

AFFORDABLE RESIDENTIAL COMMUNITIES INC  
Form 10-Q/A  
March 13, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q/A**  
**(Amendment No. 1)**

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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

Commission File Number 1-31987

**Affordable Residential Communities Inc.**

(Exact name of Registrant as specified in its charter)

**MARYLAND**  
(State of incorporation)

**84-1477939**  
(I.R.S. employer identification no.)

**7887 East Belleview Avenue, Suite 200**  
**Englewood, Colorado**  
(Address of principal executive offices)

**80111**  
(Zip code)

**(303) 291-0222**

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The number of shares of the Registrant's common stock outstanding at August 4, 2006 was 41,329,705.

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## AFFORDABLE RESIDENTIAL COMMUNITIES INC.

## FORM 10-Q/A

FOR THE QUARTER ENDED JUNE 30, 2006

## Explanatory Note

On March 8, 2007, the Audit Committee of the Board of Directors of Affordable Residential Communities Inc. (the Company) determined that the Company should restate its unaudited consolidated financial statements as of and for the quarterly periods ended March 31, 2006, June 30, 2006 and September 30, 2006, to correct the allocation of income taxes (intra-period tax allocation) between continuing operations and discontinued operations for the first three quarters of 2006, as more fully described below. The Company does not expect any aggregate income tax expense or benefit for the year ended December 31, 2006. The above corrections do not have an adverse impact on any covenants associated with the Company's debt facilities. As a result of the restatement, we are amending our originally filed Form 10-Q.

This amended report does not reflect events occurring after the filing of the original Form 10-Q except for the following: (1) amounts have been recast for discontinued communities; (2) in accordance with SFAS No. 128, Earnings per Share, our basic and diluted weighted average shares outstanding have been increased by a factor of approximately 1.06 to reflect the dilutive impact of our January 2007 rights offering in which ten million shares of our common stock were purchased by our stockholders at the below-market price of \$8.00 per share; and (3) the items reflected in Note 14 Subsequent Events. This filing should be read in conjunction with the Company's filings with the Securities and Exchange Commission subsequent to the filing of the initial reports.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), requires that a company with a loss from continuing operations consider all items reported apart from continuing operations (for example extraordinary items, discontinued operations and other comprehensive income) in determining the tax benefit that results from a loss from continuing operations. In our case, because we had a loss from continuing operations and a gain from discontinued operations in each of the periods referenced above, in accordance with SFAS 109 and Emerging Issues Task Force Topic D32, *Intra-period Tax Allocation of the Tax Effect of Pre-Tax Income from Continuing Operations*, we should have considered the gain from discontinued operations in determining the amount of tax benefit to allocate to continuing operations. However, we originally determined the allocation of income taxes (intra-period allocation) between continuing and discontinued operations using a with and without methodology. That is, we did not believe that a tax benefit resulted from the loss from continuing operations because we did not believe there was an incremental benefit from the loss generated from our continuing operations. Additionally, we believed that the gain from discontinued operations did not attract a tax consequence.

In accordance with FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods - An Interpretation of APB Opinion No. 28*, the tax benefit recognized in continuing operations is calculated using an effective rate methodology and therefore will be provided for over the course of the year. The tax expense recognized in discontinued operations is recognized on a discrete basis and therefore the entire amount of tax expense is recognized at the time the pretax gain on the discontinued operations is recognized. This mismatch in the timing of the recognition of tax benefits and expense resulted in a restatement of the net loss for the quarter and six months ended June 30, 2006.

We have also updated our evaluation of disclosure controls and procedures, as reflected in Item 4. Controls and Procedures.

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**AFFORDABLE RESIDENTIAL COMMUNITIES INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF JUNE 30, 2006 AND DECEMBER 31, 2005**  
**(in thousands, except share and per share data)**  
**(unaudited)**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
	<b>(as restated)</b>	
<b>Assets</b>		
Rental and other property, net	\$ 1,417,451	\$ 1,453,097
Assets held for sale	30,409	132,340
Cash and cash equivalents	32,195	27,926
Restricted cash	6,648	7,022
Tenant and other receivables, net	4,445	3,942
Notes receivable, net	32,485	33,418
Loan origination costs, net	14,972	16,164
Loan reserves	38,635	35,088
Lease intangibles and customer relationships, net	9,259	12,055
Prepaid expenses and other assets	14,040	7,429
Total assets	\$ 1,600,539	\$ 1,728,481
<b>Liabilities and Stockholders' Equity</b>		
Notes payable	\$ 1,063,194	\$ 1,146,331
Liabilities related to assets held for sale	21,329	56,827
Accounts payable and accrued expenses	26,096	32,653
Dividends payable	1,903	1,887
Tenant deposits and other liabilities	22,640	14,786
Total liabilities	1,135,162	1,252,484
Minority interest	28,972	31,902
Commitments and contingencies		
Stockholders' equity		
Preferred stock, no par value, 5,750,000 shares authorized, 5,000,000 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively; liquidation preference of \$25 per share plus accrued but unpaid dividends	119,108	119,108
Common stock, \$.01 par value, 100,000,000 shares authorized, 41,306,485 and 40,971,423 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	413	410
Additional paid-in capital	793,868	791,201
Accumulated other comprehensive income		583
Retained deficit	(476,984)	(467,207)
Total stockholders' equity	436,405	444,095
Total liabilities and stockholders' equity	\$ 1,600,539	\$ 1,728,481

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

**AFFORDABLE RESIDENTIAL COMMUNITIES INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005**  
(in thousands, except per share data)  
(unaudited)

	Three Months Ended June 30, 2006 (as restated)		Six Months Ended June 30, 2006 (as restated)	
	2006	2005	2006	2005
<b>Revenue</b>				
Rental income	\$ 51,959	\$ 46,834	\$ 102,865	\$ 93,179
Sales of manufactured homes	2,993	16,390	5,665	23,854
Utility and other income	6,270	5,063	12,747	9,991
Net consumer finance interest income	245		424	
Total revenue	61,467	68,287	121,701	127,024
<b>Expenses</b>				
Property operations	16,256	18,093	32,678	36,334
Real estate taxes	5,024	4,070	10,160	8,037
Cost of manufactured homes sold	2,565	14,672	4,874	22,050
Retail home sales, finance and insurance	2,830	3,544	4,728	6,884
Property management	1,586	2,366	3,178	4,513
General and administrative	4,991	6,389	9,412	11,883
Depreciation and amortization	21,775	18,762	43,386	35,057
Loss on sale of airplane			541	
Net consumer finance interest expense		204		650
Interest expense	20,006	17,036	39,587	32,724
Total expenses	75,033	85,136	148,544	158,132
Interest income	(448)	(269)	(871)	(641)
Loss from continuing operations before income tax benefit and allocation to minority interest	(13,118)	(16,580)	(25,972)	(30,467)
Income tax benefit from continuing operations	3,372		4,571	
Loss from continuing operations before allocation to minority interest	(9,746)	(16,580)	(21,401)	(30,467)
Minority interest	166	628	402	1,172
Loss from continuing operations	(9,580)	(15,952)	(20,999)	(29,295)
Income from discontinued operations	689	302	2,381	1,083
Gain (loss) on sale of discontinued operations	15,613	52	25,909	(678)
Income tax expense from discontinued operations	(6,521)		(11,316)	
Minority interest in discontinued operations	(343)	(17)	(596)	(19)
Net loss	(142)	(15,615)	(4,621)	(28,909)
Preferred stock dividend	(2,578)	(2,578)	(5,156)	(5,156)
Net loss attributable to common stockholders	\$ (2,720)	\$ (18,193)	\$ (9,777)	\$ (34,065)
<b>Loss per share from continuing operations</b>				
Basic loss per share	\$ (0.28)	\$ (0.43)	\$ (0.60)	\$ (0.80)
Diluted loss per share	\$ (0.28)	\$ (0.43)	\$ (0.60)	\$ (0.80)
<b>Income per share from discontinued operations</b>				
Basic income per share	\$ 0.22	\$ 0.01	\$ 0.38	\$ 0.01
Diluted income per share	\$ 0.22	\$ 0.01	\$ 0.38	\$ 0.01
<b>Loss per share attributable to common stockholders</b>				
Basic loss per share	\$ (0.06)	\$ (0.42)	\$ (0.22)	\$ (0.79)
Diluted loss per share	\$ (0.06)	\$ (0.42)	\$ (0.22)	\$ (0.79)
<b>Weighted average share information</b>				
Basic shares outstanding	43,696	43,257	43,632	43,249

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

**AFFORDABLE RESIDENTIAL COMMUNITIES INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2006 and 2005**  
**(in thousands) (unaudited)**

	Six Months Ended June 30, 2006 (as restated)	2005
Cash flow from operating activities		
Net income (loss)	\$ (4,621 )	\$ (28,909 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	43,386	35,057
Intra-period income taxes	6,745	
Adjustments to fair value for interest rate caps	(436 )	227
Amortization of loan origination costs	3,045	3,421
Stock grant compensation expense	98	326
Partnership preferred unit distributions declared	552	786
Minority interest	(954 )	(1,958 )
Depreciation and minority interest included in income from discontinued operations	801	3,801
(Gain) loss on sale of discontinued operations	(25,909 )	678
Loss on sale of airplane	541	
Gain on sale of manufactured homes	(791 )	(1,804 )
Changes in operating assets and liabilities	(7,002 )	(10,636 )
Net cash provided by operating activities	15,455	989
Cash flow from investing activities		
Purchases of manufactured homes	(6,693 )	(68,300 )
Proceeds from community sales	123,431	48,721
Proceeds from manufactured home sales	5,428	13,014
Proceeds from sale of airplane	1,170	
Community improvements and equipment purchases	(2,055 )	(32,605 )
Restricted cash	374	3,609
Loan reserves	(3,547 )	(4,227 )
Net cash provided by (used in) investing activities	118,108	(39,788 )
Cash flow from financing activities		
Proceeds from issuance of debt	30,535	155,483
Repayment of debt	(147,372 )	(94,352 )
Deposits on refinance transaction	(4,900 )	
Payment of common dividends and OP unit distributions		(27,045 )
Payment of preferred dividends	(5,156 )	(5,156 )
Payment of partnership preferred distributions	(552 )	(786 )
Repurchase of OP Units		(1,836 )
Loan origination costs	(1,849 )	(3,879 )
Net cash (used in) provided by financing activities	(129,294 )	22,429
Net increase (decrease) in cash and cash equivalents	4,269	(16,370 )
Cash and cash equivalents, beginning of period	27,926	32,859
Cash and cash equivalents, end of period	\$ 32,195	\$ 16,489
Non-cash financing and investing transactions:		
Notes receivable for manufactured home sales	\$ 3,740	\$ 11,402
Fair value of OP Units redeemed for common stock	\$ 3,176	\$
Supplemental cash flow information:		
Cash paid for interest	\$ 40,187	\$ 33,931



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

**AFFORDABLE RESIDENTIAL COMMUNITIES INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**1. Business, Basis of Presentation and Summary of Significant Accounting Policies**

**Business**

Affordable Residential Communities Inc. is a Maryland corporation that is engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses including acting as agent in the sale of homeowners insurance and related products, all exclusively to residents in our communities. We were organized in July 1998 and operate primarily through Affordable Residential Communities LP (the Operating Partnership or OP) and its subsidiaries, of which we are the sole general partner and owned 96.5% as of June 30, 2006.

On March 30, 2006, the Company elected not to be taxed as a Real Estate Investment Trust (REIT) for the year ending December 31, 2006 primarily because, in certain circumstances, gains on sales of properties that the Company realized in 2006 could have resulted in a Federal income tax liability equal to the amount of the gain for Federal income tax purposes (a 100% tax rate) if the Company had elected to remain a REIT.

As of June 30, 2006, we owned and operated 275 communities (excluding five communities classified as discontinued operations, see Note 10) consisting of 57,240 homesites (net of 1,108 homesites classified as discontinued operations) in 23 states with occupancy of 83.5%. Our five largest markets are Dallas-Fort Worth, Texas, with 12.5% of our total homesites; Atlanta, Georgia, with 8.7% of our total homesites; Salt Lake City, Utah, with 6.6% of our total homesites; the Front Range of Colorado, with 5.7% of our total homesites; and Kansas City-Lawrence-Topeka, with 4.2% of our total homesites. We also conduct a retail home sales business.

Our common stock is traded on the New York Stock Exchange under the symbol ARC. Our Series A Cumulative Redeemable Preferred Stock is traded on the New York Stock Exchange under the symbol ARC-PA. We have no public trading history prior to February 12, 2004.

**Basis of Presentation**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America and in conformity with the rules and regulations of the Securities and Exchange Commission requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amount of revenues and expenses during the reporting period. Actual results may differ from previously estimated amounts.

The interim consolidated financial statements presented herein reflect all adjustments that are necessary to fairly present the financial position, results of operations and cash flows of the Company, and all such adjustments are of a normal and recurring nature. The results of operations for the interim period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The December 31, 2005 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the financial statements included in our Current Report on Form 8-K for the year ended December 31, 2005 filed on October 5, 2006.

The accompanying consolidated financial statements include all of our accounts, which include the results of operations of the manufactured home communities acquired only for the periods subsequent to the date of acquisition. We have eliminated all significant inter-company balances and transactions.

We have reclassified certain prior period amounts to conform to the current year presentation.

## Summary of Significant Accounting Policies

### *Rental and Other Property*

We carry rental property at cost, less accumulated depreciation. We capitalize significant renovations and improvements that extend the useful life of assets and depreciate them over their estimated remaining useful lives. We expense maintenance and repairs as incurred. Depreciation is computed primarily using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the various classes of rental property assets are as follows:

Asset Class	Estimated Useful Lives (Years)
Manufactured home communities and improvements	10 to 30
Buildings	10 to 20
Rental homes	10 or rent-to-own term
Furniture and other equipment	5
Computer software and hardware	3

We evaluate the recoverability of our investment in rental property whenever events or changes in circumstances indicate that the recoverability of the net book value of the asset is questionable. Our assessment of the recoverability of rental property includes, but is not limited to, recent operating results and expected net operating cash flows from future operations. In the event that facts and circumstances indicate that the carrying amount of rental property may be impaired, we perform an evaluation of recoverability in which we compare the estimated future undiscounted cash flows associated with the asset to the asset's carrying amount to determine if an impairment adjustment is required. If this review indicates that the asset's carrying amount will not be fully recoverable, we will reduce the carrying value of the asset to its estimated fair value. We recorded no impairment charges during the six months ended June 30, 2006 and 2005.

### *Restricted Stock Grants*

During 2004 we granted 95,000 shares of restricted common stock that vest over five years. In June 2004, 42,500 of these restricted shares were forfeited and in October 2004, an additional 37,500 shares of restricted stock were forfeited pursuant to the terms of their issuance, leaving 15,000 restricted shares outstanding. During both of the six month periods ended June 30, 2006 and 2005, 3,000 shares vested leaving 9,000 shares unvested at June 30, 2006. We have recorded the unvested portion of the remaining 9,000 outstanding restricted shares as of June 30, 2006 in additional paid-in capital and are amortizing the balance ratably over the vesting period. We recorded \$14,000 and \$28,000, respectively, in compensation expense related to these restricted shares during both of the three and six month periods ended June 30, 2006 and 2005. In accordance with SFAS No. 123(R) (see Recent Statements of Financial Accounting Standards below) unearned compensation continues to be amortized over the vesting period but is now included as part of additional paid-in capital on the consolidated balance sheets. We expect that there will be no forfeitures of the unvested restricted stock outstanding at June 30, 2006.

We consider the number of vested shares issued under our 2003 equity incentive plan as common stock outstanding and include them in the denominator of our calculation of basic earnings per share. We also consider the total number of unvested restricted shares granted under our 2003 equity incentive plan in the denominator of our calculation of diluted earnings per share if they are dilutive. We return shares forfeited to the 2003 equity incentive plan as shares eligible for future grant and adjust any compensation expense previously recorded on such shares in the period the forfeiture occurs.

### *Income Taxes*

Deferred tax assets and liabilities are recorded for the estimated future tax effects of the temporary difference between the tax basis and book basis of assets and liabilities reported in the accompanying consolidated balance sheets. Deferred tax assets are reduced by a valuation allowance to the extent that their benefits are not expected to be realized. At June 30, 2006, a valuation allowance of \$74.9 million was recorded to reduce deferred tax assets to the amount expected to be recoverable.



We allocate income taxes between continuing and discontinued operations in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ), particularly paragraph 140. We recognize interim income tax benefits in continuing operations on the effective rate method and income tax expense in discontinued operations without such pro-ration in accordance with Accounting Principles Bulletin 28, *Interim Financial Reporting* ( APB 28 ) and FASB Interpretations 18, *Accounting for Income Taxes in Interim Periods - An interpretation of APB Opinion No. 28* ( FIN 18 ).

#### ***Accumulated Other Comprehensive Income and Comprehensive Loss***

Amounts recorded in accumulated other comprehensive income as of December 31, 2005 represent unrecognized gains on our interest rate swap, which qualified as a cash flow hedge and was marked to market over the life of the instrument. Including these unrecognized gains or losses, our comprehensive loss for the three and six months ended June 30, 2006 was \$2.7 million and \$10.4 million, respectively, compared with a comprehensive loss of \$18.5 million and \$34.1 million, respectively, during the same periods in 2005. Our interest rate swap agreement expired in February 2006 and was not renewed.

#### ***Recent Statements of Financial Accounting Standards***

On December 16, 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ( SFAS No. 123(R) ), which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS No. 123 ). SFAS No. 123(R) became effective on January 1, 2006 and we have adopted the standard using the modified prospective method. Since our only share based payments are nominal restricted stock issuance and shares issued to members of the board of directors as compensation, the implementation of SFAS No. 123(R) did not have a material impact on our financial position as of June 30, 2006 or our operations or cash flows for the three months ended June 30, 2006.

## **2. Restatement**

On March 8, 2007, the Audit Committee of the Board of Directors of Affordable Residential Communities Inc. (the Company ) determined that the Company should restate its unaudited consolidated financial statements as of and for the quarterly periods ended March 31, 2006, June 30, 2006 and September 30, 2006, to correct the allocation of income taxes (intra-period tax allocation) between continuing operations and discontinued operations for the first three quarters of 2006, as more fully described below. The Company does not expect any aggregate income tax expense or benefit for the year ended December 31, 2006. The above corrections do not have an adverse impact on any covenants associated with the Company's debt facilities.

Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ), requires that a company with a loss from continuing operations consider all items reported apart from continuing operations (for example extraordinary items, discontinued operations and other comprehensive income) in determining the tax benefit that results from a loss from continuing operations. In our case, because we had a loss from continuing operations and a gain from discontinued operations in each of the periods referenced above, in accordance with SFAS 109 and Emerging Issues Task Force Topic D32, *Intra-period Tax Allocation of the Tax Effect of Pre-Tax Income from Continuing Operations*, we should have considered the gain from discontinued operations in determining the amount of tax benefit to allocate to continuing operations. However, we originally determined the allocation of income taxes (intra-period allocation) between continuing and discontinued operations using a with and without methodology. That is, we did not believe that a tax benefit resulted from the loss from continuing operations because we did not believe there was an incremental benefit from the loss generated from our continuing operations. Additionally, we believed that the gain from discontinued operations did not attract a tax consequence.

In accordance with FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods - An Interpretation of APB Opinion No. 28*, the tax benefit recognized in continuing operations is calculated using an effective rate methodology and therefore will be provided for over the course of the year. The tax expense recognized in discontinued operations is recognized on a discrete basis and therefore the entire amount of tax expense is recognized at the time the pretax gain on the discontinued operations is recognized. This mismatch in the timing of the recognition of tax benefits and expense resulted in a restatement of the net loss for the quarter and six months ended June 30, 2006.

The impact of the restatement on our consolidated balance sheet and consolidated statement of operations is outlined in the table below (dollars in thousands). This restatement did not have an impact on our cash flows from operating, investing or financing activities or periods prior to 2006. The previously reported amounts have been recast for discontinued communities. However, the associated amounts were not separately reflected as they were considered immaterial to the presentation. Intra-period taxes are included in tenant deposits and other liabilities. In accordance with SFAS No. 128, Earnings per Share, our basic and diluted weighted average shares outstanding have been increased by a factor of approximately 1.06 to reflect the dilutive impact of our January 2007 rights offering in which ten million shares of our common stock were purchased by our stockholders at the below-market price of \$8.00 per share.

	As of June 30, 2006	
	Previously Reported	As Restated
<b>Consolidated Balance Sheet</b>		
Tenant deposits and other liabilities	\$ 16,340	\$ 22,640
Total liabilities	\$ 1,128,862	\$ 1,135,162
Minority interest	\$ 29,195	\$ 28,972
Retained deficit	\$ (470,907 )	\$ (476,984 )
Total stockholders' equity	\$ 442,482	\$ 436,405
Total liabilities and stockholders' equity	\$ 1,600,539	\$ 1,600,539

	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
	Previously Reported	As Restated	Previously Reported	As Restated
<b>Consolidated Statement of Operations</b>				
Loss from continuing operations before income tax benefit and allocation to minority interest	\$ (13,118 )	\$ (13,118 )	\$ (25,972 )	\$ (25,972 )
Income tax benefit from continuing operations		3,372		4,571
Loss before allocation to minority interest	(13,118 )	(9,746 )	(25,972 )	(21,401 )
Minority interest				