001 from related parties) | 25,549 | 17,620 |
| Nonperforming, nonaccruing | 1,700 | 5,247 |
| | ----- | ----- |
| | 27,249 | 22,867 |
| Less--allowance for estimated losses | (739) | (818) |
| | ----- | ----- |
| | 26,510 | 22,049 |
| Investment in real estate entities | 15,887 | 14,230 |
| Cash and cash equivalents | 4,946 | 10,346 |
| Other assets (including \$14,297 in 2002 and \$14,170 in 2001 from affiliates and related parties) | 39,240 | 39,840 |
| | ----- | ----- |
| | \$ 720,198 | \$ 709,152 |
| | ===== | ===== |

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS - Continued

| | March 31, 2002 | De |
|--|-----------------------------------|-----|
| | (dollars in thou except per sh | |
| Liabilities and Stockholders' Equity | | |
| Liabilities | | |
| Notes and interest payable | \$ 472,486 | \$ |
| Other liabilities (including \$421 in 2002 and \$1,068 in 2001 to affiliates and related parties) | 25,674 | --- |
| | ----- | --- |

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| | |
|---|------------|
| | 498,160 |
| Commitments and contingencies | |
| Minority interest | 6,673 |
| Stockholders' equity | |
| Preferred Stock | |
| Series A; \$.01 par value; authorized, 6,000 shares; issued and outstanding 5,829 shares (liquidation preference \$583) | -- |
| Series C; \$.01 par value; authorized, issued and outstanding 30,000 shares; (liquidation preference \$3,000) | -- |
| Common Stock, \$.01 par value; authorized, 10,000,000 shares; issued and outstanding 8,042,594 shares in 2002 and 2001 | 80 |
| Paid-in capital | 271,761 |
| Accumulated distributions in excess of accumulated earnings | (56,453) |
| Foreign currency translation loss | (23) |
| | ----- |
| | 215,365 |
| | ----- |
| | \$ 720,198 |
| | ===== |

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the Three Months Ended March 31, | |
|---|---|-----------|
| | 2002 | 2001 |
| | (dollars in thousands, except per share) | |
| Property revenue | | |
| Rents (including \$30 from affiliates in 2002 and 2001) | \$ 30,420 | \$ 34,405 |
| Property expense | | |
| Property operations (including \$807 in 2002 and \$643 in 2001 to affiliates and related parties) | 18,695 | 19,854 |
| | ----- | ----- |
| Operating income | 11,725 | 14,551 |
| Other income | | |
| Interest and other (including \$74 in 2002 | | |

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| | | |
|---|------------|---------|
| from related parties) | 1,067 | 638 |
| Equity loss of equity investees | (1,276) | (1,373) |
| Gain on sale of real estate | -- | 6,484 |
| | ----- | ----- |
| | (209) | 5,749 |
| Other expense | | |
| Interest | 9,116 | 11,003 |
| Depreciation | 5,132 | 4,941 |
| Advisory fee to affiliate | 1,415 | 1,502 |
| Net income fee to affiliate | -- | 26 |
| General and administrative (including \$786 in 2002 and \$769 in 2001 to affiliates) | 2,202 | 2,425 |
| Minority interest | (59) | 19 |
| | ----- | ----- |
| | 17,806 | 19,916 |
| | ----- | ----- |
| Net income (loss) from continuing operations | (6,290) | 384 |
| Discontinued operations: | | |
| Loss from operations | (474) | (68) |
| Gain on sale of operations | 2,508 | -- |
| Equity in investees gain on sale of real estate | 2,921 | -- |
| | ----- | ----- |
| | 4,955 | (68) |
| Net income (loss) | (1,335) | 316 |
| Preferred dividend requirement | (45) | (7) |
| | ----- | ----- |
| Net income (loss) applicable to Common shares | \$ (1,380) | \$ 309 |
| | ===== | ===== |

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS - Continued

| | For the Three Months Ended March 31, | |
|--|---|--------|
| | 2002 | 2001 |
| | ----- | ----- |
| | (dollars in thousands, except per share) | |
| Basic earnings per share | | |
| Net loss from continued operations | \$ (.78) | \$.04 |
| Discontinued operations | .62 | - |
| | ----- | ----- |
| Net income applicable to Common shares | \$ (.17) | \$.04 |
| | ===== | ===== |

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| | | |
|---|-----------|-----------|
| Diluted earnings per share | | |
| Net loss from continued operations | \$ (.78) | \$.04 |
| Discontinued operations | .62 | - |
| | ----- | ----- |
| Net income (loss) applicable to Common shares | \$ (.17) | \$.04 |
| | ===== | ===== |
| Weighted average Common shares used in computing earnings per share | | |
| Basic | 8,042,594 | 8,661,091 |
| Diluted | 8,291,884 | 8,734,388 |

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

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

| | Common Stock | | Paid-in | Accumulate |
|--|--------------|--------|------------|-----------------------------|
| | Shares | Amount | Capital | Distributio |
| | ----- | ----- | ----- | in Excess |
| | | | | Accumulate |
| | | | | Earnings |
| | | | | ----- |
| | | | | (dollars in thousands, exce |
| Balance, January 1, 2002 | 8,042,594 | \$ 80 | \$ 271,761 | \$ (55,073 |
| Unrealized loss on foreign currency translation | -- | -- | -- | -- |
| Net income | -- | -- | -- | (1,335 |
| Series A Preferred Stock cash dividend (\$1.25 per share) | -- | -- | -- | (7 |
| Series C Preferred Stock cash dividends (\$1.25 per share) | -- | -- | -- | (38 |
| | ----- | ----- | ----- | ----- |
| Balance, March 31, 2002 | 8,042,594 | \$ 80 | \$ 271,761 | \$ (56,453 |
| | ===== | ===== | ===== | ===== |

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Three Months Ended March 31 | |
|--|--|----------|
| | 2002 | |
| | (dollars in thousands) | |
| Cash Flows from Operating Activities | | |
| Rents collected (including \$90 in 2002 and \$30 in 2001 from affiliates) | \$ | 31,003 |
| Interest collected (including \$74 in 2002 from related parties) | | 850 |
| Interest paid | | (8,994) |
| Payments for property operations (including \$807 in 2002 and \$643 in 2001 to affiliates and related parties) | | (19,126) |
| Advisory and net income fee paid to affiliate | | (1,454) |
| General and administrative expenses paid (including \$786 in 2002 and \$769 in 2001 to affiliates and related parties) | | (2,264) |
| Other | | -- |
| Net cash provided by operating activities | | 15 |
| Cash Flows from Investing Activities | | |
| Collections on notes receivable (including \$2,045 in 2002 from related parties) | | 4,472 |
| Funding of notes receivable (including \$4,448 in 2002 to related parties) | | (5,351) |
| Acquisition of real estate | | (2,412) |
| Real estate improvements | | (15,476) |
| Proceeds from sale of real estate | | 6,779 |
| Deposits on pending purchases and financings | | 35 |
| Distributions from/(contributions to) equity investees | | 323 |
| Net cash (used in) provided by investing activities | | (11,630) |
| Cash Flows from Financing Activities | | |
| Payments on notes payable | | (7,838) |
| Proceeds from notes payable | | 14,328 |
| Deferred financing costs (including \$27 in 2002 to affiliates and related parties) | | (133) |
| Payments from advisor | | 2,573 |
| Advance to affiliates and related parties | | (2,670) |
| Dividends to stockholders | | (45) |
| Net cash provided by (used in) financing activities | | 6,215 |
| Net increase (decrease) in cash and cash equivalents | | (5,400) |
| Cash and cash equivalents, beginning of period | | 10,346 |
| Cash and cash equivalents, end of period | \$ | 4,946 |

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

TRANSCONTINENTAL 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 provided by operating activities | | |
| Net income (loss) | \$ (1,335) | \$ 309 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 5,242 | 5,057 |
| Gain on sale of real estate | (5,429) | (6,484) |
| Equity loss of equity investees | 1,276 | 1,367 |
| (Increase) decrease in interest receivable | 30 | (121) |
| Decrease in other assets | 657 | 2,832 |
| (Decrease) increase in interest payable | (134) | 8 |
| Decrease in other liabilities | (292) | (2,348) |
| | \$ 15 | \$ 620 |
| | ===== | ===== |
| Schedule of noncash investing and financing activities | | |
| Notes payable assumed on purchase of real estate | \$ 1,389 | \$ -- |
| Limited partnership interest received on sale of real estate | -- | 550 |
| Notes receivable provided on sale of real estate | 4,000 | -- |
| Real estate received on exchange with related party | 4,145 | -- |
| Real estate exchanged with related party | (4,145) | -- |

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

TRANSCONTINENTAL REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

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

The accompanying Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial

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

Operating results for the 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 included in TCI's Annual Report on Form 10-K for the year ended December 31, 2001 (the "2001 Form 10-K").

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

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

In April 2002, the FASB issued Statement 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction" ("SFAS No. 145"). Statement 4, "Reporting Gains and Losses from Extinguishment of Debt" ("SFAS No. 4"), required that gains and losses from the extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary item. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 will require TCI to reclassify prior period items that do not meet the extraordinary classification. The provisions of SFAS No. 145 that relate to the rescission of SFAS No.

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

NOTE 1. BASIS OF PRESENTATION (Continued)

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

In June 2002, the FASB issued SFAS No. 146, "Accounting for costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force ("EITF") Issue No. 94-3. TCI will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a company's commitment to an exit plan. SFAS No. 146 also establishes that the

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liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized.

NOTE 2. REAL ESTATE

In 2002, TCI purchased the following properties:

| Property | Location | Units/ Sq.Ft./Acres | Purchase Price | Net Cash Paid | Debt Incurred |
|------------------------|----------------|------------------------|-------------------|------------------|------------------|
| First Quarter | | | | | |
| Apartments | | | | | |
| Blue Lakes Villas/(1)/ | Waxahachie, TX | 186 Units | \$ 1,012 | \$ 1,048 | \$ -- |
| Echo Valley/(1)/ | Dallas, TX | 216 Units | 787 | 788 | -- |
| Spy Glass/(1)/ | Mansfield, TX | 256 Units | 1,280 | 1,042 | 208 |
| Razor/(1) (2)/ | Plano, TX | 200 Units | 2,319 | 310 | -- |
| Shopping Center | | | | | |
| Oak Tree Village/(2)/ | Lubbock, TX | 45,623 Sq.Ft. | 1,467 | 196 | 1,389 |
| Land | | | | | |
| Lakeshore Villas/(2)/ | Humble, TX | 16.89 Acres | 947 | 127 | -- |

(1) Land purchased for apartment construction.

(2) Property exchanged with American Realty Investors, Inc. ("ARI"), a related party, for the Plaza at Bachman Retail Center.

In 2002, TCI sold the following properties:

| Property | Location | Units/Sq.Ft. | Sales Price | Net Cash Received | Debt Discharged |
|----------------------|-----------------|----------------|----------------|----------------------|--------------------|
| First Quarter | | | | | |
| Apartments | | | | | |
| Primrose | Bakersfield, CA | 162 Units | \$ 5,000 | \$ 1,722 | \$ 2,920 |
| Office Building | | | | | |
| Hartford | Dallas, TX | 174,513 Sq.Ft. | 4,000 | -- | -- |
| Industrial Warehouse | | | | | |
| Central Storage | Dallas, TX | 216,035 Sq.Ft. | 4,000 | 2,095 | 1,063 |

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| Property | Location | Units/Sq.Ft. | Sales Price | Net Cash Received | Debt Dischar |
|---------------------------------------|------------|---------------|-------------|-------------------|--------------|
| First Quarter - Continued | | | | | |
| Shopping Center Plaza at Bachman/(2)/ | Dallas, TX | 80,278 Sq.Ft. | 4,707 | -- | -- |

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

In the first quarter of 2001, TCI sold the following properties:

| Property | Location | Units/Sq.Ft./ Acres | Sales Price | Net Cash Received | Debt Dischar |
|----------------------|-----------------|---------------------|-------------|-------------------|--------------|
| Apartments | | | | | |
| Forest Ridge | Denton, TX | 56 Units | \$ 2,000 | \$ 682 | \$ 1 |
| Heritage | Tulsa, OK | 136 Units | 2,286 | 206 | 1 |
| Park at Colonnade | San Antonio, TX | 211 Units | 5,800 | 927 | 4 |
| Industrial Warehouse | | | | | |
| Zodiac | Dallas, TX | 35,435 Sq.Ft. | 762 | 183 | |
| Land | | | | | |
| McKinney 36 | McKinney, TX | 1.822 Acres | 476 | 476 | |
| Round Mountain | Austin, TX | 110.0 Acres | 2,560 | 2,455 | |

- (1) Excludes a \$550,000 gain from a limited partnership interest in the sold property.

At March 31, 2002, TCI had the following properties under construction:

| Property | Location | Units/Rooms | Amount Expended | Additional Amount to Expend | Constr L Fun |
|------------------|----------------|-------------|-----------------|-----------------------------|--------------|
| Apartments | | | | | |
| Blue Lake Villas | Waxahachie, TX | 186 Units | \$ 3,126 | \$ 9,464 | \$ |
| Echo Valley | Dallas, TX | 216 Units | 981 | 13,238 | |
| Falcon Lakes | Arlington, TX | 284 Units | 1,695 | 14,050 | |
| Limestone Ranch | Lewisville, TX | 252 Units | 12,081 | 2,540 | |
| Razor Glen | Plano, TX | 200 Units | 2,418 | 13,164 | |
| River Oaks | Wiley, TX | 180 Units | 2,235 | 9,756 | |

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| | | | | |
|-----------------------|-----------------|-----------|--------|--------|
| Sendero Ridge | San Antonio, TX | 384 Units | 6,577 | 22,084 |
| Spyglass | Mansfield, TX | 256 Units | 2,698 | 15,305 |
| Tivoli | Dallas, TX | 190 Units | 4,755 | 8,679 |
| Verandas at City View | Fort Worth, TX | 314 Units | 2,895 | 20,055 |
| Waters Edge IV | Gulfport, MS | 80 Units | 3,226 | 857 |
| | | | | |
| Hotel | | | | |
| Akademia | Wroclaw, Poland | 165 Rooms | 15,325 | 3,410 |

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

NOTE 3. NOTES AND INTEREST RECEIVABLE

In January 2002, TCI purchased 100% of the outstanding common shares of ART Two Hickory Corporation ("Two Hickory"), a wholly-owned subsidiary of ARI, a related party, for \$4.4 million cash. Two Hickory owns the 96,217 sq. ft. Two Hickory Center Office Building in Farmers Branch, Texas. ARI has guaranteed that the asset shall produce at least a 12% annual return of the purchase price for a period of three years from the purchase date. If the asset fails to produce the 12% annual return, ARI shall pay TCI any shortfall. In addition, if the asset fails to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the shares of Two Hickory for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI.

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

In August 2001, TCI agreed to fund up to \$5.6 million under a revolving line of credit secured by an office building in Dallas, Texas. In February 2002, TCI funded an additional \$600,000. At March 31, 2002, TCI had funded a total of \$2.3 million of the note.

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

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

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

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In April 2002, TCI purchased 100% of the following entities: ART One Hickory Corporation ("One Hickory"), Garden Confederate Point, LP

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

NOTE 3. NOTES AND INTEREST RECEIVABLE (Continued)

("Confederate Point"), Garden Foxwood, LP ("Foxwood"), and Garden Woodsong, LP ("Woodsong"), all wholly-owned subsidiaries of ARI, a related party, for \$10.0 million. One Hickory owns the 120,615 sq. ft. One Hickory Center Office Building in Farmers Branch, Texas, Confederate Point owns the 206 unit Confederate Apartments in Jacksonville, FL, Foxwood owns the 220 unit Foxwood Apartments in Memphis, Tennessee, and Woodsong owns the 190 unit Woodsong Apartments in Smyrna, Georgia. ARI has guaranteed that these assets shall produce at least a 12% return annually of the purchase price for a period of three years from the purchase date. If the assets fail to produce the 12% return, ARI shall pay TCI any shortfall. In addition, if the assets fail to produce the 12% return for a calendar year and ARI fails to pay the shortfall, TCI may require ARI to repurchase the entities for the purchase price. Because ARI has guaranteed the 12% return and TCI has the option of requiring ARI to repurchase the entities, management has classified this related party transaction as a note receivable from ARI.

NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES

Prior to the first quarter of 2002, TCI accounted for its investments in Tri-City, Nakash and Jor-Trans on the equity method. In the first quarter of 2002, TCI began accounting for its investment in Tri-City, Nakash and Jor-Trans using a consolidated basis.

Real estate entities. TCI's investment in real estate entities at March 31, 2002, included equity securities of two publicly traded real estate entities, IORI and ARI, related parties, and interests in real estate joint venture partnerships. Basic Capital Management, Inc. ("BCM"), TCI's advisor, serves as advisor to IORI and ARI.

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

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

| Investee | Percentage of TCI'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 |
|-------------|--|---|---|--|
| IORI | 24.0% | \$ 4,809 | \$ 9,782 | \$ 6,275 |
| ARI | 6.5% | 10,249 | 5,685 | 5,266 |
| | | ----- | ----- | ----- |
| | | 15,058 | \$ 15,467 | \$ 11,541 |
| | | | ===== | ===== |
| Other | | 829 | | |

 \$15,887
 =====

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

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

NOTE 4. INVESTMENT IN REAL ESTATE ENTITIES (Continued)

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

| | 2002 | 2001 |
|--|-----------|-----------|
| | ----- | ----- |
| Revenues | \$ 41,527 | \$ 45,000 |
| Equity in income of partnerships | (429) | 4 |
| Property operating expenses | (35,631) | (39,295) |
| Depreciation | (4,096) | (4,714) |
| Interest expense | (19,854) | (19,587) |
| | ----- | ----- |
| (Loss) before gains on sale of real estate ... | (18,483) | (18,592) |
| | ----- | ----- |
| Gain on sale of real estate | 25,586 | 20,215 |
| | ----- | ----- |
| Net income | \$ 7,103 | \$ 1,623 |
| | ===== | ===== |

TCI's share of equity investees' loss before gains on the sale of real estate was \$1.3 million for the first quarter of 2002, and its share of equity investees' gains on sale of real estate was \$2.9 million for the first quarter of 2002.

NOTE 5. OTHER ASSETS

Related Party. From time-to-time, TCI and its affiliates and related parties have made advances to each other, which generally have not had specific repayment terms and have been reflected in TCI's financial statements as other assets. At March 31, 2002, TCI had receivables of \$9.1 million, \$1.9 million and \$3.3 million from BCM, GS Realty Services, Inc. and ARI, respectively.

NOTE 6. NOTES AND INTEREST PAYABLE

In 2002, TCI refinanced the following property:

| Property | Location | Sq.Ft. | Debt Incurred | Debt Discharged | Net Cash Received | Inter Rat |
|----------------------|----------|--------|------------------|--------------------|----------------------|--------------|
| ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| First Quarter | | | | | | |
| Industrial Warehouse | | | | | | |

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Addison Hanger/(1)/ Addison, TX 23,650 Sq.Ft. \$ 2,687 \$1,580 \$ 942

6.7

-
- (1) The mortgage is cross-collateralized with the 29,000 sq. ft. Addison Hanger II in Addison, Texas.
 - (2) Variable interest rate.

In the second quarter of 2002, TCI sold 12 residential properties to Metra Capital, LLC ("Metra"). These properties include: the 75 unit Apple Lane Apartments in Lawrence, Kansas, the 195 unit Arbor Point Apartments in Odessa, Texas, the 264 unit Fairway View Estates Apartments in El Paso, Texas, the 152 unit Fairways Apartments in Longview, Texas, the 166 unit Fountain Lake Apartments in Texas City, Texas, the 172 unit Fountains of Waterford Apartments in Midland, Texas,

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

NOTE 6. NOTES AND INTEREST PAYABLE (Continued)

the 122 unit Harper's Ferry Apartments in Lafayette, Louisiana, the 108 unit Oak Park IV Apartments in Clute, Texas, the 131 unit Quail Oaks Apartments in Balch Springs, Texas, the 300 unit Sunchase Apartments in Odessa, Texas, the 180 unit Timbers Apartments in Tyler, Texas, and the 112 unit Willow Creek Apartments in El Paso, Texas. One of the members of Metra is Third Millenium Partners, LLC which has as a member, Joseph Mizrachi, a Director of ARI, a related party. Another member of Metra is Innovo Realty, Inc., a subsidiary of Innovo Group, Inc. ("Innovo"), which also has Joseph Mizrachi as a director. Due to TCI's relationship with ARI and Mr. Mizrachi, management has determined to treat this sale as a refinancing transaction. TCI will continue to report the assets and the new debt incurred by Metra on its financial statements. The sales price for the properties totaled \$37.6 million. TCI received net cash of \$10.5 million after paying off the existing debt of \$18.0 million and various closing costs, including \$376,000 in brokerage commissions to Third Millenium Partners, LLC. The new debt of \$30.3 million bears interest at 7.57% per annum, requires monthly interest only payments of \$212,000 and matures in May 2012. TCI also received \$5.7 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.

NOTE 7. OPERATING SEGMENTS

Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative expenses. Management evaluates the performance of each of the operating segments and allocates resources to each based on its operating income and cash flow. Items of income not reflected in

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the segments are interest, equity in partnerships and gains on sales of real estate from equity investees which totaled \$3.3 million and \$539,000 for the first quarter of 2002 and 2001, respectively. Expenses not reflected in the segments are general and administrative expenses, minority interest, advisory fees, and net income fees which totaled \$3.6 million and \$4.0 million for the first quarter of 2002 and 2001, respectively. Also excluded from segment assets are assets of \$86.6 million at March 31, 2002, and \$92.3 million at March 31, 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses.

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

NOTE 7. OPERATING SEGMENTS (Continued)

Presented below is the operating income of each operating segment for the first quarter of 2002 and 2001, and each segment's assets at March 31.

| Quarter Ended March 31, 2002 | Land | Commercial Properties | Apartments | Hotels | Total |
|----------------------------------|--------|-----------------------|------------|--------|-----------|
| Rents | \$ 161 | \$ 16,158 | \$ 13,213 | \$ 888 | \$ 30,000 |
| Property operating expenses | 470 | 9,182 | 8,196 | 847 | 18,695 |
| Operating income (loss) | (309) | 6,976 | 5,017 | 41 | 11,725 |
| Depreciation | -- | 3,487 | 1,343 | 302 | 5,132 |
| Interest | 493 | 4,618 | 3,693 | 312 | 9,116 |
| Real estate improvements | 40 | 1,537 | 10,309 | 3,590 | 15,476 |
| Assets | 63,308 | 298,813 | 237,371 | 34,123 | 633,615 |

| Property Sales | Commercial Properties | Apartments | Total |
|---------------------|-----------------------|------------|-----------|
| Sales price | \$ 12,707 | \$ 5,000 | \$ 17,707 |
| Cost of sales | (11,466) | (4,341) | (15,807) |
| Gain on sale | \$ 1,241 | \$ 659 | \$ 1,900 |

(1) Excludes TCI's share of gains on sale of real estate recognized by an equity investee of \$2.9 million and a previously deferred gain on the sale of the Madison at Bear Creek Apartments of \$608,000.

| Quarter Ended March 31, 2001 | Land | Commercial Properties | Apartments | Hotels | Total |
|------------------------------|------|-----------------------|------------|--------|-------|
|------------------------------|------|-----------------------|------------|--------|-------|

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| | | | | | |
|----------------------------------|--------|-----------|-----------|----------|-----------|
| Rents | \$ 136 | \$ 17,151 | \$ 15,788 | \$ 1,330 | \$ 34,405 |
| Property operating expenses | 382 | 9,002 | 9,272 | 1,198 | 19,854 |
| | ----- | ----- | ----- | ----- | ----- |
| Operating income (loss) | (246) | 8,149 | 6,516 | 132 | 14,551 |
| Depreciation | -- | 1,557 | 3,131 | 253 | 4,941 |
| Interest | 311 | 5,838 | 4,493 | 361 | 11,003 |
| Real estate improvements | -- | 1,251 | 34 | 143 | 1,428 |
| Assets | 57,966 | 345,071 | 204,991 | 19,821 | 627,849 |

| | | | | |
|---------------------|----------|--------------------------|------------|--------|
| Property Sales | Land | Commercial Properties | Apartments | Total |
| | ----- | ----- | ----- | ----- |
| Sales price | \$ 3,036 | \$ 762 | \$10,086 | \$13,8 |
| Cost of sales | 1,634 | 595 | 6,445 | 8,6 |
| | ----- | ----- | ----- | ----- |
| Gain on sale | \$ 1,402 | \$ 167 | \$ 3,641 | \$ 5,2 |
| | ===== | ===== | ===== | ===== |

(1) Excludes TCI's share of gains on sale of real estate recognized by an equity investee of \$1.3 million.

NOTE 8. DISCONTINUED OPERATIONS

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

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

NOTE 8. DISCONTINUED OPERATIONS (Continued)

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

For the three months ended March 31, 2002, income from discontinued operations relates to 4 properties that TCI sold during 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 |
| ----- | ----- |

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| | | |
|---|----------|---------|
| Revenue | | |
| Rental | \$ 449 | \$ 859 |
| Property operations | 774 | 541 |
| | ----- | ----- |
| | (325) | 318 |
| Expenses | | |
| Interest | 40 | 207 |
| Depreciation | 109 | 179 |
| | ----- | ----- |
| | 149 | 386 |
| | ----- | ----- |
| Net loss from discontinued operations before gains on sale of real estate | (474) | (68) |
| Gain on sale of operations | 2,508 | -- |
| Equity in investees gain on sale of real estate | 2,921 | -- |
| | ----- | ----- |
| Net income from discontinued operations | \$ 4,955 | \$ (68) |
| | ===== | ===== |

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

NOTE 9. COMMITMENTS AND CONTINGENCIES

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

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

Litigation. TCI is involved in various lawsuits arising in the ordinary course of business. Except for the Olive Litigation (see PART II).

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

NOTE 9. COMMITMENTS AND CONTINGENCIES (Continued)

OTHER INFORMATION, ITEM 1. "LEGAL PROCEEDINGS), management is of the opinion that the outcome of these lawsuits will have no material impact on TCI's financial condition, results of operations or liquidity.

NOTE 10. INCOME TAXES

Financial statement income varies from taxable income principally due to the

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accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. TCI had a loss for federal income tax purposes in the first quarter of 2002 and 2001; therefore, it recorded no provision for income taxes.

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

Introduction

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

Liquidity and Capital Resources

Cash and cash equivalents totaled \$4.9 million at March 31, 2002, compared with \$10.3 million at December 31, 2001. TCI's principal sources of cash have been and will continue to be from property operations, proceeds from property sales, the collection of mortgage notes receivable and borrowings. Management anticipates that TCI's cash on hand, as well as cash generated from property operations, the sale of properties and the refinancing of certain of TCI's mortgage debt will be sufficient to meet TCI's cash requirements, including debt service obligations and expenditures for property maintenance and improvements.

Net cash provided by operating activities was \$15,000 for the first quarter of 2002, compared to \$620,000 for the first quarter of 2001. The primary factors affecting TCI's cash from operations are discussed in the following paragraphs.

Cash from property operations (rents collected less payments for expenses applicable to rental income) decreased to \$11.9 million in the first quarter of 2002, from the \$16.4 million in 2001. Decreases in cash flow from property operations of \$2.0 million were from the sale of 16 apartments in 2002 and 2001, \$3.1 million was from the sale of nine commercial properties in 2002 and 2001, and \$97,000 was from decreased room revenues at TCI's hotels. These decreases were offset by increases in cash flow of \$578,000 and \$94,000 from the purchase of five existing

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

Liquidity and Capital Resources (Continued)

apartments in 2001 and one commercial property in 2002. Management believes that this trend of decreased cash flow from property operations may continue depending on TCI's selling of income producing properties to meet its cash requirements.

Interest collected increased to \$850,000 in the first quarter of 2002, from \$216,000 in 2001. The increase was primarily due to TCI funding seven loans in 2001.

Interest paid decreased to \$9.0 million in the first quarter of 2002, from \$10.6 million in the first quarter of 2001. Of the decreases, \$2.1 million was from the sale of 24 properties in 2002 and 2001 subject to debt, and \$503,000 was from lower variable interest rates and principal paydowns in 2002 and 2001. These decreases were offset by increases of \$853,000 from the purchase of nine

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properties in 2002 and 2001 subject to debt, and \$130,000 from the refinancing of one land property in 2001.

Advisory and net income fees paid decreased to \$1.5 million in the first quarter of 2002, from \$2.6 million in the first quarter of 2001. The decrease was due to TCI having a net loss in the fourth quarter of 2001.

General and administrative expenses paid decreased to \$2.3 million in first quarter of 2002, from \$3.0 million in the first quarter of 2001. This decrease was mainly due to a decrease in legal fees and consulting fees.

In the first quarter 2002, TCI sold one apartment, one warehouse, one shopping center and one office building for a total of \$17.7 million, receiving net cash of \$3.8 million after the payoff of existing debt and the payment of various closing costs.

Also in the first quarter of 2002, TCI financed an industrial warehouse for \$2.7 million, receiving \$942,000 in cash after the payment of various closing costs.

Further in the first quarter of 2002, TCI purchased four apartments, one shopping center and one parcel of unimproved land for a total of \$7.8 million, paying \$3.5 million in cash, including various closing costs, and assumed existing mortgage debt of \$1.4 million. TCI also expended \$13.3 million on property construction in the quarter, of which \$10.9 million was funded by debt. As of March 31, 2002, TCI has expended a total of \$58.0 million on property construction, of which \$30.0 million was funded by debt. For the remainder of 2002, TCI expects to expend an additional \$132.6 million on property construction projects, of which \$127.0 million will be funded by debt.

Management reviews the carrying values of TCI's properties and mortgage notes receivable at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow

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

Liquidity and Capital Resources (Continued)

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

Results of Operations

TCI had a net loss of \$1.3 million in the first quarter of 2002, including gains on sale of real estate totaling \$5.4 million, compared to net income of \$316,000 in the corresponding period in 2001, including gains on sale of real estate totaling \$6.5 million. Fluctuations in this and other components of revenues and expense between the 2002 and 2001 periods are discussed below.

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Rents in the first quarter of 2002, decreased to \$30.4 million compared to \$34.4 million in 2001. Of this decrease, \$4.8 million was due to the sale of 16 apartments in 2002 and 2001 and \$2.2 million was due to the sale of nine commercial properties in 2002 and 2001 and \$326,000 was due to lower occupancies at TCI's hotels. These decreases were offset by increases of \$1.9 million due to the purchase of five apartments in 2002 and 2001 and \$31,000 was due to the purchase of one commercial property in 2002. Rental rates and occupancies increased by \$208,000 for TCI's apartments and by \$795,000 for TCI's commercial properties. Rents in the remaining quarters of 2002 may decrease as TCI sells income producing properties.

Property operations expense decreased in the first quarter of 2002, to \$18.7 million from \$19.9 million compared to the corresponding period in 2001. Of this decrease, \$2.7 million was due to the sale of 16 apartments in 2002 and 2001, \$449,000 was due to the sale of nine commercial properties and hotel operating expenses decreased by \$351,000. These decreases were offset by increases of \$1.5 million due to the purchase of five apartments in 2002 and 2001 and \$15,000 due to the purchase of one commercial property in 2002. Apartment operating expenses increased by \$242,000 due to increased leasing costs and utilities and an increase of \$800,000 was due to increased leasing, utility and maintenance costs at TCI's commercial properties.

Interest and other income increased to \$1.1 million in the first quarter of 2002, compared to \$638,000 in 2001. The increase was primarily due to TCI funding seven loans in 2001 and one loan in 2002. Interest income for the remaining quarters of 2002 is expected to increase from the additional loans funded in 2001 and 2002.

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

Results of Operations (Continued)

Equity losses of investees decreased to \$1.3 million in the first quarter of 2002, from \$1.4 million in the first quarter of 2001. The decreases in losses from equity investees are primarily attributed to decreased operating losses for IORI and ARI.

In the first quarter of 2002, gains on sale of real estate totaling \$5.4 million were recognized, \$659,000 on the sale of the Primrose Apartments, \$1.2 million on the sale of the Central Storage Warehouse, a \$608,000 deferred gain on the sale of the Madison at Bear Creek Apartments and \$2.9 million on gains on sale of real estate from equity investees.

In the first quarter of 2001, gains on sale of real estate totaling \$6.5 million were recognized, \$1.6 million on the sale of the Heritage Apartments, \$167,000 on the sale of Zodiac Warehouse, \$355,000 on the sale of a tract of the McKinney 36 land parcel, \$1.0 million on the sale of Forest Ridge Apartments, \$1.1 million on the sale of Park at Colonade Apartments, \$1.0 million on the sale of a tract of the Round Mountain land parcel and \$1.3 million on gains on sale of real estate from an equity investee.

Interest expense decreased to \$9.2 million in the first quarter of 2002, from \$11.0 million in 2001. Of this decrease, \$1.4 million was due to the sale of 16 apartments in 2002 and 2001, \$769,000 was due to the sale of five commercial properties in 2002 and 2001, and decreases of \$20,000 were due to principal paydowns in 2001. Of the remaining decreases, \$341,000 was due to lower variable

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interest rates at TCI's apartments, \$478,000 was due to lower variable interest rates at TCI's commercial properties, and \$49,000 was due to lower variable interest rates at TCI's hotels. These decreases were offset by increases of \$823,000 due to the purchase of five apartments in 2002 and 2001, and \$194,000 due to the financing of one property in 2001. Interest expense for the remaining quarters of 2002 are expected to decrease as TCI selectively sells properties.

Depreciation expense increased to \$5.1 million in the first quarter of 2002, from \$4.9 million in 2001. Of these increases, \$273,000 was due to the purchase of five apartments in 2002 and 2001, and \$548,000 was due to building and tenant improvements at TCI's commercial properties. These increases were offset by decreases of \$450,000 due to the sale of 16 apartments and \$283,000 due to the sale of five commercial properties in 2002 and 2001. Depreciation expense for the remaining quarters of 2002 is expected to decrease as TCI selectively sells properties.

Advisory fee decreased to \$1.4 million in the first quarter of 2002, from \$1.5 million in 2001. The decrease was due to a decrease in TCI's gross assets from 2001, the basis for such fee. Advisory fees for the remaining quarters of 2002 are expected to decrease with decreases in TCI's gross assets.

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

Results of Operations (Continued)

Net income fee to affiliate was \$26,000 in the first quarter of 2001. The net income fee is payable to TCI's advisor based on 7.5% of TCI's net income.

General and administrative expenses decreased to \$2.2 million in the first quarter of 2002, from \$2.4 million in 2001. These decreases were mainly due to a decrease in legal fees and other professional fees.

Tax Matters

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. TCI had a loss for federal income tax purposes in the first quarter of 2002 and 2001; therefore, it recorded no provision for income taxes.

Inflation

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

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, TCI may be potentially liable for removal or remediation costs, as well as certain other potential costs, relating to hazardous or toxic substances (including governmental fines and injuries to persons and property) where

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property-level managers have arranged for the removal, disposal or treatment of hazardous or toxic substances. In addition, certain environmental laws impose liability for release of asbestos-containing materials into the air, and third parties may seek recovery for personal injury associated with such materials.

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

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

| | Balance ----- | Weighted Average Interest Rate ----- | Effect of 1% Increase In Base Rates ----- |
|--|---------------------|---|--|
| Notes payable: | | | |
| Variable rate | \$ 149,099 ===== | 6.28% | \$ 1,491 ===== |
| Total decrease in TCI's annual net income | | | \$ 1,491 ===== |
| Per share | | | \$.18 ===== |

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

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

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

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This evaluation was completed in April 2000

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ITEM 1. LEGAL PROCEEDINGS (Continued)

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

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

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

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None.

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

A Current Report on Form 8-K, dated April 10, 2002, was filed with respect to Item 5. "Other Events and Regulation FD Disclosures," which reports the Amendment to the Second Amendment to the Modification of Stipulation of Settlement in Olive, et al. v. National Income Realty Trust et al.

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SIGNATURES

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

TRANSCONTINENTAL REALTY
INVESTORS, INC.

Date: March 4, 2003

By: /s/ Ronald E. Kimbrough

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

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CERTIFICATION

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

1. I have reviewed this quarterly report on Form 10-Q/A of TCI;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. I am responsible for establishing and maintaining internal controls and procedures and have:
 - a. designed such internal controls to insure that material information relating to TCI and its consolidated subsidiaries is made known to me by others within those entities, particularly for the periods presented in this quarterly report;
 - b. evaluated the effectiveness of TCI's internal controls as of a date within 90 days prior to the filing date of this quarterly report; and
 - c. presented in this quarterly report my conclusions about the effectiveness of the disclosure controls and procedures based on a date within 90 days prior to the filing date of this quarterly report;

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5. I have disclosed to TCI's auditors and Audit Committee of the Board of Directors (or persons fulfilling the equivalent function):
- a. all significant deficiencies in the design or operation of internal controls which could adversely affect TCI's ability to record, process, summarize, and report financial data and have identified for TCI's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in TCI's internal controls; and

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

Date: March 4, 2003

/s/ Ronald E. Kimbrough

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

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TRANSCONTINENTAL REALTY INVESTORS, INC.

EXHIBITS TO

QUARTERLY REPORT ON FORM 10-Q/A

For the Quarter ended March 31, 2002

| Exhibit Number | Description | Page Number |
|-------------------|---|----------------|
| 99.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | 29 |

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