PREFERRED APARTMENT COMMUNITIES INC
Form 10-Q
November 10, 2014

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

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File No. 001-34995

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

Maryland	27-1712193
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3284 Northside Parkway NW, Suite 150, Atlanta, GA 30327
(Address of principal executive offices) (Zip Code)
Registrant’s telephone number, including area code: (770) 818-4100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec. 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).
Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
The number of shares outstanding of the registrant’s Common Stock, as of November 7, 2014 was 19,865,065.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
Preferred Apartment Communities, Inc.
Consolidated Balance Sheets
(Unaudited)

	September 30, 2014	December 31, 2013
Assets		
Real estate		
Land	$76,845,362	$34,520,000
Building and improvements	367,282,876	147,510,836
Tenant improvements	2,494,907	—
Furniture, fixtures, and equipment	36,545,602	22,363,098
Construction in progress	204,269	55,226
Gross real estate	483,373,016	204,449,160
Less: accumulated depreciation	(21,484,686)	(14,133,421)
Net real estate	461,888,330	190,315,739
Real estate loans, net of deferred fee income ($17,733,427 and $14,332,658 carried at fair value)	124,429,147	103,433,147
Real estate loans to related parties, net	23,061,207	7,164,768
Total real estate and real estate loans, net	609,378,684	300,913,654
Cash and cash equivalents	13,587,705	9,180,431
Restricted cash	4,778,567	2,064,819
Notes receivable	15,512,662	10,248,178
Note receivable and revolving line of credit from related party	10,472,805	6,858,227
Accrued interest receivable on real estate loans	6,461,446	3,286,660
Acquired intangible assets, net of amortization of $14,333,442 and $12,569,581	13,436,330	907,883
Deferred loan costs, net of amortization of $1,168,648 and $963,043	5,383,147	1,719,194
Deferred offering costs	6,718,587	5,255,636
Tenant receivables and other assets	2,610,587	1,202,013
Total assets	$688,340,520	$341,636,695
Liabilities and equity		
Liabilities		
Mortgage notes payable	$345,373,830	$140,516,000
Revolving credit facility	36,000,000	29,390,000
Term note payable	44,250,000	—
Real estate loan participation obligation	3,338,204	—
Accounts payable and accrued expenses	5,294,334	1,638,401
Accrued interest payable	532,844	443,099
Dividends and partnership distributions payable	3,654,469	2,900,478
Acquired below market lease intangibles, net of amortization of $463,548	5,757,243	—
Security deposits and other liabilities	1,178,582	695,998
Total liabilities	445,379,506	175,583,976

Commitments and contingencies (Note 11)

Equity

Stockholders' equity		
Series A Redeemable Preferred Stock, $0.01 par value per share; 989,408 shares authorized; 146,574 and 89,408 shares issued; 146,145 and 89,313 shares outstanding at September 30, 2014 and December 31, 2013, respectively	1,461	893
Common Stock, $0.01 par value per share; 400,066,666 shares authorized; 19,862,963 and 15,294,578 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	198,629	152,945
Additional paid in capital	252,414,783	177,824,720
Accumulated deficit	(11,433,148)	(13,391,341)
Total stockholders' equity	241,181,725	164,587,217
Non-controlling interest	1,779,289	1,465,502
Total equity	242,961,014	166,052,719
Total liabilities and equity	$688,340,520	$341,636,695

The accompanying notes are an integral part of these consolidated financial statements.
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Preferred Apartment Communities, Inc.
Consolidated Statements of Operations
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Rental revenues	$6,546,945	$5,426,402	$18,460,968	$14,789,074
Other property revenues	799,716	630,970	2,205,424	1,596,022
Interest income on loans and notes receivable	4,871,387	2,531,116	13,656,982	5,819,146
Interest income from related party	964,612	163,787	2,164,558	207,700
Total revenues	13,182,660	8,752,275	36,487,932	22,411,942
Operating expenses:				
Property operating and maintenance	1,067,849	922,762	2,941,383	2,402,837
Property salary and benefits reimbursement to related party	632,051	600,547	1,866,416	1,633,530
Property management fees to related party	283,805	238,026	814,600	643,387
Real estate taxes	712,752	640,627	2,102,065	1,656,204
General and administrative	177,291	159,646	598,895	446,251
Equity compensation to directors and executives	456,961	290,860	1,347,107	889,946
Depreciation and amortization	3,185,739	3,682,087	8,791,045	12,678,709
Acquisition and pursuit costs	3,056,997	10,682	3,407,392	212,818
Acquisition fees to related parties	3,443,059	—	3,500,327	1,029,487
Management fees to related party	787,115	536,738	2,207,385	1,388,369
Insurance, professional fees and other expenses	458,367	161,747	1,270,281	740,799
Total operating expenses	14,261,986	7,243,722	28,846,896	23,722,337
Operating (loss) income	(1,079,326)	1,508,553	7,641,036	(1,310,395)
Interest expense	2,150,047	1,538,567	5,650,096	3,923,331
Loss on early extinguishment of debt	—	—	—	604,337
Net (loss) income	(3,229,373)	(30,014)	1,990,940	(5,838,063)
Consolidated net loss (income) attributable to non-controlling interests	26,481	127,738	(32,747)	225,894
Net (loss) income attributable to the Company	(3,202,892)	97,724	1,958,193	(5,612,169)
Dividends declared to preferred stockholders	(1,903,517)	(973,069)	(4,924,832)	(2,769,001)
Deemed non-cash dividend to holders of Series B Preferred Stock	—	—	—	(7,028,557)
Earnings attributable to unvested restricted stock	(6,275)	(4,352)	(17,227)	(13,496)
Net loss attributable to common stockholders	$(5,112,684)	$(879,697)	$(2,983,866)	$(15,423,223)
Net loss per share of Common Stock, available to Common Stockholders, basic and diluted	$(0.29)	$(0.08)	$(0.18)	$(1.88)

Dividends per share declared on Common Stock	$0.16	$0.15	$0.48	$0.445
Weighted average number of shares of Common Stock outstanding, basic and diluted	17,564,091	11,041,359	16,399,675	8,197,531

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

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Preferred Apartment Communities, Inc.
Consolidated Statements of Stockholders' Equity
For the nine months ended September 30, 2014 and 2013
(Unaudited)

	Series A Redeemable Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated (Deficit)	Total Stockholders' Equity	Non-Controlling Interest	Total Equity
Balance at January 1, 2013	$198	$52,885	$59,412,744	$(9,408,253)	$50,057,574	$1	$50,057,575
Issuance of Units	522	—	51,304,427	—	51,304,949	—	51,304,949
Syndication and offering costs	—	—	(7,816,159)	—	(7,816,159)	—	(7,816,159)
Equity compensation to executives and directors	—	28	889,918	—	889,946	—	889,946
Vesting of restricted stock	—	330	(330)	—	—	—	—
Vesting of Class B Units and conversion to Class A Units	—	—	(479,841)	—	(479,841)	479,841	—
Conversion of Class A OP Units to Common Stock	—	61	25,562	—	25,623	(25,623)	—
Current period amortization of Class B OP Units	—	—	(672,549)	—	(672,549)	672,549	—
Conversion of Series B Preferred Stock to Common Stock	—	57,143	39,942,857	—	40,000,000	—	40,000,000
Net loss	—	—	—	(5,612,169)	(5,612,169)	(225,894)	(5,838,063)
Reallocation adjustment to non-controlling interests	—	—	(260,767)	—	(260,767)	260,767	—
Distributions to non-controlling interests	—	—	—	—	—	(47,610)	(47,610)
Dividends to series A preferred stockholders ($5.00 per share per month)	—	—	(2,078,525)	—	(2,078,525)	—	(2,078,525)
Dividends to series B preferred							

stockholders ($17.26 per share)	—	—	(690,476)	—	(690,476)	—	(690,476)
Dividends to common stockholders ($0.445 per share)	—	—	(4,093,017)	—	(4,093,017)	—	(4,093,017)
Balance at September 30, 2013	$720	$110,447	$135,483,844	$(15,020,422)	$120,574,589	$1,114,031	$121,688,620
Balance at January 1, 2014	$893	$152,945	$177,824,720	$(13,391,341)	$164,587,217	$1,465,502	$166,052,719
Issuance of Units	571	—	57,132,980	—	57,133,551	—	57,133,551
Redemptions of Series A Preferred Stock	(3)	331	(24,842)	—	(24,514)	—	(24,514)
Issuance of Common Stock	—	43,985	37,077,020	—	37,121,005	—	37,121,005
Syndication and offering costs	—	—	(7,603,807)	—	(7,603,807)	—	(7,603,807)
Equity compensation to executives and directors	—	35	249,682	—	249,717	—	249,717
Vesting of restricted stock	—	293	(293)	—	—	—	—
Conversion of Class A Units to Common Stock	—	1,040	565,158	—	566,198	(566,198)	—
Current period amortization of Class B OP Units	—	—	—	—	—	1,097,389	1,097,389
Net income	—	—	—	1,958,193	1,958,193	32,747	1,990,940
Reallocation adjustment to non-controlling interests	—	—	168,889	—	168,889	(168,889)	—
Distributions to non-controlling interests	—	—	—	—	—	(81,262)	(81,262)
Dividends to series A preferred stockholders ($5.00 per share per month)	—	—	(4,924,832)	—	(4,924,832)	—	(4,924,832)
Dividends to common stockholders ($0.48 per share)	—	—	(8,049,892)	—	(8,049,892)	—	(8,049,892)
Balance at September 30, 2014	$1,461	$198,629	$252,414,783	$(11,433,148)	$241,181,725	$1,779,289	$242,961,014

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

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

	Nine months ended September 30,	
	2014	2013
Operating activities:		
Net income (loss)	$1,990,940	$(5,838,063)
Reconciliation of net income (loss) to net cash provided by operating activities:		
Depreciation expense	7,348,550	5,788,718
Amortization expense	1,442,495	6,889,991
Amortization of above and below market leases	(96,056)	(330,394)
Deferred fee income amortization	(805,360)	(241,732)
Deferred loan cost amortization	433,609	571,721
(Increase) in accrued interest income on real estate loans	(3,219,158)	(1,804,548)
Equity compensation to executives and directors	1,347,107	889,946
Deferred cable income amortization	(14,073)	(8,201)
Loss on asset disposal	2,804	—
Changes in operating assets and liabilities:		
Decrease in tenant receivables and other assets	279,345	82,612
Increase in accounts payable and accrued expenses	1,146,507	13,829
Prepaid interest on operating loans	1,298	—
Increase in accrued interest payable	89,745	28,892
Increase in prepaid rents	19,033	43,309
Increase (decrease) in security deposits and other liabilities	30,798	(11,025)
Net cash provided by operating activities	9,997,584	6,075,055
Investing activities:		
Investments in real estate loans	(39,513,149)	(43,720,651)
Repayments of real estate loans	3,125,202	—
Notes receivable issued	(9,111,133)	(11,155,618)
Notes receivable repaid	3,810,504	956,665
Note receivable issued to and draws on line of credit by related party	(9,312,953)	(6,538,982)
Repayments of line of credit by related party	5,359,560	3,168,909
Acquisition fees received on real estate loans	836,755	1,410,098
Acquisition fees paid on real estate loans	(438,465)	(705,049)
Acquisition of properties	(285,302,277)	(33,447,617)
Additions to real estate assets - improvements	(1,661,807)	(1,129,263)
Proceeds from asset disposal	4,773	—
(Increase) in restricted cash	(648,950)	(701,770)
Net cash used in investing activities	(332,851,940)	(91,863,278)
Financing activities:		
Proceeds from mortgage notes payable	217,956,000	59,045,000
Payments for mortgage extinguishment	(13,098,170)	(56,594,389)
Payments for deposits and other mortgage loan costs	(4,903,701)	(1,607,394)
Proceeds from real estate loan participants	3,338,204	—
Proceeds from lines of credit	73,683,305	48,909,149
Payments on lines of credit	(67,073,306)	(38,799,679)

Proceeds from Term Loan	44,250,000	—
Proceeds from sales of Series B Preferred Stock, net of offering costs	—	36,959,366
Proceeds from sales of Units, net of offering costs and redemptions	51,479,498	47,560,602
Proceeds from sales of Common Stock	36,058,950	—
Common Stock dividends paid	(7,563,679)	(3,203,573)
Series A Preferred Stock dividends paid	(4,663,139)	(2,500,386)
Distributions to non-controlling interests	(75,179)	(31,561)
Payments for deferred offering costs	(2,127,153)	(1,469,415)
Net cash provided by financing activities	327,261,630	88,267,720
Net increase in cash and cash equivalents	4,407,274	2,479,497
Cash and cash equivalents, beginning of period	9,180,431	2,973,509
Cash and cash equivalents, end of period	$13,587,705	$5,453,006

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

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

	Nine months ended September 30,	
	2014	2013
Supplemental cash flow information:		
Cash paid for interest	$5,132,292	$4,175,177
Supplemental disclosure of non-cash activities:		
Accrued capital expenditures	$70,392	$94,747
Dividends payable - common	$2,937,911	$1,661,060
Dividends payable - preferred	$693,357	$348,483
Deemed non-cash dividend to holders of Series B Preferred Stock	$—	$7,028,557
Partnership distributions payable to non-controlling interest	$23,202	$16,048
Accrued and payable deferred offering costs	$175,598	$452,874
Reclass of offering costs from deferred asset to equity	$739,831	$362,511
Bridge loans converted to mezzanine loans	$17,334,271	$—
Mortgage loans assumed on acquisitions	$—	$69,428,389
Mezzanine loan balance applied to purchase of property	$—	$6,326,898

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

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements
September 30, 2014
(Unaudited)

1. Organization and Basis of Presentation

Preferred Apartment Communities, Inc. was formed as a Maryland corporation on September 18, 2009, and elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, effective with its tax year ended December 31, 2011. Unless the context otherwise requires, references to the "Company", "we", "us", or "our" refer to Preferred Apartment Communities, Inc., together with its consolidated subsidiaries, including Preferred Apartment Communities Operating Partnership, L.P., or the Operating Partnership. The Company was formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As part of its business strategy, the Company may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the development of multifamily communities and other properties. As a secondary strategy, the Company also may acquire or originate senior mortgage loans, subordinate loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets and invest not more than 20% of its assets in other real estate related investments such as grocery-anchored necessity retail properties, as determined by its Manager (as defined below) as appropriate for the Company. The Company is externally managed and advised by Preferred Apartment Advisors, LLC, or its Manager, a Delaware limited liability company and related party (see Note 6).

The Company completed its initial public offering, or IPO, on April 5, 2011. As of September 30, 2014, the Company had 19,862,963 shares of common stock, par value $0.01 per share, or Common Stock, issued and outstanding and owned units in the Operating Partnership which represented a weighted-average ownership percentage of 99.18% for the three-month period ended September 30, 2014. The number of partnership units not owned by the Company totaled 145,011 at September 30, 2014 and represented Class A OP Units of the Operating Partnership, or Class A OP Units. The Class A OP Units are convertible at any time at the option of the holder into the Company's choice of either cash or Common Stock. In the case of cash, the value is determined based upon the trailing 20-day volume weighted average price of the Company's Common Stock.

The Company controls the Operating Partnership through its sole general partner interest and plans to conduct substantially all of its business through the Operating Partnership. New Market Properties, LLC, a wholly-owned subsidiary of the Operating Partnership, owns and conducts the business of the Company's grocery-anchored necessity retail properties.

Basis of Presentation

These unaudited consolidated financial statements include all of the accounts of the Company and the Operating Partnership presented in accordance with accounting principles generally accepted in the United States of America, or GAAP. All significant intercompany transactions have been eliminated in consolidation. Certain adjustments have been made consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair presentation of the Company's financial condition and results of operations. The year end condensed balance sheet data was derived from audited financial statements, but does not include all the disclosures required by GAAP. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on March 17, 2014.

2. Summary of Significant Accounting Policies

Use of Estimates

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

Acquisitions and Impairments of Real Estate Assets

The Company generally records its initial investments in income-producing real estate at fair value at the acquisition date in accordance with ASC 805-10, Business Combinations. The aggregate purchase price of acquired properties is apportioned to the tangible and identifiable intangible assets and liabilities acquired at their estimated fair values. The value of acquired land, buildings

and improvements is estimated by formal appraisals, observed comparable sales transactions, and information gathered during pre-acquisition due diligence activities and the valuation approach considers the value of the property as if it were vacant. The values of furniture, fixtures, and equipment are estimated by calculating their replacement cost and reducing that value by factors based upon estimates of their remaining useful lives. Intangible assets and liabilities for multifamily communities include the values of in-place leases, customer relationships, and above-market or below-market leases. Additional intangible assets for retail properties also include costs to initiate leases such as commissions and legal costs.

In-place lease values for multifamily communities are estimated by calculating the estimated time to fill a hypothetically empty apartment complex to its stabilization level (estimated to be 92% occupancy) based on historical observed move-in rates for each property, and which approximate market rates. Carrying costs during these hypothetical expected lease-up periods are estimated, considering current market conditions and include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates. The intangible assets are calculated by estimating the net cash flows of the in-place leases to be realized, as compared to the net cash flows that would have occurred had the property been vacant at the time of acquisition and subject to lease-up. The acquired in-place lease values are amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. The amounts of above-market or below-market lease values are developed by comparing the Company's estimate of the average market rent to the average contract rent of the leases in place at the property acquisition date. This ratio is applied on a lease by lease basis to derive a total asset or liability amount for the property. The above-market or below-market lease values are recorded as a reduction or increase, respectively, to rental income over the remaining average non-cancelable term of the respective leases, plus any below market probable renewal options.

The fair values of in-place leases for retail shopping centers represent the value of direct costs associated with leasing, including opportunity costs associated with lost rentals that are avoided by acquiring in-place leases. Direct costs associated with obtaining a new tenant include commissions, legal and marketing costs, incentives such as tenant improvement allowances and other direct costs. Such direct costs are estimated based on our consideration of current market costs to execute a similar lease. The value of opportunity costs is estimated using the estimated market lease rates and the estimated absorption period of the space. These direct costs and opportunity costs are included in the accompanying consolidated balances sheets as acquired intangible assets in the accompanying consolidated balance sheets and are amortized to expense over the remaining term of the respective leases. The fair values of above-market and below-market in-place leases for retail shopping centers are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) our estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining terms of the leases, taking into consideration the probability of renewals for any below-market leases. The capitalized above-market and below-market lease values are included in acquired intangible assets and amortized as an adjustment to rental income over the remaining terms of the respective leases, plus any below market probable renewal options.

Estimating the fair values of the tangible and intangible assets requires us to estimate market lease rates, property operating expenses, carrying costs during lease-up periods, discount and capitalization rates, market absorption periods, and the number of years the property is held for investment. The use of inappropriate estimates would result in an incorrect assessment of our purchase price allocations, which would impact the amount of our reported net income. Acquired intangible assets and liabilities have no residual value.

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

Loans and Notes Held for Investment

The Company carries its investments in real estate loans at amortized cost with assessments made for impairment in the event recoverability of the principal amount becomes doubtful. If, upon testing for impairment, the fair value result is lower than the carrying amount of the loan, a valuation allowance is recorded to lower the carrying amount to fair value, with a loss recorded in earnings. Recoveries of valuation allowances are only recognized in the event of maturity or a sale or disposition in an amount above carrying value. The balances of real estate loans presented on the consolidated balance sheets consist of drawn amounts on the loans, net of deferred loan fee revenue. See the "Revenue Recognition" section of this Note for other loan-related policy

disclosures required by ASC 310-10-50-6. Certain loans contain contingent exit fees, which are deemed to be embedded derivatives. The Company elects the fair value option for these loans and recognizes in earnings any material changes in fair value.

Deferred Offering Costs

Deferred offering costs represent direct costs incurred by the Company related to current equity offerings, excluding costs specifically identifiable to a closing, such as commissions, dealer-manager fees, and other registration fees. For issuances of equity that occur on one specific date, associated offering costs are reclassified as a reduction of proceeds raised on the date of issue. Our ongoing offering of up to a maximum of 900,000 units, consisting of one share of Series A Redeemable Preferred Stock, or Series A Preferred Stock, and one warrant, or Warrant, to purchase 20 shares of Common Stock, or Units, generally closes on a bimonthly basis in variable amounts. Such offering is referred to herein as the Follow-on Offering, pursuant to our registration statement on Form S-3 (registration number 333-183355), as may be amended from time to time. Deferred offering costs related to the Follow-on Offering and Shelf Offering (as defined in note 5) are reclassified to the stockholders' equity section of the consolidated balance sheet as a reduction of proceeds raised on a pro-rata basis equal to the ratio of total Units or value of shares issued to the maximum number of Units, or the value of shares, as applicable, that are expected to be issued.

Revenue Recognition

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

Rental revenue from tenants' operating leases in the Company's retail shopping centers is recognized on a straight-line basis over the term of the lease regardless of when payments are due. Revenue based on "percentage rent" provisions that provide for additional rents that become due upon achievement of specified sales revenue targets (as specified in each lease agreement) is recognized only after the tenant exceeds its specified sales revenue target. Revenue from reimbursements of the tenants' share of real estate taxes, insurance and common area maintenance, or CAM, costs are recognized in the period in which the related expenses are incurred. Lease termination revenues are recognized ratably as rental revenue over the revised remaining lease term after giving effect to the termination notice. Rents and tenant reimbursements collected in advance are recorded in the accompanying consolidated balance sheets. The Company estimates the collectability of the tenant receivable related to rental and reimbursement billings due from tenants and straight-line rent receivables, which represent the cumulative amount of future adjustments necessary to present rental income on a straight-line basis, by taking into consideration the Company's historical write-off experience, tenant credit-worthiness, current economic trends, and remaining lease terms.

The Company may provide retail tenants an allowance for the construction of leasehold improvements. These leasehold improvements are capitalized and depreciated over the shorter of the useful life of the improvements or the remaining lease term. If the allowance represents a payment for a purpose other than funding leasehold improvements, or in the event the Company is not considered the owner of the improvements, the allowance is considered to be a lease incentive and is recognized over the lease term as a reduction of minimum rent. Determination of the appropriate

accounting for the payment of a tenant allowance is made on a lease-by-lease basis, considering the facts and circumstances of the individual tenant lease. When the Company is the owner of the leasehold improvements, recognition of lease revenue commences when the lessee is given possession of the leased space upon completion of tenant improvements. However, when the leasehold improvements are owned by the tenant, the lease inception date is the date the tenant obtains possession of the leased space for purposes of constructing its leasehold improvements.

Interest income on real estate loans and notes receivable is recognized on an accrual basis over the lives of the loans or notes using the effective interest method. In the event that a loan or note is refinanced with the proceeds of another loan issued by the Company, any unamortized loan fee revenue from the first loan will be recognized as interest revenue over the term of the new loan. Direct loan origination fees and origination or acquisition costs applicable to real estate loans are amortized over the lives of the loans as adjustments to interest income. The accrual of interest on all these instruments is stopped when there is concern as to the ultimate collection of principal or interest, which is generally a delinquency of 30 days in required payments of interest or principal. Any payments received on such non-accrual loans are recorded as interest income when the payments are received. Real estate loan assets are reclassified as accrual-basis once interest and principal payments become current. Certain real estate loan assets

include limited purchase options and exit fees or additional interest payments that are due the Company at maturity or in the event of a sale of the property or refinancing of the loan by the borrower to a third party. If the Company purchases the subject property, any accrued exit fee will be treated as additional consideration for the acquired project.

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

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

Discontinued Operations

The Company evaluates all disposal groups for held-for-sale classification and for those disposal groups for which it will have no continuing involvement, nor receipt of cash flows post-disposal, for presentation in the consolidated financial statements according to criteria provided by ASC 360-10-45-9. If the disposal group meets the criteria necessary for held for sale classification, the assets and liabilities to be transferred upon sale or disposal are summarized into single line items entitled property held for sale on the consolidated balance sheets, and the results of operations are reclassified into a single line entitled gain/loss from discontinued operations on the consolidated statements of operations and depreciation expense is no longer recorded. Previous periods are similarly reclassified for comparability. In the event a disposal group no longer meets the criteria necessary for held for sale classification, any reclassification adjustments previously made to the assets, liabilities, and results of operations are reversed and depreciation expense is adjusted to recognize any such expense applicable to periods for which the disposal group was classified as held for sale.

New Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2014-08 ("ASU 2014-08"), Reporting Discontinued Operations and Disclosures of Disposals of Components of Entity. Under this new guidance, a disposal of a component of an entity or a group of components of an entity shall only be reported in discontinued operations if the disposal represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results. ASU 2014-08 is to be applied prospectively for annual and interim periods beginning on or after December 31, 2014, with early adoption permitted. Early adoption is not permitted for assets that have previously been reported as held for sale in the consolidated financial statements. Therefore, application of this new guidance was not permitted for the Company's Trail Creek multifamily community, which was reported as held for sale in the Company's Annual Report on Form 10-K for the twelve-month period ended December 31, 2013 and in the Company's Quarterly Report on Form 10-Q for the three-month period ended March 31, 2014. The Company does not expect the adoption of this guidance to materially impact its financial position or results of operations.

In May 2014, the FASB issued Accounting Standards Update 2014-09 ("ASU 2014-09"), Revenue from Contracts with Customers (Topic 606). ASU 2014-09 provides a single comprehensive revenue recognition model for contracts

with customers (excluding certain contracts, such as lease contracts) to improve comparability within industries. ASU 2014-09 requires an entity to recognize revenue to reflect the transfer of goods or services to customers at an amount the entity expects to be paid in exchange for those goods and services and provide enhanced disclosures, all to provide more comprehensive guidance for transactions such as service revenue and contract modifications. ASU 2014-09 is effective for interim and annual periods beginning after December 15, 2016 and may be applied using either a full retrospective or a modified approach upon adoption. The Company is currently evaluating the impact this standard may have on its financial statements.

In August 2014, the FASB issued Accounting Standards Update 2014-15 (“ASU 2014-15”), Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. This new guidance requires management to evaluate, at each annual and interim reporting period, whether there are conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date the financial statements are issued and provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15,

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2016 and interim periods thereafter, early adoption is permitted. The Company is currently in the process of evaluating the impact the adoption of ASU 2014-15 will have on the Company’s condensed consolidated financial statements.

3. Real Estate Assets

The Company's real estate assets consisted of 10 multifamily communities with 3,326 total units and 9 grocery-anchored necessity retail shopping centers at September 30, 2014; at September 30, 2013, the Company owned 6 multifamily communities with 1,789 total units. The acquired second phases of the Trail Creek and Summit Crossing communities are managed in combination with the initial phases of these communities and are therefore considered single properties. At June 30, 2014, the combined phases of our Trail Creek communities, which were previously classified as held for sale, were reclassified pursuant to action taken by the investment committee of the Company's Manager during the second quarter 2014.

On September 5, 2014, the Company completed the acquisition of the following two grocery-anchored necessity retail shopping centers, for approximately $24.1 million, an amount which approximated the fair value of the acquired assets and assumed liabilities:

Seller	Property	Location	Gross leasable area (square feet)
Newco-Columbia, LLC	Spring Hill Plaza	Nashville, Tennessee	61,570
Newco-Ridley, LLC	Parkway Towne Centre	Nashville, Tennessee	65,587
			127,157

The Company allocated the purchase price of the assets to the acquired assets and liabilities based upon their fair values, as shown in the following table. The purchase price allocation was based upon the Company's best estimates of the fair values of the acquired assets and liabilities, but is preliminary and is subject to refinement for a period of up to one year from the closing of the acquisition.

	Total Nashville Portfolio
Land	$ 7,429,756
Buildings and improvements	12,926,230
Tenant improvements	1,872,156
In-place leases	2,280,106
Above-market leases	11,107
Leasing costs	842,551
Below-market leases	(1,228,006)
Other assets	29,521
Other liabilities	(89,974)
Net assets acquired	$ 24,073,447
Cash paid	$ 6,973,447

Mortgage debt	17,100,000
Total consideration	$ 24,073,447

The tenant improvements, in-place leases, above market leases, leasing costs, and below-market leases will continue to be amortized over the remaining non-cancelable lease terms, which range from three months to 12 years as of September 30, 2014, with a weighted average remaining lease term of approximately 7.9 years as of September 30, 2014. Since the acquisition date of September 5, 2014, Spring Hill Plaza and Parkway Town Centre collectively contributed approximately $172,000 of revenue and $33,000 of net income to the Company's consolidated results for the three-month and nine-month periods ended September 30, 2014. The Company expensed acquisition costs of approximately $2,200,000 in conjunction with these acquisitions.

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On September 26, 2014, the Company completed the acquisition of the following multifamily communities, referred to collectively as the Dunbar Portfolio, for approximately $181.3 million, an amount which approximated the fair value of the acquired assets and assumed liabilities:

Seller	Property	Location	Units
Estancia Dallas, LLC	Estancia at Vista Ridge [1]	Dallas, Texas	300
Sandstone Overland Park, LLC	Sandstone Creek Apartments	Kansas City, Kansas	364
Stoneridge Nashville, LLC	Stoneridge Farms at Hunt Club	Nashville, Tennessee	364
Vineyards Houston, LLC	Vineyards Apartments	Houston, Texas	369
			1,397

[1] Property was renamed Enclave at Vista Ridge upon acquisition.

Each of the four sellers are wholly-owned subsidiaries of JTL AREP Investments, LLC, a Delaware limited liability company.

The Company allocated the purchase price of the assets to the acquired assets and liabilities based upon their fair values, as shown in the following table. The purchase price allocation was based upon the Company's best estimates of the fair values of the acquired assets and liabilities, but is preliminary and is subject to refinement for a period of up to one year from the closing of the acquisition.

	Total Dunbar Portfolio
Land	$ 16,033,101
Buildings and improvements	148,701,272
Furniture, fixtures and equipment	13,345,980
Lease intangibles	3,564,244
Prepaids & other assets	75,600
Escrows	1,519,846
Accrued taxes	(1,694,340)
Security deposits, prepaid rents, and other liabilities	(221,610)
Net assets acquired	$ 181,324,093
Cash paid	$ 61,432,093
Mortgage debt	119,892,000
Total consideration	$ 181,324,093

The lease intangibles will continue to be amortized over the remaining non-cancelable lease terms, all of which were 6 months as of September 30, 2014. Since the acquisition date of September 26, 2014, the Dunbar Portfolio contributed approximately $256,000 of revenue and $436,000 of net loss (primarily due to the incurrence of amortization expense related to intangible assets) to the Company's consolidated results for the three-month and nine-month period ended September 30, 2014. The Company expensed acquisition costs of $2,952,562 in conjunction with the Dunbar Portfolio

acquisition.

On September 30, 2014, the Company completed the acquisition of the following six grocery-anchored necessity retail shopping centers, referred to collectively as the Sunbelt Portfolio, for approximately $74.2 million, an amount which approximated the fair value of the acquired assets and assumed liabilities:

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Seller	Property	Location	Rentable square feet
U. S. Retail Income Fund VII, LLC	Deltona Landing	Orlando, Florida	59,996
U. S. Retail Income Fund VII, LLC	Powder Springs	Atlanta, Georgia	77,853
U. S. Retail Income Fund VII, LLC	Kingwood Glen	Houston, Texas	103,397
U. S. Retail Income Fund VII, LLC	Parkway Centre	Columbus, Georgia	53,088
U. S. Retail Income Fund VI, LLC	Barclay Crossing	Tampa, Florida	54,958
U. S. Retail Income Fund VI, LLC	Sweetgrass Corner	Charleston, South Carolina	89,124
			438,416

The two selling legal entities are directed and administered by BVT Equity Holdings, Inc. of Munich, Germany. The Company transferred its right to purchase a seventh shopping center in the portfolio, located in Miami, Florida, to the anchoring grocery tenant.

The Company allocated the purchase price of the assets to the acquired assets and liabilities based upon their fair values, as shown in the following table. The purchase price allocation was based upon the Company's best estimates of the fair values of the acquired assets and liabilities, but is preliminary and is subject to refinement for a period of up to one year from the closing of the acquisition.

	Total Sunbelt Portfolio
Land	$ 17,111,929
Buildings and improvements	54,171,413
Furniture, fixtures and equipment	105,293
In-place leases	5,400,067
Above market leases	319,501
Leasing commissions and legal	1,202,561
Below market leases	(4,160,764)
Escrows	318,120
Other assets	357,039
Other liabilities	(621,814)
Net assets acquired	$ 74,203,345
Cash paid	$ 27,343,345
Mortgage debt	46,860,000
Total consideration	$ 74,203,345

The in-place leases, above market leases, leasing costs, and below-market leases will continue to be amortized over the remaining non-cancelable lease terms, which range from 2 months to 10 years as of September 30, 2014, with a weighted average remaining lease term of 4.9 years as of September 30, 2014. The Company expensed acquisition

costs of approximately $1.4 million in conjunction with the Sunbelt Portfolio acquisition.

On February 12, 2014, the Company completed the acquisition of a 66,122 square foot retail shopping center in Woodstock, Georgia, or Woodstock Crossing, for approximately $5.7 million, which approximated the fair value of the acquired assets and assumed liabilities.

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The Company allocated the purchase price of the assets to the acquired assets and liabilities based upon their fair values, as shown in the following table. The purchase price allocation was based upon the Company's best estimates of the fair values of the acquired assets and liabilities, but is preliminary and is subject to refinement for a period of up to one year from the closing of the acquisition.

	Woodstock
Land	$ 1,750,576
Buildings and improvements	3,760,654
Escrow fund for improvements	226,830
Tenant improvements	39,447
In-place leases	245,850
Above market leases	30,051
Leasing costs	123,731
Below market leases	(450,310)
Other liabilities	(25,436)
Net assets acquired	$ 5,701,393

The tenant improvements, in-place leases, above market leases, legal fees and commissions, and below-market leases will continue to be amortized over the remaining non-cancelable lease terms, which range from six months to ten years as of September 30, 2014, with a weighted average remaining lease term of 8 years as of September 30, 2014. Since the acquisition date of February 12, 2014, Woodstock Crossing contributed approximately $183,000 and $463,000 of revenue and $28,000 and $133,000 of net income to the Company's consolidated results for the three-month and nine-month periods ended September 30, 2014, respectively. The Company expensed acquisition costs of approximately $268,000 in conjunction with the Woodstock Crossing acquisition.

On January 23, 2013, the Company completed the acquisition of 100% of the membership interests of the following three entities from Williams Multifamily Acquisition Fund, LP, a Delaware limited partnership, or WMAF, an entity whose properties were also managed by Preferred Residential Management LLC.

- Ashford Park REIT, Inc., the fee-simple owner of a 408-unit multifamily community located in Atlanta, Georgia, or Ashford Park, for a total purchase price of approximately $39.6 million, exclusive of assumed mortgage debt, acquisition-related and financing-related transaction costs. The Company expensed acquisition costs of approximately $455,000 in conjunction with the Ashford Park acquisition.

- Lake Cameron REIT, Inc., the fee-simple owner of a 328-unit multifamily community located in Raleigh, North Carolina, or Lake Cameron, for a total purchase price of approximately $30.5 million, exclusive of assumed mortgage debt, acquisition-related and financing-related transaction costs. The Company expensed acquisition costs of approximately $358,000 in conjunction with the Lake Cameron acquisition.

- McNeil Ranch REIT, Inc., the fee-simple owner of a 192-unit multifamily community located in Austin, Texas, or McNeil Ranch, for a total purchase price of approximately $21.0 million, exclusive of assumed mortgage debt, acquisition-related and financing-related transaction costs. The Company expensed acquisition costs of approximately $277,000 in conjunction with the McNeil Ranch acquisition.

As discussed in note 16, on October 6, 2014 the Company acquired a third grocery-anchored necessity retail shopping center located in Nashville Tennessee. As of the date of filing of this Quarterly Report on Form 10-Q, the initial

accounting, including the purchase price allocation for this transaction was not complete.

On December 4, 2013, pursuant to the approval of the investment committee of the Manager, the Company entered into an exclusive marketing agreement with an outside firm to market for sale the combined phases of its Trail Creek multifamily community (Trail I and Trail II). The operating results of the community were classified as held for sale at December 31, 2013 and March 31, 2014. Effective on December 4, 2013, the Company ceased recording depreciation on the combined Trail Creek community. On June 20, 2014, again pursuant to approval of the investment committee of the Manager, the Company removed the Trail Creek community from held for sale classification. As such, Trail Creek is included in the Company's consolidated financial statements as of and for the three months and nine months ended September 30, 2014 and 2013.

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Amortization of acquired intangible assets for the nine-month period ended September 30, 2013 related to the Ashford Park, McNeil Ranch and Lake Cameron communities commenced on January 23, 2013, the date of acquisition. The intangible assets were amortized over a period ranging from the average remaining lease term, which was approximately six to twelve months, to the average remaining lease term plus the average estimated renewal period.

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Depreciation:				
Buildings and improvements	$ 1,475,098	$ 1,027,767	$ 3,833,974	$ 2,845,693
Furniture, fixtures, and equipment	1,248,832	1,077,922	3,521,459	2,943,025
	2,723,930	2,105,689	7,355,433	5,788,718
Amortization:				
Acquired intangible assets	460,618	1,575,247	1,432,040	6,886,537
Website development costs	1,191	1,151	3,572	3,454
Total depreciation and amortization	$ 3,185,739	$ 3,682,087	$ 8,791,045	$ 12,678,709

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

At September 30, 2014, our portfolio of real estate loans consisted of:

Project/Property (1)	Location	Date of loan	Maturity date	Optional extension date	Total loan commitments	Approved senior loan held by unrelated third party	Current / deferred interest % per annum
City Park	Charlotte, NC	9/6/2012	9/5/2017	N/A	$ 10,000,000	$ 18,600,000	