Howard Hughes Corp
Form 10-Q
August 08, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2013

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission file number 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-4673192**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

13355 Noel Road, 22nd Floor, Dallas, Texas 75240

(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant s telephone number, including area code)

N / A

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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). x Yes o 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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of common stock, $0.01 par value, outstanding as of August 5, 2013 was 39,576,344.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

	June 30, 2013	December 31, 2012
	(In thousands, except share amounts)	
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,562,745	$ 1,563,122
Land	253,341	252,593
Buildings and equipment	719,111	657,268
Less: accumulated depreciation	(123,794)	(112,491)
Developments	307,434	273,613
Net property and equipment	2,718,837	2,634,105
Investment in Real Estate Affiliates	56,732	32,179
Net investment in real estate	2,775,569	2,666,284
Cash and cash equivalents	213,196	229,197
Accounts receivable, net	18,667	13,905
Municipal Utility District receivables, net	116,982	89,720
Notes receivable, net	22,976	27,953
Tax indemnity receivable, including interest	313,925	319,622
Deferred expenses, net	17,478	12,891
Prepaid expenses and other assets, net	125,803	143,470
Total assets	$ 3,604,596	$ 3,503,042
Liabilities:		
Mortgages, notes and loans payable	$ 715,530	$ 688,312
Deferred tax liabilities	89,331	77,147
Warrant liabilities	267,800	123,573
Uncertain tax position liability	136,387	132,492
Accounts payable and accrued expenses	178,232	170,521
Total liabilities	1,387,280	1,192,045
Commitments and Contingencies (see Note 14)		
Equity:		
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued		
Common stock: $.01 par value; 150,000,000 shares authorized, 39,576,344 shares issued and outstanding as of June 30, 2013 and 39,498,912 shares issued and outstanding as of December 31, 2012	396	395
Additional paid-in capital	2,826,609	2,824,031
Accumulated deficit	(609,291)	(509,613)
Accumulated other comprehensive loss	(7,773)	(9,575)
Total stockholders equity	2,209,941	2,305,238
Noncontrolling interests	7,375	5,759
Total equity	2,217,316	2,310,997

Total liabilities and equity	$	3,604,596	$	3,503,042

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	$ 66,021	$ 43,928	$ 113,247	$ 80,017
Builder price participation	2,426	1,528	3,701	2,341
Minimum rents	20,134	20,577	39,060	39,474
Tenant recoveries	5,065	6,003	10,390	11,867
Condominium rights and unit sales	30,381	134	30,381	267
Resort and conference center revenues	11,270	11,970	22,374	21,626
Other land revenues	3,830	3,531	6,632	7,048
Other rental and property revenues	7,925	6,268	11,358	11,062
Total revenues	147,052	93,939	237,143	173,702
Expenses:				
Master Planned Community cost of sales	29,854	22,978	55,553	41,657
Master Planned Community operations	9,794	9,979	18,290	21,026
Other property operating costs	17,334	15,044	32,854	29,373
Rental property real estate taxes	3,359	3,171	7,116	7,009
Rental property maintenance costs	2,143	2,086	3,948	4,041
Condominium rights and unit cost of sales	15,272	36	15,272	96
Resort and conference center operations	7,680	7,371	15,156	14,785
Provision for doubtful accounts	277	164	706	45
General and administrative	6,769	8,160	17,940	16,557
Depreciation and amortization	6,780	5,893	13,224	10,951
Total expenses	99,262	74,882	180,059	145,540
Operating income	47,790	19,057	57,084	28,162
Interest income	2,067	2,342	4,423	4,673
Interest expense		(200)	(143)	(201)
Warrant liability gain (loss)	(111,200)	23,430	(144,227)	(98,421)
Reduction in tax indemnity receivable	(7,499)	(8,782)	(9,403)	(8,782)
Equity in earnings from Real Estate Affiliates	5,707	446	8,440	3,122
Income (loss) before taxes	(63,135)	36,293	(83,826)	(71,447)
Provision for income taxes	13,361	1,301	15,840	5,085
Net income (loss)	(76,496)	34,992	(99,666)	(76,532)
Net income attributable to noncontrolling interests	(58)	(682)	(12)	(1,418)
Net income (loss) attributable to common stockholders	$ (76,554)	$ 34,310	$ (99,678)	$ (77,950)
Basic earnings (loss) per share:	$ (1.94)	$ 0.91	$ (2.53)	$ (2.06)

Diluted earnings (loss) per share:	$	(1.94)	$	0.27	$	(2.53)	$	(2.06)

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

UNAUDITED

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(In thousands)		(In thousands)	
Comprehensive income (loss), net of tax:				
Net income (loss)	$ (76,496)	$ 34,992	$ (99,666)	$ (76,532)
Other comprehensive income (loss):				
Interest rate swaps (a)	2,112	(2,263)	2,533	(2,161)
Capitalized swap interest (b)	(318)	(159)	(731)	(569)
Other comprehensive income (loss)	1,794	(2,422)	1,802	(2,730)
Comprehensive income (loss)	(74,702)	32,570	(97,864)	(79,262)
Comprehensive income attributable to noncontrolling interests	(58)	(682)	(12)	(1,418)
Comprehensive income (loss) attributable to common stockholders	$ (74,760)	$ 31,888	$ (97,876)	$ (80,680)

(a) Net of deferred tax expense of $0.3 million and $0.4 million for the three and six months ended June 30, 2013. Net of deferred tax benefit of $0.3 million and $0.2 million for the three and six months ended June 30, 2012.

(b) Net of deferred tax benefit of $0.2 million and $0.4 million for the three and six months ended June 30, 2013. Net of deferred tax benefit of $0.1 million and $0.3 million for the three and six months ended June 30, 2012.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

UNAUDITED

(In thousands, except share amounts)	Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balance, January 1, 2012	37,945,707	$ 379	$ 2,711,109	$ (381,325)	$ (5,578)	$ 5,014	$ 2,329,599
Net income (loss)				(77,950)		1,418	(76,532)
Interest rate swaps, net of tax of ($150)					(2,161)		(2,161)
Capitalized swap interest, net of tax of $330					(569)		(569)
Stock plan activity	27,933		2,069				2,069
Balance, June 30, 2012	37,973,640	$ 379	$ 2,713,178	$ (459,275)	$ (8,308)	$ 6,432	$ 2,252,406
Balance, January 1, 2013	39,498,912	$ 395	$ 2,824,031	$ (509,613)	$ (9,575)	$ 5,759	$ 2,310,997
Net income (loss)				(99,678)		12	(99,666)
Adjustment to noncontrolling interest						1,616	1,616
Preferred dividend payment on behalf of REIT subsidiary						(12)	(12)
Interest rate swaps, net of tax of ($379)					2,533		2,533
Capitalized swap interest, net of tax of $377					(731)		(731)
Stock plan activity	77,432	1	2,578				2,579
Balance, June 30, 2013	39,576,344	$ 396	$ 2,826,609	$ (609,291)	$ (7,773)	$ 7,375	$ 2,217,316

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	$ (99,666)	$ (76,532)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation	11,427	8,853
Amortization	1,797	2,098
Amortization of deferred financing costs and debt market rate adjustments, net	338	(155)
Amortization of intangibles other than in-place leases	192	(89)
Straight-line rent amortization	(705)	(482)
Deferred income taxes	15,871	4,612
Restricted stock and stock option amortization	2,578	2,069
Warrant liability loss	144,227	98,421
Reduction in tax indemnity receivable	9,403	8,782
Equity in earnings (loss) from Real Estate Affiliates, net of distributions	(5,441)	72
Provision for doubtful accounts	706	45
Master Planned Community development expenditures	(67,484)	(47,235)
Master Planned Community cost of sales	48,731	39,371
Condominium development expenditures	(6,761)	
Condominium cost of sales	15,270	96
Deferred revenue from sale of condominium rights	17,119	
Net changes:		
Accounts and notes receivable	(4,951)	9,682
Prepaid expenses and other assets	11,776	2,191
Deferred expenses	(760)	(1,730)
Accounts payable and accrued expenses	(5,918)	(20,508)
Other, net	1,666	(10)
Cash provided by operating activities	89,415	29,551
Cash Flows from Investing Activities:		
Real estate and property expenditures	(96,175)	(20,036)
Consideration paid to acquire Millennium Waterway Apartments, net of cash acquired		(2,721)
Distribution from Millennium Waterway Apartments		6,876
Proceeds from sales of investment in Real Estate Affiliates		8,579
Investments in Summerlin Las Vegas Baseball Club, LLC	(10,200)	
Investment in KR Holdings, LLC	(16,750)	
Investments in other Real Estate Affiliates, net	(758)	(1,450)
Change in restricted cash	(12,673)	7,703
Cash used in investing activities	(136,556)	(1,049)
Cash Flows from Financing Activities:		
Proceeds from issuance of mortgages, notes and loans payable	94,575	35,827

Principal payments on mortgages, notes and loans payable	(60,829)	(36,308)
Deferred financing costs	(460)	(1,299)
Preferred dividend payment on behalf of REIT subsidiary	(12)	
Distributions to noncontrolling interests	(2,134)	
Cash provided provided by (used in) financing activities	31,140	(1,780)

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Six Months Ended June 30,	
	2013	**2012**
	(In thousands)	
Net change in cash and cash equivalents	(16,001)	26,722
Cash and cash equivalents at beginning of period	229,197	227,566
Cash and cash equivalents at end of period	$ 213,196	$ 254,288
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 15,401	$ 10,284
Interest capitalized	18,202	13,253
Income taxes paid	1,914	824
Non-Cash Transactions:		
Acquisition of Millennium Waterway Apartments		
Land		(15,917)
Building and equipment		(56,002)
Other Assets		(2,669)
Mortgages, notes and loans payable		55,584
Other liabilities		754
Reduction in investments in Real Estate Affiliates due to the Millennium Waterway Apartments acquisition		22,405
Special Improvement District bond transfers associated with land sales	6,823	2,189
Real estate and property expenditures	27,469	4,345
Non-cash increase in Property due to consolidation of Real Estate Affiliate	3,750	
Transfer of condominium buyer deposits to Real Estate Affiliate	34,220	

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the Securities and Exchange Commission (the SEC). Such condensed consolidated financial statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (Quarterly Report) should refer to The Howard Hughes Corporation s (HHC or the Company) audited Consolidated and Combined Financial Statements for the year ended December 31, 2012 which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2012. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods have been included. The results for the three and six months ended June 30, 2013 are not necessarily indicative of the results for the full fiscal year.

Management has evaluated all material events occurring subsequent to the date of the condensed consolidated financial statements up to the date and time this Quarterly Report was filed.

NOTE 2 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010 (the Effective Date), we issued warrants to purchase 8.0 million shares of our common stock to certain of our sponsors (the Sponsors Warrants) with an estimated initial value of approximately $69.5 million. The initial exercise price for the warrants of $50.00 per share and the number of shares of common stock underlying each warrant are subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. On December 7, 2012, the affiliates of Blackstone Real Estate Partners and the Fairholme Fund and the Fairholme Focused Income Fund, each sold their sponsor warrants totaling 333,333 and 1,916,667, respectively, to HHC for $30.00 cash per warrant. These transactions were accounted for as the settlement of a liability for cash consideration of $67.5 million. On November 9, 2012, affiliates of Brookfield Asset Management, Inc. (Brookfield), one of our sponsors, exercised their warrants to purchase 1,525,272 shares of our common stock at an exercise price of $50.00 per warrant, or $76.3 million. In addition, Brookfield sold their remaining warrants to purchase 2,308,061 shares of our common stock to HHC for $89.3 million. The cash consideration paid to Brookfield net of the exercise price was $13.0 million. As a result of these transactions, $108.6 million of additional paid-in capital was recorded in our financial statements in the year ended December 31, 2012. The Sponsors Warrants expire on November 9, 2017.

In November 2010 and February 2011, we entered into certain agreements (the Management Warrants) with David R. Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our Chief Financial Officer, in each case prior to his appointment to such position, to purchase shares of our common stock. The Management Warrants representing 2,862,687 underlying shares, which may be adjusted pursuant to a net settlement option, were issued pursuant to such agreements at fair value in exchange for a combined total of approximately $19.0 million in cash from such executives at the commencement of their respective employment. Mr. Weinreb and Mr. Herlitz s warrants have exercise prices of $42.23 per share and Mr. Richardson s warrant has an exercise price of $54.50 per share. Generally, the Management Warrants become exercisable in November 2016 and expire by February 2018.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The estimated $126.4 million fair value for the Sponsors Warrants representing warrants to purchase 1,916,667 shares and estimated $141.4 million fair value for the Management Warrants representing warrants to purchase 2,862,687 shares outstanding as of June 30, 2013, have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsors Warrants and Management Warrants were $58.5 million and $65.1 million, respectively, as of December 31, 2012. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 6 Fair Value of Financial Instruments. Decreases and increases in the fair value of the Sponsors Warrants and the Management Warrants are recognized as either warrant liability gains or losses, respectively, in the Condensed Consolidated Statements of Operations.

NOTE 3 EARNINGS PER SHARE

Basic earnings (loss) per share (EPS) is computed by dividing net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding. Diluted EPS is computed after adjusting the numerator and denominator of the basic EPS computation for the effects of all potentially dilutive common shares. The dilutive effect of options and nonvested stock issued under stock-based compensation plans is computed using the treasury stock method. The dilutive effect of the Sponsors Warrants and Management Warrants is computed using the if-converted method. Gains associated with the Sponsors Warrants and Management Warrants are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti-dilutive.

Information related to our EPS calculations is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands, except per share amounts)			
Basic EPS:				
Numerator:				
Net income (loss)	$ (76,496)	$ 34,992	$ (99,666)	$ (76,532)
Net income attributable to noncontrolling interests	(58)	(682)	(12)	(1,418)
Net income (loss) attributable to common stockholders	$ (76,554)	$ 34,310	$ (99,678)	$ (77,950)
Denominator:				
	39,445	37,907	39,443	37,905

Weighted average basic common shares outstanding								
Diluted EPS:								
Numerator:								
Net income (loss) attributable to common stockholders	$	(76,554)	$	34,310	$	(99,678)	$	(77,950)
Less: Warrant liability gain				(23,430)				
Adjusted net income (loss) attributable to common stockholders	$	(76,554)	$	10,880	$	(99,678)	$	(77,950)
Denominator:								
Weighted average basic common shares outstanding		39,445		37,907		39,443		37,905
Restricted stock and stock options				5				
Warrants				2,339				
Weighted average diluted common shares oustanding		39,445		40,251		39,443		37,905
Basic earnings (loss) per share:	$	(1.94)	$	0.91	$	(2.53)	$	(2.06)
Diluted earnings (loss) per share:	$	(1.94)	$	0.27	$	(2.53)	$	(2.06)

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The diluted EPS computation for the three and six months ended June 30, 2013 excludes 918,440 stock options, 122,332 shares of restricted stock, 1,916,667 shares of common stock underlying the Sponsors Warrants and 2,862,687 shares of common stock underlying the Management Warrants because their inclusion would have been anti-dilutive.

Additionally, the diluted EPS computation for the three months ended June 30, 2012 excludes 847,937 stock options and 14,900 shares of restricted stock because their inclusion would have been anti-dilutive. The diluted EPS computation for the six months ended June 30, 2012 excludes 847,937 stock options, 57,933 shares of restricted stock and 10,862,687 Sponsors and Management warrants because their inclusion would have been anti-dilutive.

NOTE 4 RECENT TRANSACTIONS

In 2012, we formed another 50/50 joint venture, KR Holdings, LLC (KR Holdings) with two partners to develop a 23-story luxury condominium tower, ONE Ala Moana Tower Condominium Project. On September 17, 2012, KR Holdings closed on $40.0 million non-recourse mezzanine financing commitments with List Island Properties, LLC and A & B Properties, Inc., including funding for $3.0 million of pre-development costs.

On May 15, 2013, KR Holdings, LLC (KR Holdings) closed on a first mortgage construction loan. Upon closing and under the terms of our joint venture agreement, we sold to KR Holdings our interest in the condominium rights for $47.5 million and received net cash proceeds of $30.8 million and a 50% equity interest in KR Holdings. Our partner contributed $16.8 million of cash for their 50% equity interest. Due to our continuing involvement in KR Holdings, we accounted for the transaction as a partial sale representing 50% of the $47.5 million sales value of the condominium rights, and accordingly, we recognized net profit of $11.8 million. The remaining $23.7 million sales value of the condominium rights will be recognized on the same percentage of completion basis as KR Holdings. As of June 30, 2013 the project was 27.9% complete, and we recognized an additional $3.3 million of profit on the sale for the three months ended June 30, 2013. Please refer to Note 7 Real Estate Affiliates for further discussion of the ONE Ala Moana Tower Condominium Project.

NOTE 5 IMPAIRMENT

We review our real estate assets, including operating assets, land held for development and sale and developments in progress, for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. GAAP requires that if impairment indicators exist and the undiscounted cash flows expected to be generated by an asset are less than its carrying amount, an impairment charge should be recorded to write down the carrying amount of such asset to fair value (or for land held for sale, fair value less cost to sell). The impairment analysis does not consider the timing of future cash flows and whether the asset is expected to earn an above or below market rate of return.

Our investment in each of the Real Estate Affiliates is evaluated periodically and as deemed necessary for recoverability and valuation declines that are other-than-temporary. If the decrease in value of our investment in a Real Estate Affiliate is deemed to be other-than-temporary, our investment in such Real Estate Affiliate is reduced to its estimated fair value.

No impairment charges were recorded during the three or six months ended June 30, 2013 or 2012. We continually evaluate our strategic alternatives with respect to each of our properties and may revise our strategy from time to time, including our intent to hold the asset on a long-term basis or the timing of potential asset dispositions. For example, we may decide to sell property that is held for use and the sale price may be less than the carrying amount. As a result, these changes in strategy could result in impairment charges in future periods.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents, for each of the fair value hierarchy levels required under Accounting Standards Codification (ASC) 820, Fair Value Measurement, our assets and liabilities that are measured at fair value on a recurring basis.

	June 30, 2013 Fair Value Measurements Using				December 31, 2012 Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)				(In thousands)			
Liabilities								
Warrants	$ 267,800	$	$	$ 267,800	$ 123,573	$	$	$ 123,573
Interest rate swaps	4,281		4,281		7,183		7,183	

The valuation of warrants is based on an option pricing valuation model. The inputs to the model include the fair value of the stock related to the warrants, exercise price of the warrants, term, expected volatility, risk-free interest rate and dividend yield.

The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates derived from observable market interest rate curves.

The following table presents a reconciliation of the beginning and ending balances of the fair value measurements using significant unobservable inputs (Level 3) which are our Sponsors and Management Warrants:

	2013	2012
	(In thousands)	
Balance as of January 1,	$ 123,573	$ 127,764

Warrant liability loss		144,227		98,421
Balance as of June 30,	$	267,800	$	226,185

The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data. Changes in the fair value of the Sponsors Warrants and the Management Warrants are recognized in earnings as a warrant liability gain or loss.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The significant unobservable input used in the fair value measurement of our warrants designated as Level 3 as of June 30, 2013 is as follows:

	Fair Value (In thousands)	**Valuation Technique**	**Unobservable Input**	**Average Volatility**
Warrants	$ 267,800	Option Pricing Valuation Model	Expected Volatility (a)	28.0%

(a) Based on the asset volatility of comparable companies.

The expected volatility in the table above is a significant unobservable input used to estimate the fair value of our warrant liabilities. An increase in expected volatility would increase the fair value of the liability, while a decrease in expected volatility would decrease the fair value of the liability.

The estimated fair values of our financial instruments that are not measured at fair value on a recurring basis are as follows:

Assets:				
Tax indemnity receivable, including interest	313,925	(a)	319,622	(a)
Liabilities:				
Variable-rate debt (b)	515,497	515,497	479,964	479,964
Total mortgages, notes and loans payable	$ 715,530	$ 715,772	$ 688,312	$ 695,318

(a) It is not practicable to estimate the fair value of the tax indemnity receivable, including interest, as the timing and ultimate amount received under contract is highly dependent on numerous future events that cannot be reliably predicted.
(b) As more fully described below, $172.0 million of variable-rate debt has been swapped to a fixed rate for the term of the related debt.

Notes receivable are carried at net realizable value, which approximates fair value. The estimated fair values of these notes receivable are categorized as Level 3 due to certain factors, such as current interest rates, terms of the note and credit worthiness of the borrower.

The fair value of debt in the table above was estimated based on a discounted future cash payment model using Level 2 inputs, which includes risk premiums for loans of comparable quality and a risk free rate derived from the current London Interbank Offered Rate (LIBOR) or U.S. Treasury obligation interest rates. The discount rates reflect our judgment as to what the approximate current lending rates for loans or groups of loans with similar maturities and credit quality would be if credit markets were operating efficiently and assuming that the debt is outstanding through maturity.

The carrying amounts of cash and cash equivalents and accounts receivable approximate fair value because of the short-term maturity of these instruments.

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NOTE 7 REAL ESTATE AFFILIATES

In the ordinary course of business, we enter into partnerships or joint ventures primarily for the development and operations of real estate assets which are referred to as Real Estate Affiliates . These partnerships or joint ventures are typically characterized by a non-controlling ownership interest with decision making and distribution of expected gains and losses being proportionate to the ownership interest. We account for these partnerships and joint ventures in accordance with ASC 810 (ASC 810).

In accordance with ASC 810, we assess our joint ventures at inception to determine if any meet the qualifications of a variable interest entity (VIE). We consider a partnership or joint venture a VIE if: (a) the total equity investment is not sufficient to permit the entity to finance its activities without additional subordinated financial support; (b) characteristics of a controlling financial interest are missing (either the ability to make decisions through voting or other rights, the obligation to absorb the expected losses of the entity or the right to receive the expected residual returns of the entity); or (c) the voting rights of the equity holders are not proportional to their obligations to absorb the expected losses of the entity and/or their rights to receive the expected residual returns of the entity, and substantially all of the entity s activities either involve or are conducted on behalf of an investor that has disproportionately few voting rights. Upon the occurrence of certain events outlined in ASC 810, we reassess our initial determination of whether the partnership or joint venture is a VIE.

We also perform a qualitative assessment of each VIE on an ongoing basis to determine if we are the primary beneficiary, as required by ASC 810. Under ASC 810, a company concludes that it is the primary beneficiary and consolidates the VIE if the company has both (a) the power to direct the economically significant activities of the entity and (b) the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the VIE. The company considers the contractual agreements that define the ownership structure, distribution of profits and losses, risks, responsibilities, indebtedness, voting rights and board representation of the respective parties in determining if the company is the primary beneficiary. As required by ASC 810, management s assessment of whether the company is the primary beneficiary of a VIE is continuously performed.

We account for investments in joint ventures deemed to be VIEs for which we are not considered to be the primary beneficiary but have significant influence using the equity method, and investments in joint ventures where we do not have significant influence on the joint venture s operations and financial policies, on the cost method. Generally, the operating agreements with respect to our Real Estate Affiliates provide that assets, liabilities and funding obligations are shared in accordance with our ownership percentages.

In certain cases, the company is required to consolidate certain VIEs. As of June 30, 2013, the carrying values of the assets and liabilities associated with the operations of the consolidated VIEs were $34.1 million and $2.3 million, respectively. As of December 31, 2012, the

carrying values of the assets and liabilities associated with the operations of the consolidated VIEs were $28.3 million and $1.0 million, respectively. The assets of the VIEs are restricted for use only by the particular VIEs and are not available for our general operations.

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Our recent and more significant VIEs are discussed below.

ONE Ala Moana Condominium Project

On October 11, 2011, we joined two local development partners to form a joint venture called HHMK Development, LLC (HHMK Development) to explore the development of a luxury condominium tower at the Ala Moana Center in Honolulu, Hawaii. On June 14, 2012, we formed another 50/50 joint venture, KR Holdings, LLC (KR Holdings), with the same development partners. We own 50% of each venture and our partners jointly own the remaining 50%.

On September 17, 2012, KR Holdings closed on two $20.0 million non-recourse mezzanine loan commitments with List Island Properties, LLC and A & B Properties, Inc. These loans have a blended interest rate of 12%, were drawn in full on May 15, 2013 and mature on April 30, 2018 with the option to extend for one year. In addition to the mezzanine loans, A & B Properties and List Island Properties both have a profit interest in KR Holdings, which entitles them to receive a share of the profits, up to a maximum of $3.0 million, after a return of, and a 13% preferred return, on our capital.

KR Holdings closed the first mortgage construction loan on May 15, 2013. Upon closing and under the terms of the venture agreement, we sold to KR Holdings our interest in the condominium rights for net cash proceeds of $30.8 million and a 50% equity interest in KR Holdings. Our partner contributed $16.8 million of cash for their 50% equity interest.

The construction loan will be drawn over the course of construction with the total proceeds not to exceed $132.0 million. The loan is secured by the condominium rights and buyers deposits, has no recourse to us, matures on May 15, 2016, and bears interest at one-month LIBOR plus 3.00%. Revenue recognition for individual units in a condominium project requires, among other criteria, that the sales contracts be analyzed to ascertain that the buyer s initial and continuing investments are adequate. KR Holdings determined that the value of the buyers deposits qualified as sufficient investment by the buyers to recognize revenue using the percentage of completion method. We recorded $5.2 million in equity in earnings from Real Estate Affiliates related to KR Holdings in the condensed consolidated statement of operations for the three months ended June 30, 2013.

Millennium Woodlands Phase II, LLC

On May 14, 2012, we entered into a joint venture, Millennium Woodlands Phase II, LLC (Millennium Phase II), with The Dinerstein Companies, the same joint venture partner related to the Millennium Waterway Apartments I project, for the construction of a new 314-unit Class A multi-family complex in The Woodlands Town Center. Our partner is the managing member of Millennium Phase II. As the managing member, our partner controls, directs, manages and administers the affairs of Millennium Phase II. On July 5, 2012, Millennium Phase II was capitalized by our contribution of 4.8 acres of land valued at $15.5 million to the joint venture, our partner s contribution of $3.0 million in cash and a construction loan in the amount of $37.7 million which is guaranteed by our partner. The development of Millennium Phase II further expands our multi-family portfolio in The Woodlands Town Center.

Columbia Parcel D Joint Venture (The Metropolitan)

On October 27, 2011, we entered into a joint venture, Parcel D Development, LLC, with a local developer, Kettler, Inc., to construct a Class A apartment building with ground floor retail space in downtown Columbia, Maryland. We and our partner each own 50% of the venture, and unanimous consent of the partners is required for all major decisions. At formation, we contributed land with a fair value of $20.3 million and have since made capital contributions to the venture of $0.6 million. Pursuant to the joint venture agreement, we have been making improvements to the land. Subsequent to June 30, 2013, the joint venture closed a $64.1 million construction loan which is non-recourse to us, and we received a cash distribution of $7.6 million. The loan bears interest at LIBOR plus 2.4% and matures in July 2020.

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Summerlin Las Vegas Baseball Club

On August 6, 2012, we entered into a joint venture for the purpose of acquiring 100% of the operating assets of the Las Vegas 51s, a Triple-A baseball team which is a member of the Pacific Coast League. We own 50% of the venture and our partners jointly own the remaining 50%. Unanimous consent of the partners is required for all major decisions. In August 2012, we contributed $0.3 million to the joint venture pending final approval of the acquisition by Major League Baseball. In May 2013, after approval was received, we funded our remaining capital obligation of $10.2 million and the joint venture completed the acquisition. Our strategy in acquiring an ownership interest is to pursue a potential relocation of the team to a to-be-built stadium in our Summerlin master planned community. There can be no assurance that such a stadium will ultimately be built.

HHMK Development, KR Holdings, Millennium Phase II, Parcel D Development, LLC and the Summerlin Las Vegas Baseball Club joint venture entities included in the table below are VIEs. We are not the primary beneficiary of any of these VIEs because we do not have the power to direct activities that most significantly impact the economic performance of such joint ventures and therefore we report our interests on the equity method. The aggregate carrying value of the unconsolidated VIEs was $32.7 million and $8.1 million as of June 30, 2013 and December 31, 2012, respectively, and was classified as Investments in Real Estate Affiliates in the Condensed Consolidated Balance Sheets. Our maximum exposure to loss as a result of these investments is limited to the aggregate carrying value of the investment as we have not provided any guarantees or otherwise made firm commitments to fund amounts on behalf of these VIEs.

Below is a summary of our Investments in Real Estate Affiliates:

	Economic/ Legal Ownership		Carrying Value		Share of Earnings/Dividends			
	June 30,	December 31,	June 30,	December 31,	Three Months Ended June 30,		Six Months Ended June 30,	
Equity Method Investments	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**
	(In percentages)		(In thousands)		(In thousands)			
Circle T	50.00%	50.00%	$ 9,036	$ 9,004	$	$	$	$
Forest View/Timbermill Apartments (a)						2		4
HHMK Development, LLC	50.00%	50.00%	163	1,257	153		153	
KR Holdings, LLC	50.00%	50.00%	13,508		5,191		5,191	
Millennium Waterway Apartments (b)	100.00%	100.00%				185		406
	81.43%	81.43%	2,196	2,190				

Millennium Woodlands Phase II, LLC (c)								
Parcel D Development, LLC	50.00%	50.00%	6,302	4,330				
Stewart Title	50.00%	50.00%	3,887	3,871	326	257	517	316
Woodlands Sarofim #1	20.00%	20.00%	2,526	2,450	37	2	76	20
Summerlin Las Vegas Baseball Club	50.00%	50.00%	10,500	300				
			48,118	23,402	5,707	446	5,937	746
Cost basis investments (d)			8,614	8,777			2,503	2,376
Investment in Real Estate Affiliates			$ 56,732	$ 32,179	$ 5,707	$ 446	$ 8,440	$ 3,122

(a) On April 19, 2012, the joint ventures owning the Forest View and Timbermill Apartments completed their sale to a third party. Our share of the distributable cash, after repayment of debt and transaction expenses, was $8.6 million.

(b) On May 31, 2012, we acquired our partner s interest for $6.9 million and consolidated this property. See below for further discussion.

(c) Represents our ownership percentage as of July 5, 2012, the date that the partners contributed capital to the venture.

(d) Includes distribution received from Summerlin Hospital Medical Center.

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On May 31, 2012, we acquired our partner s interest in the 393-unit Millennium Waterway Apartments for $6.9 million, following the funding of a $55.6 million ten-year non-recourse mortgage bearing interest at 3.75%. Prior to the acquisition, we accounted for our investment in Millennium Waterway Apartments under the equity method. We now own 100% of this stabilized Class A multi-family property located in The Woodlands Town Center. Total assets of $78.6 million and liabilities of $56.4 million, including the then recently funded loan, were consolidated into our financial statements at fair value as of the acquisition date.

As of June 30, 2013, approximately $56.7 million of indebtedness was secured by the properties owned by our Real Estate Affiliates of which our share was approximately $29.5 million based upon our economic ownership. The debt is non-recourse to us.

NOTE 8 MORTGAGES, NOTES AND LOANS PAYABLE

Mortgages, notes and loans payable are summarized as follows:

	June 30, 2013	December 31, 2012
	(In thousands)	
Fixed-rate debt:		
Collateralized mortgages, notes and loans payable	$ 158,310	$ 158,636
Special Improvement District bonds	41,723	49,712
Variable-rate debt:		
Collateralized mortgages, notes and loans payable (a)	515,497	479,964
Total mortgages, notes and loans payable	$ 715,530	$ 688,312

(a) As more fully described below, $172.0 million of variable-rate debt has been swapped to a fixed rate for the term of the related debt.

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The following table presents our mortgages, notes, and loans payable by property:

$ In thousands	Maturity (a)	Interest Rate	Maximum Facility Amount	Carrying Value June 30, 2013	Carrying Value December 31, 2012
				(In thousands)	
Master Planned Communities					
The Woodlands Master Credit Facility (b)	March 2015	5.00%	$ 270,000	$ 176,663	$ 176,704
Bridgeland Land Loan (c)	June 2022	5.50%		18,066	18,066
Bridgeland Development Loan (d)	June 2015	5.00%	30,000	10,388	
Summerlin West - S808/S810	April 2031	7.13%		18,432	22,185
Summerlin South - S151	June 2025	6.00%		7,034	10,501
Summerlin South - S128C	December 2030	6.05%		5,625	5,739
Summerlin South - S132	December 2020	6.00%		4,478	4,822
Summerlin South - S108	December 2016	5.95%		947	1,067
Summerlin South - S128	December 2020	7.30%		747	787
Summerlin South - S124	December 2019	5.95%		305	324
Master Planned Communities Total				242,685	240,195
Operating Assets					
Victoria Ward (e)	September 2016	3.39%	250,000	229,000	229,000
Millennium Waterway Apartments	June 2022	3.75%		55,584	55,584
4 Waterway Square	December 2023	4.88%		39,695	40,140
The Woodlands Resort and Conference Center (f)	February 2019	3.69%	95,000	36,100	36,100
110 N. Wacker (g)	October 2019	5.21%		29,000	29,000
3 Waterway Square (h)	January 2017	2.84%	43,295	26,713	9,150
70 Columbia Corporate Center	August 2017	4.25%		16,287	16,037
20/25 Waterway Avenue	May 2022	4.79%		14,450	14,450
9303 New Trails	December 2023	4.88%		13,554	13,706
Columbia Regional Building (i)	March 2018	2.25%	23,008	1,266	
Capital lease obligation	various	3.82%		13	41
Operating Assets Total				461,662	443,208
Strategic Developments					
One Hughes Landing (j)	November 2017	2.84%	38,000	6,367	10
The Shops at Summerlin - S128	December 2030	6.05%		3,635	3,701
The Shops at Summerlin - S108	December 2016	5.95%		520	586
Strategic Developments Total				10,522	4,297
Other Financing Arrangements	July 2015			661	612
				$ 715,530	$ 688,312

(a) Maturity date includes any extension periods which can be exercised at our option.

(b) Loan bears interest at one-month LIBOR + 4.00% and has a 5.00% minimum rate.

(c) Loan is for ten year term. First five years interest is fixed at 5.50% and for second five years interest rate is floating based on three-month LIBOR +2.75%.

(d) Revolving development loan provides for a maximum of $30.0 million outstanding balance at any time with all draws not exceeding $140.0 million. The loan bears interest at the greater of 5.00% or LIBOR + 3.25%.

(e) Loan has a stated interest rate of one-month LIBOR + 2.50%. $143.0 million of the outstanding principal balance is swapped to a 3.80% fixed rate through maturity.

(f) Loan was refinanced in February 2013 and bears interest at one-month LIBOR + 3.50%.

(g) Loan has a stated interest rate of one-month LIBOR + 2.25%. The $29.0 million outstanding principal balance is swapped to a 5.21% fixed rate through maturity.

(h) On August 2, 2013, the loan was refinanced with a $52.0 million loan bearing interest at 3.94% and maturity in August 2028.

(i) Loan bears interest at prime rate for draws less than $0.5 million. For draws over $0.5 million, we may elect to use LIBOR + 2.00% or the prime rate.

(j) Loan bears interest at one-month LIBOR + 2.65%.

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The weighted average interest rate on our mortgages, notes and loans payable was 4.25% and 4.49% as of June 30, 2013 and December 31, 2012, respectively.

Mortgages, Notes and Loans Payable

As of June 30, 2013, we had $715.5 million of mortgages, notes and loans payable. All of the debt is secured by the individual properties as listed in the table above and is non-recourse to HHC, except for a $7.0 million parent guarantee associated with the 110 N. Wacker mortgage. The Woodlands Master Credit Facility and Resort and Conference Center loans are also recourse to the partnerships that directly own The Woodlands operations. Certain of our loans contain provisions which grant the lender a security interest in the operating cash flow of the property that represents the collateral for the loan. Such provisions are not expected to impact our operations in 2013. Certain mortgage notes may be prepaid, but may be subject to a prepayment penalty equal to a yield-maintenance premium, defeasance or a percentage of the loan balance. As of June 30, 2013, land, buildings and equipment and developments in progress with a cost basis of $1.6 billion have been pledged as collateral for our mortgages, notes and loans payable. On July 26, 2013, we closed on a $22.5 million loan to acquire a company airplane. The loan bears interest at 3.0 %, requires $1.0 million annual amortization and matures in July 2018.

As of June 30, 2013, we were in compliance with all of the financial covenants related to our debt agreements.

Master Planned Communities

The Woodlands Master Credit Facility is a $270.0 million facility consisting of a $170.0 million term loan and a $100.0 million revolving credit line (together, the TWL Facility). As of June 30, 2013, the TWL Facility had an outstanding balance of $176.7 million. The TWL Facility bears interest at one-month LIBOR plus 4.00% with a 5.00% floor, has a March 29, 2014 initial maturity date and a one-year extension at borrower s option. The TWL Facility also contains certain restrictions or covenants that, among other things, require the maintenance of specified financial ratios, limit the incurrence of additional recourse indebtedness at The Woodlands, and limit distributions from The Woodlands to us. Until The Woodlands leverage, as defined by the credit agreement, is less than a 40.0% loan to value ratio, we must amortize the debt on a dollar for dollar basis for any distributions that we make from The Woodlands. As of June 30, 2013, leverage was approximately 25.5%. There was $58.3 million of undrawn and available borrowing capacity under the TWL Facility based on the collateral underlying the facility and covenants as of June 30, 2013. The TWL Facility also requires mandatory principal amortization payments during its initial term and during the extension period, if exercised. Repayments of $30.0 million are required on March 29, 2014. Furthermore, $10.0 million is due on each of June 29, September 29 and December 29, 2014 during the extension period.

During the second quarter of 2012, we refinanced $18.1 million of existing debt related to our Bridgeland Master Planned Community with a ten-year term loan facility at a fixed interest rate of 5.50% for the first five years and three-month LIBOR plus 2.75% for the remaining term and maturing on June 29, 2022. Beginning on June 29, 2014, annual principal payments are required in the amount of 5.00% of the then outstanding principal balance. In addition, we simultaneously entered into a three-year revolving credit facility with aggregate borrowing capacity of $140.0 million of which $39.2 million has been utilized and which has a $30.0 million maximum outstanding loan amount at any time. The revolving loan bears interest at the greater of 5.00% or LIBOR plus 3.25% and matures on June 29, 2015. This loan is intended to provide working capital at Bridgeland in order to accelerate development efforts to meet the demand of homebuilders for finished lots in the community. The Bridgeland loans are cross-collateralized and cross-defaulted and the Bridgeland Master Planned Community serves as collateral for the loans. The loans also require that Bridgeland maintain a minimum $3.0 million cash balance and a minimum net worth of $250.0 million. Additionally, we are restricted from making cash distributions from Bridgeland unless the revolver has no outstanding balance and one year of real estate taxes and debt service on the term loan have been escrowed with the lender.

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The Summerlin Master Planned Community uses Special Improvement District bonds to finance certain common infrastructure improvements. These bonds are issued by the municipalities and, although unrated, are secured by the assessments on the land. The majority of proceeds from each bond issued is held in a construction escrow and disbursed to us as infrastructure projects are completed, inspected by the municipalities and approved for reimbursement. Accordingly, the Special Improvement District bonds have been classified as debt. The Summerlin Master Planned Community pays the debt service on the bonds semi-annually. However, our residential land sales contracts provide for the reimbursement of the principal amounts included in these debt service payments. In addition, as Summerlin sells land, the purchasers assume a proportionate share of the bond obligation.

Operating Assets

On March 15, 2013, we closed on a non-recourse financing totaling $23.0 million for the redevelopment of The Columbia Regional Building (also known as The Rouse Building), an office building located in Columbia, Maryland. The loan bears interest at one-month LIBOR plus 2.00% and is interest only through the initial maturity date of March 15, 2016. The loan has two, one-year extension options.

On February 8, 2013, we closed on a $95.0 million non-recourse construction loan which repaid the existing $36.1 million mortgage and provides funding for the redevelopment of The Woodlands Resort and Conference Center. The loan bears interest at one-month LIBOR plus 3.50% and has an initial maturity of February 8, 2016, with three one-year extensions at our option. The loan is secured by a 440-room and 40-acre conference center and resort located within The Woodlands, and requires the maintenance of specified financial ratios after completion of construction.

On August 15, 2012, we assumed a $16.0 million loan as part of the acquisition of 70 Columbia Corporate Center (70 CCC). The non-recourse, interest only promissory note matures on August 31, 2017, has a fixed rate of 4.25% and is secured by the property. The loan includes a participation right to the lender for 30% of the appreciation in the market value of the property after our 10% cumulative preferred return and repayment of the outstanding debt and our contributed equity. The fair value of the participation obligation is remeasured each quarter and the change in fair value is recorded through interest expense. For the six months ended June 30, 2013, $2.7 million relating to the increase in value of the participation due to increased leasing of the property was recorded as interest expense. Virtually all of the interest was capitalized due to our development activities.

On May 31, 2012, as part of the acquisition of our former partner s interest in Millennium Waterway Apartments, we consolidated a $55.6 million non-recourse first mortgage loan. The proceeds from the mortgage were used to refinance the joint venture s existing debt and to fund our acquisition of the partner s interest in the property. The loan matures on June 1, 2022 and has a fixed interest rate of 3.75%. Payments are interest

only until June 2017, then monthly principal and interest payments of $257,418 with the unpaid principal balance due at maturity.

On April 26, 2012, we closed on a 10-year, fixed rate loan with interest at 4.79% secured by 20/25 Waterway Avenue. The proceeds from the loan were $13.6 million.

On February 2, 2012, we closed on a non-recourse financing totaling $43.3 million for the construction of 3 Waterway Square, an eleven-story, 232,000-square foot office building in The Woodlands. The loan matures on January 31, 2015 and has two, one-year extension options. The loan bears interest at one-month LIBOR plus 2.65%. On August 2, 2013, we refinanced the loan with a $52.0 million non-recourse first mortgage financing bearing interest at 3.94% and maturing in August 2028.

On December 5, 2011, we obtained a $41.0 million loan for 4 Waterway Square and a $14.0 million loan for 9303 New Trails. The non-recourse mortgages mature on December 11, 2023 and have fixed interest rates of 4.88%.

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On September 30, 2011, we closed on a $250.0 million non-recourse first mortgage financing secured by Ward Centers in Honolulu, Hawaii, that bears interest at one-month LIBOR plus 2.50%. The loan may be drawn to a maximum $250.0 million to fund capital expenditures at the property, provided that the outstanding principal balance cannot exceed 65% of the property s appraised value, and the borrowers are required to have a minimum 10.0% debt yield in order to draw additional loan proceeds under the facility. The loan also permits partial repayment during its term in connection with property releases for development. The loan matures on September 29, 2016, and $143.0 million of the principal balance was swapped to a 3.80% fixed rate for the term of the loan. The loan had a weighted-average interest rate of 3.39% as of June 30, 2013. The unused portion of this mortgage was $21.0 million as of June 30, 2013.

Strategic Developments

On November 14, 2012, we closed on a non-recourse financing totaling $38.0 million for the construction of One Hughes Landing, an eight-story, 197,000 square foot office building in The Woodlands. The loan matures on November 15, 2015 and has two, one-year extension options. The loan bears interest at LIBOR plus 2.65%.

NOTE 9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are primarily exposed to interest rate risks related to our variable interest debt, and we seek to manage this risk by utilizing interest rate derivatives. Our objectives in using interest rate derivatives are to add stability to interest costs by reducing our exposure to interest rate movements. To accomplish this objective, we use interest rate swaps and caps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up-front premium.

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income (AOCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The outstanding derivatives as of June 30, 2013, were used to hedge the variable cash flows associated with existing variable-rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and six months ended June 30, 2013, the ineffective portion recorded in earnings was insignificant.

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. Over the next 12 months, we estimate that an additional $2.3 million will be reclassified as an increase to interest expense.

As of June 30, 2013, we had gross notional amounts of $172.0 million for interest rate swaps and a $100.0 million interest rate cap that were designated as cash flow hedges of interest rate risk. The fair value of the interest rate cap derivative was insignificant.

If the interest rate swap agreements are terminated prior to their maturity, the amounts previously recorded in AOCI are recognized into earnings over the period that the hedged transaction impacts earnings. If the hedging relationship is discontinued because it is probable that the forecasted transaction will not occur according to the original strategy, any related amounts previously recorded in AOCI are recognized in earnings immediately.

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The table below presents the fair value of our derivative financial instruments which are included in accounts payable and accrued liabilities in the Condensed Consolidated Balance Sheets:

	June 30, 2013	December 31, 2012
	(In thousands)	
Interest Rate Swaps	$ 4,281	$ 7,183
Total derivatives designated as hedging instruments	$ 4,281	$ 7,183

The table below presents the effect of our derivative financial instruments on the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012:

Cash Flow Hedges	Three Months Ended June 30, 2013 Amount of Gain Recognized in OCI	Three Months Ended June 30, 2012 Amount of (Loss) Recognized in OCI	Location of Gain (Loss) Reclassified from AOCI into Earnings	Three Months Ended June 30, 2013 Amount of (Loss) Reclassified from AOCI into Earnings	Three Months Ended June 30, 2012 Amount of (Loss) Reclassified from AOCI into Earnings
	(In thousands)			(In thousands)	
Interest Rate Swaps	$ 1,583	$ (2,770)	Interest Expense	$ (528)	$ (507)
	$ 1,583	$ (2,770)		$ (528)	$ (507)

Cash Flow Hedges	Six Months Ended June 30, 2013 Amount of Gain Recognized in OCI	Six Months Ended June 30, 2012 Amount of (Loss) Recognized in OCI	Location of Gain (Loss) Reclassified from AOCI into Earnings	Six Months Ended June 30, 2013 Amount of (Loss) Reclassified from AOCI into Earnings	Six Months Ended June 30, 2012 Amount of (Loss) Reclassified from AOCI into Earnings
	(In thousands)			(In thousands)	
Interest Rate Swaps	$ 1,486	$ (3,161)	Interest Expense	$ (1,047)	$ (1,000)
	$ 1,486	$ (3,161)		$ (1,047)	$ (1,000)

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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NOTE 10 INCOME TAXES

Several of our subsidiaries are involved in a dispute with the IRS relating to years in which those subsidiaries were owned by General Growth Properties (GGP), and in connection therewith, GGP has provided us with an indemnity against certain potential tax liabilities. Pursuant to the Tax Matters Agreement, GGP has indemnified us from and against 93.75% of any and all losses, claims, damages, liabilities and reasonable expenses to which we become subject (the Tax Indemnity), in each case solely to the extent directly attributable to certain taxes related to sales of certain assets in our Master Planned Communities segment prior to March 31, 2010 (MPC Taxes), in an amount up to $303.8 million, plus interest and penalties related to these amounts (the Indemnity Cap) so long as GGP controls the action in the United States Tax Court (the Tax Court) related to the dispute with the IRS as described below. We recorded the Tax Indemnity receivable at the Indemnity Cap amount as of the spinoff date. The unrecognized tax benefits and related accrued interest recorded through June 30, 2013 are primarily related to the taxes that are the subject of the Tax Indemnity. We have recorded interest income receivable on the Tax Indemnity receivable in the amounts of $40.2 million and $36.4 million as of June 30, 2013 and December 31, 2012, respectively.

The timing of the utilization of the tax assets attributable to indemnified and non-indemnified gains results in changes to the Tax Indemnity receivable and is dependent on numerous future events, such as the timing of recognition of indemnified and non-indemnified gains, the amount of each type of gain recognized in each year, the use of specific deductions and the ultimate amount of indemnified gains recognized. These non-cash changes could be material to our financial statements. Resolution of the Tax Court case noted below could also result in changes to the Master Planned Community deferred gains and the timing of utilization of the tax assets, both of which could result in changes to the Tax Indemnity receivable. We record the Tax Indemnity receivable based on the amounts indemnified which are determined in accordance with the provisions set forth in ASC 740 (Income Taxes).

During the three and six months ended June 30, 2013, the reduction in tax indemnity receivable of $7.5 million and $9.4 million related to our utilization of tax assets that contractually limit the amount we can receive pursuant to the Tax Matters Agreement and changes to our deferred tax liability for the MPC Taxes.

On May 6, 2011, GGP filed Tax Court petitions on behalf of the two former taxable REIT subsidiaries of GGP seeking a redetermination of federal income tax for the years 2007 and 2008. The petitions seek to overturn determinations by the IRS that the taxpayers were liable for combined deficiencies totaling $144.1 million. On October 20, 2011, GGP filed a motion in the Tax Court to consolidate the cases of the two former taxable REIT subsidiaries of GGP subject to litigation with the Internal Revenue Service due to the common nature of the cases facts and circumstances and the issues being litigated. The Tax Court granted the motion to consolidate. The case was heard by the Tax Court in November 2012. We expect the Tax Court to rule on the case within the next 12 months.

Unrecognized tax benefits recorded pursuant to uncertain tax positions were $95.9 million as of June 30, 2013 and December 31, 2012, excluding interest, of which this entire amount would not impact our effective tax rate. Accrued interest related to these unrecognized tax benefits amounted to $40.5 million and $36.6 million as of June 30, 2013 and December 31, 2012, respectively. We recognized an increase in interest expense related to the unrecognized tax benefits of $1.8 million and $3.9 million for the three and six months ended June 30, 2013, respectively. A significant amount of the unrecognized tax benefits recorded in the financial statements are related to the Tax Court litigation and are expected to be resolved within the next 12 months.

We file a consolidated corporate tax return which includes all of our subsidiaries with the exception of Victoria Ward, Limited (Ward), substantially all of which is owned by us. Ward elected to be taxed as a REIT, commencing with the taxable year beginning January 1, 2002. Ward has satisfied the REIT distribution requirements for 2012, and presently we intend to continue to operate Ward as a REIT.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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NOTE 11 STOCK-BASED PLANS

Stock Options

Our stock based plans are described, and informational disclosures provided, in the Notes to the Consolidated Financial Statements included in our Form 10-K for the year ended December 31, 2012. The following table summarizes our stock option plan activity for the six months ended June 30, 2013:

	Stock Options		Weighted Average Exercise Price
Stock Options Outstanding at December 31, 2012	861,940	$	59.17
Granted	72,100		92.54
Forfeited	(15,600)		59.63
Stock Options Outstanding at June 30, 2013	918,440	$	61.78

Generally, options granted vest ratably over requisite service periods, expire ten years after the grant date and generally do not become exercisable until their restriction on exercise lapses after the five-year anniversary of the grant date. In May 2013 certain key employees were granted options that vest after four years of service and half of such shares vest on a graduated scale based on total shareholder return in 2017.

Restricted Stock

During the second quarter of 2013, we granted 66,038 shares of restricted stock at a share price of $101.77. The restrictions on the shares lapse after four years of service and 50% of such shares vest on a graduated scale based on achieving certain stock price appreciation in 2017. In addition, 11,394 shares of restricted stock at a share price of $97.72 were awarded to certain non-employee directors as part of an annual retainer for their services during the second quarter of 2013. Likewise, 13,033 of restricted stock shares at a share price of $60.15 were awarded during the second quarter of 2012. The restrictions on the shares granted in 2012 have lapsed and the restrictions on the shares granted in 2013 will generally lapse in the second quarter of 2014. As of June 30, 2013, there were 122,332 shares of restricted stock outstanding.

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NOTE 12 OTHER ASSETS AND LIABILITIES

Prepaid Expenses and Other Assets

The following table summarizes the significant components of Prepaid expenses and other assets.

	June 30, 2013	December 31, 2012
	(In thousands)	
Special Improvement District receivable	$ 39,644	$ 39,659
Tenant and other receivables	9,457	2,346
Federal income tax receivable	5,349	5,367
Prepaid expenses	3,947	4,757
Below-market ground leases	20,171	20,341
Condominium deposits		19,616
Security and escrow deposits	9,689	12,865
Above-market tenant leases	1,200	1,896
Uncertain tax position asset	14,165	12,801
In-place leases	10,517	11,516
Intangibles	3,714	3,714
Other	7,950	8,592
	$ 125,803	$ 143,470

The decrease of $19.6 million in condominium deposits as of June 30, 2013 compared to December 31, 2012 is due to the sale of our condominium rights. The increase of $7.1 million in tenant and other receivables is primarily related to $2.0 million of lease incentives at Ward and a $4.5 million legal settlement at Riverwalk.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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Accounts Payable and Accrued Expenses

The following table summarizes the significant components of Accounts payable and accrued expenses.

		June 30, 2013		December 31, 2012
		(In thousands)		
Construction payable	$	29,380	$	17,501
Accounts payable and accrued expenses		53,737		39,634
Condominium deposits				19,616
Membership deposits		22,416		20,248
Above-market ground leases		2,510		2,590
Deferred gains/income		13,770		7,767
Accrued interest		2,316		2,425
Accrued real estate taxes		5,259		6,622
Tenant and other deposits		11,832		8,096
Insurance reserve		2,832		9,037
Accrued payroll and other employee liabilities		9,073		11,514
Interest rate swaps		4,281		7,183
Special assessment		2,868		2,868
Other		17,958		15,420
	$	178,232	$	170,521

The increase of $11.9 million in construction payable as of June 30, 2013 compared to December 31, 2012 is primarily due to construction and renovation activities at a number of properties under development. The decrease of $19.6 million in condominium deposits as of June 30, 2013 compared to December 31, 2012 is due to the sale of our condominium rights. The increase of $6.0 million in deferred gains/income is primarily due to increased land sales and the deferral of a portion of the income for post-sale land development obligations at our Summerlin MPC.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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NOTE 13 ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes AOCI for the period indicated (amounts in thousands):

Changes in Accumulated Other Comprehensive Income (Loss) by Component (a)

Gains and Losses on Cash Flow Hedges

(In Thousands)

For the Three Months Ended June 30, 2013			For the Six Months Ended June 30, 2013		
Balance as of April 1, 2013	$	(9,567)	Balance as of January 1, 2013	$	(9,575)
Other comprehensive income before reclassifications		1,266	Other comprehensive income before reclassifications		755
Amounts reclassified from accumulated other comprehensive income (loss)		528	Amounts reclassified from accumulated other comprehensive income (loss)		1,047
Net current-period other comprehensive income		1,794	Net current-period other comprehensive income		1,802
Balance as of June 30, 2013	$	(7,773)	Balance as of June 30, 2013	$	(7,773)

(a) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table summarizes the amounts reclassified out of AOCI for the period indicated (amounts in thousands):

Reclassifications out of Accumulated Other Comprehensive Income (Loss) (a)

(In Thousands)

Accumulated Other Comprehensive Income Components	Amounts reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended June 30, 2013	For the Six Months Ended June 30, 2013	Affected line item in the Statement of Operations
Gains and losses on cash flow hedges			
Interest rate swap contracts	$ (458)	$ (907)	Interest (expense)
	(70)	(140)	Provision for income taxes
Total reclassifications for the period	$ (528)	(1,047)	Net of tax

(a) Amounts in parentheses indicate debits to profit/loss.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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NOTE 14 COMMITMENTS AND CONTINGENCIES

In the normal course of business, from time to time, we are involved in legal proceedings relating to the ownership and operations of our properties. In management s opinion, the liabilities, if any, that may ultimately result from such legal actions are not expected to have a material effect on our consolidated financial position, results of operations or liquidity.

We had outstanding letters of credit and surety bonds of $47.9 million and $49.3 million as of June 30, 2013 and December 31, 2012, respectively. These letters of credit and bonds were issued primarily in connection with insurance requirements, special real estate assessments and construction obligations.

See Note 10 Income Taxes for additional contingencies related to our uncertain tax positions.

On June 27, 2013, the City of New York executed the amended and restated ground lease for South Street Seaport. The restated lease terms provide for annual fixed rent of $1.2 million starting July 1, 2013 with an expiration of December 30, 2072, including our option to extend. The annual rent escalates 3.0% compounded annually. In addition to the annual base rent of $1.2 million, we are required to make annual payments of $210,000 as additional rent through the term of the lease. The additional rent escalates annually at CPI. We are entitled to a total rent credit of $1.5 million, to be taken monthly over a 30 month period. Simultaneously with the execution of the lease, we executed a completion guaranty for the redevelopment of Pier 17. The completion guaranty requires us to perform certain obligations under the lease, including the commencement of construction by October 1, 2013 with a scheduled completion date of March 31, 2016.

In the fourth quarter of 2012, as a result of Superstorm Sandy, the Uplands portion of South Street Seaport suffered damage due to flooding, but the Pier 17 structure was not significantly damaged. Reconstruction efforts are ongoing and the property is only partially operating. We have received $6.0 million in insurance recoveries at South Street Seaport related to property damage recoveries through June 30, 2013. We believe that our insurance will cover substantially all of the cost of repairing the property and will also compensate us for any profits that have been lost as a result of the storm.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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NOTE 15 SEGMENTS

We have three business segments which offer different products and services. Our three segments are managed separately because each requires different operating strategies or management expertise and are reflective of management s operating philosophies and methods. In addition, our segments or assets within such segment could change in the future as development of certain properties commences or other operational or management changes occur. We do not distinguish or group our combined operations on a geographic basis. Furthermore, all operations are within the United States and no customer or tenant comprises more than 10% of revenues. Our reportable segments are as follows:

- Master Planned Communities (MPCs) includes the development and sale of land in large-scale, long-term community development projects in and around Las Vegas, Nevada; Houston, Texas; and Columbia, Maryland.

- Operating Assets includes retail and office properties, a multi-family property, The Woodlands Resort and Conference Center and other real estate investments. These assets are currently generating revenues, and we believe there is an opportunity to redevelop or reposition many of these assets to improve operating performance.

- Strategic Developments includes all properties held for development and redevelopment which have no substantial operations.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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The assets included in each segment as of June 30, 2013, are contained in the following chart:

As our segments are managed separately, different operating measures are utilized to assess operating results and allocate resources among the segments. The one common operating measure used to assess operating results for the business segments is Real Estate Property Earnings Before Taxes (REP EBT), which represents the operating revenues of the properties less property operating expenses and adjustments for interest, as further described below. We believe REP EBT provides useful information about the operating performance for all of our assets, projects and properties.

REP EBT, as it relates to our business, is defined as net income (loss) excluding general and administrative expenses, corporate interest income, corporate interest and depreciation expense, provision for income taxes, warrant liability gain (loss) and the reduction in tax indemnity receivable. We present REP EBT because we use this measure, among others, internally to assess the core operating performance of our assets. We also present this measure because we believe certain investors use it as a measure of a company s historical operating performance and its ability to service and incur debt. We believe that the inclusion of certain adjustments to net income (loss) to calculate REP EBT is appropriate to provide additional information to investors.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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Segment operating results are as follows:

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(In thousands)		(In thousands)	
Master Planned Communities				
Land sales	$ 66,021	$ 43,928	$ 113,247	$ 80,017
Builder price participation	2,426	1,528	3,701	2,341
Minimum rents	194	121	389	254
Other land revenues	3,830	3,531	6,632	7,016
Other rental and property revenues		19		35
Total revenues	72,471	49,127	123,969	89,663
Cost of sales - land	29,854	22,978	55,553	41,657
Land sales operations	8,359	8,269	15,312	17,173
Land sales real estate and business taxes	1,435	1,698	2,978	3,782
Depreciation and amortization	8	2	15	3
Interest income	(1)	(61)	(16)	(130)
Interest expense (*)	(3,646)	(3,657)	(9,606)	(7,071)
Total expenses	36,009	29,229	64,236	55,414
MPC EBT	36,462	19,898	59,733	34,249
Operating Assets				
Minimum rents	19,756	20,222	38,267	38,744
Tenant recoveries	5,041	5,956	10,293	11,787
Resort and conference center revenues	11,270	11,970	22,374	21,626
Other rental and property revenues	6,612	6,240	10,045	10,965
Total revenues	42,679	44,388	80,979	83,122
Other property operating costs	16,552	14,594	31,517	28,421
Rental property real estate taxes	2,923	2,607	5,906	5,226
Rental property maintenance costs	2,032	1,885	3,688	3,725
Resort and conference center operations	7,680	7,371	15,156	14,785
Provision for doubtful accounts	277	174	706	149
Depreciation and amortization	6,398	5,672	12,516	10,529
Interest income	(44)	(41)	(90)	(86)
Interest expense	3,893	3,714	10,698	7,060
Equity in Earnings from Real Estate Affiliates	(363)	(446)	(3,096)	(3,122)
Total expenses	39,348	35,530	77,001	66,687
Operating Assets EBT	3,331	8,858	3,978	16,435

Strategic Developments								
Minimum rents		184		234		404		476
Tenant recoveries		24		47		97		80
Condominium rights and unit sales		30,381		134		30,381		267
Other land revenues								32
Other rental and property revenues		1,313		9		1,313		62
Total revenues		31,902		424		32,195		917
Condominium rights and unit cost of sales		15,272		36		15,272		96
Condominium sales operations				13				71
Other property operating costs		782		441		1,337		952
Real estate taxes		436		564		1,210		1,783
Rental property maintenance costs		111		201		260		316
Provision for doubtful accounts								(104)
Depreciation and amortization		48		59		91		117
Interest expense *		(675)		180		(962)		254
Equity in Earnings from Real Estate Affiliates		(5,344)				(5,344)		
Total expenses		10,630		1,494		11,864		3,485
Strategic Developments EBT		21,272		(1,070)		20,331		(2,568)
REP EBT	$	61,065	$	27,686	$	84,042	$	48,116

(*) Negative interest expense amounts relate to interest capitalized on debt assigned to our Operating Assets Segments.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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The following reconciles REP EBT to GAAP-basis net income (loss):

Reconciliation of REP EBT to GAAP-net income (loss)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
	(In thousands)		(In thousands)	
REP EBT	$ 61,065	$ 27,686	$ 84,042	$ 48,116
General and administrative	(6,769)	(8,160)	(17,940)	(16,557)
Corporate interest income, net	1,594	2,277	4,304	4,499
Warrant liability gain (loss)	(111,200)	23,430	(144,227)	(98,421)
Provision for income taxes	(13,361)	(1,301)	(15,840)	(5,085)
Reduction in tax indemnity receivable	(7,499)	(8,782)	(9,403)	(8,782)
Corporate depreciation	(326)	(158)	(602)	(302)
Net income (loss)	$ (76,496)	$ 34,992	$ (99,666)	$ (76,532)

The following reconciles segment revenue to GAAP-basis consolidated revenues:

Reconciliation of Segment Basis Revenues to GAAP Revenues	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
	(In thousands)		(In thousands)	
Master Planned Communities	$ 72,471	$ 49,127	$ 123,969	$ 89,663
Operating Assets	42,679	44,388	80,979	83,122
Strategic Developments	31,902	424	32,195	917
Total revenues	$ 147,052	$ 93,939	$ 237,143	$ 173,702

The assets by segment and the reconciliation of total segment assets to the total assets in the condensed consolidated balance sheets as of June 30, 2013 and December 31, 2012 are summarized as follows:

	June 30, 2013	December 31, 2012
	(In thousands)	
Master Planned Communities	$ 1,816,675	$ 1,756,625
Operating Assets *	1,069,209	944,562

Strategic Developments		265,284		288,287
Total segment assets		3,151,168		2,989,474
Corporate and other **		453,428		513,568
Total assets	$	3,604,596	$	3,503,042

* Certain assets included in our Operating Asset segments are in various stages of redevelopment and are included in Developments on our condensed consolidated balance sheets.

** Assets included in Corporate and other consist primarily of the Tax indemnity receivable, including interest, and Cash and cash equivalents.

The increase in the Operating Assets segment s asset balance as of June 30, 2013 of $125.0 million as compared to December 31, 2012 is primarily due to $50.8 million of total assets from 3 Waterway Square being reclassified from the Strategic Developments segment because it was placed in service. The decrease in the Corporate and other segment s asset balance as of June 30, 2013 of $60.1 million as compared to December 31, 2012 is primarily due to increased real estate and property cash expenditures for our ongoing re-development and development projects within our Operating Assets and Strategic Developments segments.

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes. All references to numbered Notes are to specific notes to our Condensed Consolidated Financial Statements included in this Quarterly Report.

Forward-looking information

We may make forward-looking statements in this Quarterly Report and in other reports that we file with the SEC. In addition, our management may make forward-looking statements orally to analysts, investors, creditors, the media and others.

Forward-looking statements include:

- Projections of our revenues, operating income, net income, earnings per share, REP EBT, capital expenditures, income tax, other contingent liabilities, dividends, leverage, capital structure or other financial items;
- Forecasts of our future economic performance; and
- Descriptions of assumptions underlying or relating to any of the foregoing.

In this Quarterly Report, for example, we make forward-looking statements discussing our expectations about:

- Capital required for our operations and development opportunities for the properties in our Strategic Developments segment;
- Expected performance of our Master Planned Communities segment and other current income producing properties; and
- Future liquidity, development opportunities, development spending and management plans.

Forward-looking statements discuss matters that are not historical facts. Because they discuss future events or conditions, forward-looking statements often include words such as anticipate, believe, can, could, estimate, expect, forecast, intend, may, likely, plan, should, target, would, and other words of similar expressions. Forward-looking statements should not be unduly relied upon. They give our expectations about the future and are not guarantees.

There are several factors, many beyond our control, which could cause results to differ materially from our expectations. These risk factors are described in our Annual Report on Form 10-K for the year ended December 31, 2012 (the Annual Report) and are incorporated herein by reference. Any factor could, by itself, or together with one or more other factors, adversely affect our business, results of operations or financial condition. There may also be other factors that we have not described in this Quarterly Report or in our Annual Report that could cause results to differ from our expectations. These forward-looking statements present our estimates and assumptions only as of the date of this Quarterly Report. Except as may be required by law, we undertake no obligation to modify or revise any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report.

Real Estate Property Earnings Before Taxes

We use a number of operating measures for assessing operating performance of our communities, assets, properties and projects within our segments, some of which may not be common among all three of our segments. We believe that investors may find some operating measures more useful than others when separately evaluating each segment. One common operating measure used to assess operating results for our business segments is Real Estate Property Earnings Before Taxes (REP EBT). We believe REP EBT provides useful information about our operating performance because it excludes certain non-recurring and non-cash items which we believe are not indicative of our core business.

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REP EBT, as it relates to our business, is defined as net income (loss) excluding general and administrative expenses, corporate interest income, corporate interest and depreciation expense, provision for income taxes, warrant liability gain (loss) and the reduction in tax indemnity receivable. We present REP EBT because we use this measure, among others, internally to assess the core operating performance of our assets. We also present this measure because we believe certain investors use it as a measure of a company s historical operating performance and its ability to service and incur debt. We believe that the inclusion of certain adjustments to net income (loss) to calculate REP EBT is appropriate to provide additional information to investors. A reconciliation of REP EBT to consolidated net income (loss) as computed in accordance with GAAP has been presented in Note 15 Segments.

REP EBT should not be considered as an alternative to GAAP net income (loss) attributable to common stockholders or GAAP net income (loss), as it has limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. Some of the limitations of this metric are that it:

- does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- does not reflect corporate general and administrative expenses;
- does not reflect income taxes that we may be required to pay;
- does not reflect any cash requirements for replacement of depreciated or amortized assets or that these assets have different useful lives;
- does not reflect limitations on, or costs related to, transferring earnings from our Real Estate Affiliates to us; and
- may be calculated differently by other companies in our industry, limiting its usefulness as a comparative measure.

Operating Assets Net Operating Income

We believe that net operating income (NOI) is a useful supplemental measure of the performance of our Operating Assets because it provides a performance measure that, when compared year over year, reflects the revenues and expenses directly associated with owning and operating real estate properties and the impact on operations from trends in rental and occupancy rates and operating costs. We define NOI as revenues (rental income, tenant recoveries and other income) less expenses (real estate taxes, repairs and maintenance, marketing and other property expenses). NOI also excludes straight line rents and tenant incentives, net interest expense, depreciation, ground rent and other amortization expenses and equity in earnings from Real Estate Affiliates. We use NOI to evaluate our operating performance on a property-by-property basis because NOI allows us to evaluate the impact that factors such as lease structure, lease rates and tenant base, which vary by property, have on our operating results, gross margins and investment returns.

Although we believe that NOI provides useful information to the investors about the performance of our Operating Assets, due to the exclusions noted above, NOI should only be used as an alternative measure of the financial performance of such assets and not as an alternative to GAAP net income (loss). For reference, and as an aid in understanding our computation of NOI, a reconciliation of NOI to REP EBT has been presented in the Operating Assets segment discussion below.

Results of Operations

Consolidated revenues for the three and six months ended June 30, 2013 increased $53.1 million and $63.4 million, respectively, compared to the corresponding periods in 2012, primarily due to higher revenues in our MPCs and Strategic Developments segments. MPC segment land sale revenues increased $22.1 million and $33.2 million for the three and six months ended June 30, 2013, respectively, due to the higher demand for our residential superpad sites in Summerlin and lots in The Woodlands. Strategic Developments revenue increased $31.5 million and $31.3 million for the three and six months ended June 30, 2013 due to the sale of our ONE Ala Moana condominium rights in the second quarter.

The net loss attributable to common stockholders was $76.6 million, or $1.94 loss per diluted share, for the three months ended June 30, 2013 as compared to a net income attributable to common stockholders of $34.3 million, or $0.27 earnings per diluted share, for the corresponding period in 2012. The $110.9 million lower net income for the three months ended June 30, 2013 as compared to the same period in 2012 was primarily due to a warrant liability

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loss of $111.2 million for the three months ended June 30, 2013 compared to a warrant liability gain of $23.4 million for the corresponding period in 2012. In addition, the decrease in net income was caused by higher income tax provision of $12.1 million and lower earnings from our Operating Assets segment of $5.5 million partially offset by higher MPC and Strategic Developments segment earnings of $16.6 million and $22.3 million, respectively, lower general and administrative expenses of $1.4 million and a lower reduction in the tax indemnity receivable of $1.3 million compared to the same period in 2012.

The net loss attributable to common stockholders was $99.7 million, or $2.53 loss per diluted share, for the six months ended June 30, 2013 as compared to a net loss attributable to common stockholders of $78.0 million, or $2.06 loss per diluted share, for the corresponding period in 2012. The $21.7 million increase in net loss for 2013 as compared to 2012 was primarily due to a higher warrant liability loss of $45.8 million, lower earnings from our Operating Assets segment of $12.5 million, a higher income tax provision of $10.8 million and higher general and administrative expense of $1.4 million partially offset by higher MPC and Strategic Developments segment earnings of $25.5 million and $22.9 million, respectively, and lower income attributable to our noncontrolling interest of $1.4 million.

Segment Operations

Please refer to Note 15 - Segments for additional information including reconciliations of our segment basis results to generally accepted accounting principles (GAAP) basis results.

Master Planned Communities Segment

MPC revenues vary between periods based on economic conditions and several factors such as, but not limited to, location, development density and commercial or residential use. Although our business does not involve the sale or resale of homes, we believe that net new home sales are an important indicator of future demand for our pads sites and lots; therefore, we use this statistic in the discussion of our MPCs below. Reported results may differ significantly from actual cash flows generated principally because cost of sales for GAAP purposes is derived from margins calculated using carrying values, projected future improvements and other capitalized costs in relation to projected future land sale revenues. Carrying values, generally, represent acquisition and development costs less adjustments for previous impairment charges. Development expenditures are capitalized and generally not reflected in the Condensed Consolidated Statements of Operations in the current year.

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MPC sales data for the three months ended June 30, 2013 and 2012 is summarized as follows:

	Land Sales		Acres Sold		Number of Lots/Units Three Months ended June 30,		Price per Acre		Price per Lot	
($ in thousands)	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**
Columbia										
Residential										
Townhomes	$	$ 2,233		0.7		15	$	$	$	$ 149
		2,233		0.7		15				149
Bridgeland										
Residential										
Single family - detached	1,869	5,669	6.0	21.6	28	111	312	262	67	51
	1,869	5,669	6.0	21.6	28	111	312	262	67	51