Hilltop Holdings Inc.
Form 10-Q
August 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

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

Commission File Number 1-31987

Hilltop Holdings Inc.

(Exact name of Registrant as specified in its charter)

MARYLAND	**84-1477939**
(State of incorporation)	(I.R.S. employer identification no.)
7887 East Belleview Avenue, Suite 200	
Englewood, Colorado	**80111**
(Address of principal executive offices)	(Zip code)

(303) 291-0222

(Registrant s telephone number, including area code)

Affordable Residential Communities Inc.

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

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

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

The number of shares of the Registrant s common stock outstanding at August 9, 2007 was 56,459,298.

HILLTOP HOLDINGS INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2007

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HILLTOP HOLDINGS INC.
CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2007 AND DECEMBER 31, 2006
(in thousands, except share data)
(unaudited)

	June 30, 2007	December 31, 2006
Assets		
Rental and other property, net	$ 1,359,657	$ 1,390,564
Assets held for sale	15,435	15,326
Investments		
Trading securities, at fair value (cost of $592)	657	
Securities available for sale, at fair value (amortized cost of $119,028)	117,937	
Securities held to maturity, at amortized cost (fair value of $6,467)	6,469	
Cash and cash equivalents	74,855	29,281
Restricted cash	6,982	6,784
Tenant and other receivables, net	3,481	4,651
Reinsurance receivables, net of uncollectible amounts	3,984	
Premiums receivable	23,158	
Notes receivable, net	28,714	29,904
Loan origination costs, net	15,157	16,736
Loan reserves	36,225	33,305
Goodwill	23,708	
Indefinite lived intangible assets	3,000	
Finite lived intangible assets	18,025	6,457
Deferred income taxes	26,531	
Deferred acquisition costs	7,288	
Prepaid expenses and other assets	14,369	9,693
Total assets	$ 1,785,632	$ 1,542,701

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

HILLTOP HOLDINGS INC.
CONSOLIDATED BALANCE SHEETS (Continued)
AS OF JUNE 30, 2007 AND DECEMBER 31, 2006
(in thousands, except share data)
(unaudited)

	June 30, 2007	December 31, 2006
Liabilities and Stockholders Equity		
Notes payable	$ 1,100,441	$ 1,046,500
Reserve for losses and loss adjustment expenses	21,754	
Unearned premiums	64,178	
Liabilities related to assets held for sale	134	247
Accounts payable and accrued expenses	38,543	28,946
Dividends payable	1,719	1,903
Tenant deposits and other liabilities	18,928	17,727
Total liabilities	1,245,697	1,095,323
Minority interest	10,712	28,142
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, 2007 and December 31, 2006, 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, 56,400,427 and 41,346,287 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	564	413
Additional paid-in capital	923,826	794,653
Accumulated other comprehensive income	(439)	
Retained deficit	(513,836)	(494,938)
Total stockholders equity	529,223	419,236
Total liabilities and stockholders equity	$1,785,632	$ 1,542,701

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

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Revenue				
Rental income	$ 54,274	$ 51,959	$ 107,916	$ 102,865
Net premiums earned	26,478		43,197	
Sales of manufactured homes	2,952	2,993	5,486	5,665
Utility and other income	6,843	6,270	13,963	12,747
Fee and other insurance income	1,784		3,101	
Net investment income	1,940		3,270	
Net realized gains on investments	117		184	
Net consumer finance interest income	388	245	762	424
Total revenue	94,776	61,467	177,879	121,701
Expenses				
Property operations	17,873	16,256	35,461	32,678
Real estate taxes	4,843	5,024	9,680	10,160
Losses and loss adjustment expenses	18,638		27,515	
Cost of manufactured homes sold	2,438	2,565	4,527	4,874
Retail home sales, finance and other	2,094	2,830	3,958	4,728
Property management	1,971	1,586	3,818	3,178
General and administrative	5,597	4,991	10,982	9,412
Underwriting expenses	7,933		14,536	
Depreciation and amortization	21,745	21,775	43,611	43,386
Loss on sale of airplane				541
Interest expense	19,663	20,006	38,151	39,587
Total expenses	102,795	75,033	192,239	148,544
Interest income	(643)	(448)	(1,137)	(871)
Loss from continuing operations before income tax benefit and allocation to minority interest	(7,376)	(13,118)	(13,223)	(25,972)
Income tax (expense) benefit from continuing operations	(256)	3,372	(943)	4,571
Loss from continuing operations before allocation to minority interest	(7,632)	(9,746)	(14,166)	(21,401)
Minority interest	256	166	527	402
Loss from continuing operations	(7,376)	(9,580)	(13,639)	(20,999)
(Loss) income from discontinued operations	22	689	(106)	2,381
Gain on sale of discontinued operations		15,613		25,909
Income tax expense from discontinued operations		(6,521)		(11,316)
Minority interest in discontinued operations	(1)	(343)	3	(596)
Net loss	(7,355)	(142)	(13,742)	(4,621)
Preferred stock dividend	(2,578)	(2,578)	(5,156)	(5,156)
Net loss attributable to common stockholders	$ (9,933)	$ (2,720)	$ (18,898)	$ (9,777)
Loss per share from continuing operations				
Basic loss per share	$ (0.18)	$ (0.28)	$ (0.35)	$ (0.60)
Diluted loss per share	$ (0.18)	$ (0.28)	$ (0.35)	$ (0.60)
Income per share from discontinued operations				
Basic income per share	$	$ 0.22	$	$ 0.38
Diluted income per share	$	$ 0.22	$	$ 0.38
Loss per share attributable to common stockholders				
Basic loss per share	$ (0.18)	$ (0.06)	$ (0.35)	$ (0.22)
Diluted loss per share	$ (0.18)	$ (0.06)	$ (0.35)	$ (0.22)
Weighted average share information				
Basic shares outstanding	56,394	43,696	54,372	43,632

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

HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2007
(in thousands)
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Deficit	Total Stockholders Equity
	Shares	Amount	Shares	Amount				
Balance January 1, 2007	5,000	$ 119,108	41,346	$ 413	$ 794,653	$	$ (494,938)	$ 419,236
Common stock issued to board members			5		61			61
Rights offering shares			10,000	100	78,349			78,449
Preferred partnership unit redemption			1,628	16	17,626			17,642
Share issuance			3,374	34	33,324			33,358
Stock compensation expense					600			600
Amortization of unearned compensation					28			28
Transfer of minority interest ownership in Operating Partnership					(1,373)			(1,373)
Redemption of OP units for common stock			47	1	558			559
Accumulated other comprehensive income						(439)*		(439)
Net loss							(18,898)	(18,898)
Balance June 30, 2007	5,000	$ 119,108	56,400	$ 564	$ 923,826	$ (439)	$ (513,836)	$ 529,223

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* Net of tax effect of $229,000.

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

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2007 and 2006
(in thousands)
(unaudited)

	Six Months Ended June 30, 2007	2006
Cash flow from operating activities		
Net loss	$ (13,742)	$ (4,621)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	43,611	43,386
Intra-period income taxes		6,745
Deferred income taxes	943	
Increase in unearned premiums	14,607	
Increase in deferred acquisition costs	(7,288)	
Realized gains on investments	(184)	
Purchases of trading securities	(478)	
Proceeds from sales of trading securities	581	
Adjustments to fair value for interest rate caps	95	(436)
Amortization of loan origination costs	2,142	3,045
Stock grant compensation expense	690	98
Partnership preferred unit distributions	67	552
Minority interest	(594)	(954)
Depreciation and minority interest included in income from discontinued operations		801
Gain on sale of discontinued operations		(25,909)
Loss on sale of airplane		541
Gain on sale of manufactured homes	(959)	(791)
Changes in operating assets and liabilities	785	(7,002)
Net cash provided by operating activities	40,276	15,455
Cash flow from investing activities		
NLASCO acquisition	(115,794)	
Cash acquired from NLASCO	45,457	
Purchases of manufactured homes	(7,069)	(6,693)
Proceeds from community sales		123,431
Proceeds from manufactured home sales	4,901	5,428
Proceeds from sale of airplane		1,170
Community improvements and equipment purchases	(4,479)	(2,055)
Restricted cash	(198)	374
Loan reserves	(2,920)	(3,547)
Purchases of available-for-sale securities	(13,980)	
Purchases of held-to-maturity securities	(413)	
Proceeds from sales of available-for-sale securities	8,426	
Proceeds from maturities of held-to-maturity securities	1,200	
Net cash (used in) provided by investing activities	(84,869)	118,108

HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
FOR THE SIX MONTHS ENDED JUNE 30, 2007 and 2006
(in thousands)
(unaudited)

	Six Months Ended June 30, 2007	2006
Cash flow from financing activities		
Cash flow from rights offering and stock issuances		
Common stock rights offering	80,000	
Common stock offering expenses	(1,551)	
Proceeds from issuances of common stock	20,000	
Proceeds from issuance of debt	20,074	30,535
Repayment of debt	(22,386)	(147,372)
Deposits on refinance transaction		(4,900)
Payment of preferred dividends	(5,156)	(5,156)
Payment of partnership preferred distributions	(251)	(552)
Loan origination costs	(563)	(1,849)
Net cash provided by (used in) financing activities	90,167	(129,294)
Net increase in cash and cash equivalents	45,574	4,269
Cash and cash equivalents, beginning of period	29,281	27,926
Cash and cash equivalents, end of period	$ 74,855	$ 32,195
Non-cash financing and investing transactions:		
Debt and other liabilities assumed in the NLASCO acquisition	$ 136,288	$
Redemption of OP units for common stock	$ 18,201	$ 3,176
Fair value of common stock issued in the NLASCO acquisition	$ 13,359	$
Notes receivable issued for manufactured home sales	$ 2,386	$ 3,740
Dividends declared but unpaid	$ 1,719	$ 1,903
Supplemental cash flow information:		
Payments on notes receivable included in proceeds from manufactured home sales	$ 3,838	$ 3,804
Cash paid for interest	$ 38,290	$ 40,187

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

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HILLTOP HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

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

Business

At June 30, 2007, Affordable Residential Communities Inc. was a Maryland corporation that was 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, all exclusively to residents in our communities. Subsequently, and as of July 31, 2007, the Company closed the sale of these businesses, and retained ownership of the recently acquired NLASCO, Inc. In conjunction with this sale, the Company transferred the rights to the Affordable Residential Communities name and has changed its name to Hilltop Holdings Inc.

As of June 30, 2007, the Company was not required to reflect the sale of the business as discontinued operations due to the special meeting of stockholders on July 27, 2007, with regard to the sale, being subsequent to the reporting period.

On January 31, 2007, we acquired all of the stock of NLASCO, Inc. (NLASCO), a privately held property and casualty insurance holding company. NLASCO is a Delaware corporation that specializes in providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO operates through its wholly-owned subsidiaries, National Lloyds Insurance Company (NLIC) and Summit Insurance Company (ASIC).

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 97.4% as of June 30, 2007.

As of June 30, 2007, we owned and operated 275 communities consisting of 57,272 homesites in 23 states with occupancy of 82.4%. 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 5.8% of our total homesites; and Kansas City-Lawrence-Topeka, with 4.2% of our total homesites. Our insurance operations are headquartered in Waco, Texas.

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

RECENT EVENTS

During the reporting period, we had the following changes in executive management

On June 20, 2007, we announced the resignation of Lawrence E. Kreider as Executive Vice President, Chief Financial Officer and Chief Information Officer. Pursuant to his severance agreement, Mr. Kreider received $.4 million to be paid over the next 12 months and a one time lump sum payment of $.1 million bonus to assist in the closing of the Farallon transaction.

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, 2007 are not indicative of the results that may be expected for the year ended December 31, 2007. Operating results and cash flows of NLASCO are for the five months from the date of acquisition, January 31, 2007, through June 30, 2007. These financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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 three or six months ended June 30, 2007 and 2006.

Investment Securities

Investment securities at June 30, 2007 consist of U.S. Government, mortgage-backed, corporate debt and equity securities. We classify our fixed maturities in one of three categories: trading, available-for-sale or held-to-maturity. Our equity securities are classified as trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity debt

securities are those securities in which we have the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of trading and available-for-sale securities are determined on a specific-identification basis.

The Company regularly reviews its investment securities to assess whether the amortized cost is impaired and if impairment is other than temporary. A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

Premiums Receivable

Premiums receivable include premiums written and not yet collected. The Company regularly evaluates premiums receivable and establishes valuation allowances as appropriate. At June 30, 2007, the Company determined no valuation allowance was necessary.

Deferred Acquisition Costs

Costs of acquiring insurance that vary with and are primarily related to the production of new and renewal business, primarily consisting of commissions, premium taxes and underwriting expenses, are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Proceeds from reinsurance transactions that represent recovery of acquisition costs shall reduce applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized. Future investment income is considered in determining the recoverability of deferred acquisition costs. The Company regularly reviews the categories of acquisition costs that are deferred and assesses the recoverability of this asset. A premium deficiency and a corresponding charge to income is recognized if the sum of the expected loss and loss adjustment expenses, unamortized acquisition costs, and maintenance costs exceed related unearned premiums and anticipated investment income. At June 30, 2007, there was no premium deficiency.

Goodwill and Other Indefinite Lived Intangible Assets

Goodwill represents the excess of the cost over the fair value of the assets of NLASCO. Goodwill is tested annually for impairment and is tested more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. For goodwill, the impairment determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an

impairment loss is recognized for any excess of the carrying amount of the reporting unit s goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with FASB Statement No. 141, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. In connection with an acquisition made by NLASCO prior to its acquisition by HTH, the Company may make additional contingent acquisition payments of up to $1.5 million based on attainment of certain financial targets. Other indefinite lived intangible assets consist of $3.0 million of estimated fair value of state licenses acquired in the NLASCO purchase.

Finite Lived Intangible Assets

We record finite lived intangible assets at the estimated fair value of the assets acquired and amortize the assets over their estimated useful lives. The following finite lived intangible assets were acquired when the Company purchased NLASCO (in thousands).

	Estimated Fair Value	Estimated Useful Life
Customer relationships	$ 6,100	12 years
Agent relationships	3,600	13 years
Trade name	3,500	15 years
Software	1,500	5 years
Total	$ 14,700	
Less accumulated amortization	(827)	
Balance at June 30, 2007	$ 13,873	

Customer and agent relationships are amortized using the double declining balance method to approximate the non-renewal rate of customers and attrition of agents. The trade name and software are amortized using the straight-line method. Also included in finite lived intangible assets are lease intangibles and other customer relationships of $4.2 million related to HTH s manufactured home communities.

Losses and Loss Adjustment Expenses

The liability for losses and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in earnings currently. The liability for losses and loss adjustment expenses has not been reduced for reinsurance recoverable.

Premium Revenue Recognition

Property and liability premiums are generally recognized as revenue on a pro rata basis over the policy term. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums.

Reinsurance

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policy.

Stock Compensation

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 each of the six month periods ended June 30, 2007, 2006 and 2005, 3,000 shares vested leaving 6,000 shares unvested at June 30, 2007. We have recorded the unvested portion of the remaining 6,000 outstanding restricted shares as of June 30, 2007 as unearned compensation and are amortizing the balance ratably over the vesting period. We recorded $14,000 and $28,000 in compensation expense related to these restricted shares during both of the three and six month periods ended June 30, 2007 and 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

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax effects attributable to the temporary difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carry-forwards. Deferred tax assets are reduced by a valuation allowance to the extent that their benefits are not expected to be realized. At June 30, 2007 and December 31, 2006, valuation allowances of $68.7 million and $84.4 million, respectively, were 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), specifically 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).

Effective January 1, 2007, we adopted FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that we determine whether the benefits of our tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, we recognize the largest amount of the benefit that is more likely than not of being sustained in our consolidated financial statements. For tax positions that are not more than likely than not of being sustained upon audit, we do not recognize any portion of the benefits in our consolidated financial statements. The provisions of FIN 48 also provide guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure.

The cumulative effect of the adoption of the recognition and measurement provisions of FIN 48 resulted in no change to the January 1, 2007 balance of retained earnings. Our policy for interest and penalties related to income tax exposures is to recognize interest and penalties as incurred within the provision for income taxes in the consolidated statements of operations.

Accumulated Other Comprehensive Loss

Amounts recorded in accumulated other comprehensive loss of $0.4 million as of June 30, 2007 represent unrealized holding losses on available-for-sale securities, net of income taxes of $0.2 million. Including these unrecognized gains or losses, our comprehensive loss for the three and six months ended June 30, 2007 was $7.8 million and $14.2 million, respectively.

Statutory accounting practices

NLASCO is required to report its results of operations and financial position to insurance regulatory authorities based upon statutory accounting practices (SAP). One significant difference between SAP and generally accepted accounting principles (GAAP) is that under SAP NLASCO is required to expense all sales and other policy acquisition costs as they are incurred rather than capitalizing and amortizing them over the expected life of the policy as required by GAAP. The immediate charge off of sales and acquisition expenses and other conservative valuations under SAP generally cause a lag between the sale of a policy and the emergence of reported earnings. Because this lag can reduce the Company s gain from operations on a SAP basis, it can have the effect of reducing the amount of funds available for dividends from insurance companies. A second significant difference is that under SAP, certain assets are designated as nonadmitted and are charged directly to unassigned surplus, whereas under GAAP, such assets are included in the balance sheet net of an appropriate valuation reserve. A third significant difference between SAP and GAAP is that under SAP, investments are carried at amortized book value and under GAAP, certain investments are carried at fair value. A fourth significant difference is that surplus notes are classified as capital and surplus under SAP but classified as notes payable under GAAP.

Recent Statements of Financial Accounting Standards

In September 2006, the FASB issued SFAS No.157, *Fair Value Measurement* (SFAS No. 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP. SFAS No. 157 provides a common definition of fair value to be used throughout GAAP. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. SFAS No. 157 is effective for companies with fiscal years beginning after November 15, 2007 and we are still evaluating its impact on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FAS 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is expected to expand the use of fair value measurement, which is consistent with the Board s long-term measurement objectives for accounting for financial instruments. SFAS No. 159 is effective for companies with fiscal years beginning after November 15, 2007. Early adoption is permitted provided we also elect to apply the provisions of SFAS No. 157. We are still evaluating the impact that SFAS No. 159 will have on our financial position, results of operations and cash flows.

2. NLASCO Acquisition and Associated Equity Issuances

On January 31, 2007, we acquired all of the stock of NLASCO, a privately held property and casualty insurance holding company. In exchange for the stock, NLASCO s shareholders, consisting of C. Clifton Robinson and affiliates, received $105.75 million in cash and 1,218,880 shares of HTH common stock for a total consideration of $122.0 million. In addition, Flexpoint Fund, L.P., a fund managed by Flexpoint

Partners, LLC of Chicago, Illinois, invested $20 million to purchase 2,154,763 shares of common stock of the Company at the leading ten-day average market price of our common stock on the date the agreement was signed, subject to certain anti-dilution provisions.

In order to raise $80 million to provide a source of funding for a portion of the acquisition of NLASCO, we conducted a rights offering to our stockholders. In the rights offering, all holders of HTH common stock as of the record date of December 19, 2006 received one non-transferable right to purchase approximately 0.242 shares of common stock of the Company for each share held. The price at which the additional shares were purchased was $8.00 per share. The rights offering expired on January 23, 2007, and the company issued approximately 7.8 million shares of common stock to existing shareholders on that date. In addition, Gerald J. Ford and certain affiliates controlled by him purchased approximately 1.8 million shares that they would have been entitled to in the rights offering in a separate private placement transaction. Gerald J. Ford, one of the Company s directors and the beneficial owner of approximately 17.6% of HTH s common stock as of the record date, and certain of his affiliates also backstopped the rights offering and purchased another approximately 400,000 shares that were not purchased in the rights offering by the stockholders of record on the record date, at the rights offering price per share of $8.00.

The results of NLASCO s operations for the five months ended June 30, 2007 are included in these consolidated financial statements.

The total cash and equity consideration paid for the acquisition of NLASCO is as follows (in thousands):

Purchase price paid in cash	$ 105,750
Fair value of HTH shares issued to shareholder of NLASCO	13,359
Other consideration	2,945
Total consideration received by seller	122,054
Other acquisition expenditures	10,044
Total cash and equity consideration	$132,098

The source of funds for the above cash and equity consideration is as follows (in thousands):

Cash received from Flexpoint Partners for common stock	$ 20,000
Cash raised in the rights offering	80,000
Fair value of HTH shares issued to shareholder of NLASCO	13,359
Liability for future payment	2,945
Consideration paid by HTH from existing lines of credit	15,794
	$132,098

The total purchase price of NLASCO including liabilities assumed in the acquisition consists of the following (in thousands).*

Total cash and equity consideration	$ 129,153
Other consideration	2,945
Notes payable assumed at fair value (including $5.6 million paid by HTH)	56,680
Loss and loss adjustment expense liability assumed	18,664
Unearned premiums assumed	49,571
Accounts payable and other liabilities assumed	8,428
Total purchase price including transaction costs and assumed liabilities	$ 265,441

Our purchase price allocation is as follows (in thousands).*

Tangible assets at fair value	$ 32,780
Investments, cash and cash equivalents at fair value	166,443
Deferred income tax asset at fair value	24,782
Finite lived intangible assets	14,700
Goodwill	23,736
Other indefinite lived intangibles	3,000
	$ 265,441

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* The total purchase price of NLASCO has been adjusted, pursuant to requirements of the Stock Purchase Agreement, dated October 6, 2006, Section 2(e)(i), to reflect the Closing Stockholders Equity Adjustment.

We have prepared the following unaudited pro forma income statement information as if the NLASCO acquisition had occurred on January 1, 2006. The pro forma data is not necessarily indicative of the results that actually would have occurred if we had consummated the acquisition on January 1, 2006 (in thousands).

	Three Months Ended June 30,	**Six Months Ended June 30,**	
	2006	**2007**	**2006**
Revenue	$ 91,385	$ 189,876	$ 182,501
Total expenses	103,363	201,100	196,527
Interest income	(448)	(1,137)	(871)
Loss from continuing operations before income taxes and allocation to minority interest	(11,530)	(10,087)	(13,155)
Income tax (expense) benefit from continuing operations	1,792	(2,661)	(485)
Loss from continuing operations before allocation to minority interest	(9,738)	(12,748)	(13,640)
Minority interest	292	545	402
Loss from continuing operations	(9,446)	(12,203)	(13,238)
Discontinued operations	9,438	(103)	16,378
Net (loss) income	$ (8)	$ (12,306)	$ 3,140
Net loss attributable to common stockholders	$ (2,586)	$ (17,462)	$ (2,016)
Basic loss per share attributable to common stockholders	$ (0.05)	$ (0.32)	$ (0.04)
Diluted loss per share attributable to common stockholders	$ (0.05)	$ (0.32)	$ (0.04)
Weighted average shares	53,895	54,379	53,842

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3. Rental and Other Property, Net

The following summarizes rental and other property (in thousands).

	June 30, 2007	December 31, 2006
Land	$ 194,391	$ 194,306
Improvements to land and buildings	1,196,427	1,193,483
Rental homes and improvements	273,154	270,431
Furniture, equipment and vehicles	17,456	14,142
Subtotal	1,681,428	1,672,362
Less accumulated depreciation:		
On improvements to land and buildings	(235,041)	(210,483)
On rental homes and improvements	(75,406)	(63,092)
On furniture, equipment and vehicles	(11,324)	(8,223)
Rental and other property, net	$ 1,359,657	$ 1,390,564

4. Investments

The amortized cost (original cost for equity securities), gross unrealized holding gains and losses, and fair value of available-for-sale and held-to-maturity securities by major security type and class of security at June 30, 2007 were as follows (in thousands).

	June 30, 2007 Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	$ 56,980	$ 58	$ (614)	$ 56,424
Mortgage-backed securities	16,508	9	(241)	16,276
Corporate debt securities	36,052	64	(475)	35,641
	109,540	131	(1,330)	108,341
Equity securities	10,080	212	(39)	10,253
	119,620	343	(1,369)	118,594
Held-to-maturity securities:				
Fixed maturities:				
Government securities	6,469	6	(8)	6,467
	$ 126,089	$349	$ (1,377)	$ 125,061

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Fair values of investment securities are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The notes payable are periodically adjusted to market interest rates, therefore, the unpaid principal balance of the loan approximates fair value. Gross realized investment gains and losses for the five months ended June 30, 2007 are summarized as follows (in thousands).

	Three Months Ended June 30, 2007			**Six Months Ended June 30, 2007**		
	Gross Gains	**Gross Losses**	**Total**	**Gross Gains**	**Gross Losses**	**Total**
Fixed maturities	$	$	$	$ 6	$	$ 6
Equity securities	121	(4)	117	194	(16)	178
	$ 121	$ (4)	$ 117	$ 200	$ (16)	$ 184

Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The schedule of fixed maturities available-for-sale and held-to-maturity at June 30, 2007 by contractual maturity is as follows (in thousands).

	June 30, 2007 Amortized Cost	**Fair Value**
Available-for-sale fixed maturities:		
Due within one year	$ 14,262	$ 13,829
Due after one year through five years	35,155	35,285
Due after six years through ten years	36,222	35,580
Due after ten years	7,393	7,371
Mortgage-backed securities	16,508	16,276
	$109,540	$ 108,341
Held-to-maturity debt securities:		
Due within one year	$ 3,816	$ 3,814
Due after one year through five years	2,242	2,238
Due after six years through ten years		
Due after ten years	411	415
	$ 6,469	$ 6,467

Net investment income for the three and five months ended June 30, 2007 is as follows (in thousands).

	Three Months Ended June 30, 2007	**Six Months Ended June 30, 2007**
Gross investment income		
Cash equivalents	$ 356	$ 648
Fixed maturities	1,400	2,359
Equity securities	184	253
	1,940	3,260
Other income net of expenses		10
Net investment income	$ 1,940	$ 3,270

At June 30, 2007, the Company had on deposit in custody for various State Insurance Departments investments with carrying values of approximately $6 million.

5. Disclosures About the Fair Value of Financial Instruments

In the normal course of business, the Company invests in various financial assets and incurs various financial liabilities. The fair value estimates of financial instruments presented below are not necessarily indicative of the amounts the Company might pay or receive in actual market transactions. Potential taxes and other transaction costs have not been considered in estimating fair value. The disclosures that follow do not reflect the fair value of the Company as a whole since a number of the Company s significant assets (including deferred policy acquisition costs, land and buildings, deferred income taxes) and liabilities are not considered financial instruments and are not carried at fair value. Other assets and liabilities considered financial instruments such as cash and cash equivalents, premiums receivable, reinsurance receivable, prepaid reinsurance premiums, loss and loss adjustment expenses outstanding, unearned premiums, and reinsurance balances payable are generally of a short-term nature. Their carrying values are deemed to approximate fair value.

	June 30, 2007 Carrying Value	Fair Value
Financial assets (in thousands)		
Fixed maturities	$ 114,810	$ 114,808
Equity securities	10,253	10,253
Notes receivable	28,714	28,714
Financial liabilities (in thousands)		
Notes payable	$ 1,100,441	$ 1,120,635

Fair values of investment securities are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The notes payable are periodically adjusted to market interest rates, therefore, the unpaid principal balance of the loan approximates fair value.

6. Deferred Acquisition Costs

Policy acquisition expenses, primarily commissions, premium taxes and underwriting expenses related to issuing a policy incurred by NLASCO are deferred and charged against income ratably over the terms of the related policies. The activity in deferred acquisition costs for the five months ended June 30, 2007 is as follows (in thousands).

	Six Months Ended June 30, 2007
Beginning of period deferred acquisition costs	$
Acquisition expenses	14,545
Amortization charged to income	(7,257)
End of period deferred acquisition costs	$ 7,288

7. Notes Payable

The following table sets forth certain information regarding our notes payable (in thousands).

	June 30, 2007	December 31, 2006
Senior fixed rate mortgage due 2009, 5.05% per annum	$ 83,972	$ 84,689
Senior fixed rate mortgage due 2012, 7.35% per annum	275,896	277,616
Senior fixed rate mortgage due 2014, 5.53% per annum	187,948	189,407
Senior fixed rate mortgage due 2016, 6.24% per annum	170,000	170,000
Senior variable rate mortgage due 2009, one-month LIBOR plus 0.80% per annum (6.12% at June 30, 2007)	60,000	60,000
Various individual fixed rate mortgages due 2007 through 2031, averaging 7.13% per annum at June 30, 2007	124,579	128,567
Floorplan line of credit due 2007, ranging from prime plus 0.75% to prime plus 4.00% per annum (9.00% at June 30, 2007)	1,734	2,664
Trust preferred securities due 2035, three-month LIBOR plus 3.25% per annum (8.61% at June 30, 2007)	25,780	25,780
Consumer finance facility due 2008, one-month LIBOR plus 3.00% per annum (8.32% at June 30, 2007)	11,291	
Lease receivable facility due 2008, one-month LIBOR plus 4.125% per annum (9.445% at June 30, 2007)	10,000	10,000
Senior exchangeable notes due 2025, 7.50% per annum	96,600	96,600
Insurance company line of credit due October 2007, base rate less 0.5% per annum (7.75% at June 30, 2007)	4,018	
NLIC surplus note payable due May 2033, three-month LIBOR plus 4.10% (9.46% at June 30, 2007)	10,000	
NLIC surplus note payable due September 2033, three-month LIBOR plus 4.05% (9.41% at June 30, 2007)	10,000	
ASIC surplus note payable due April 2034, three-month LIBOR plus 4.05% (9.41% at June 30, 2007)	7,500	
Insurance company note payable due March 2035, three-month LIBOR plus 3.40% (8.76% at June 30, 2007)	20,000	
Other loans	1,123	1,177
	$ 1,100,441	$ 1,046,500

Senior Fixed Rate Mortgage Due 2009

We entered into the Senior Fixed Rate Mortgage due 2009 on February 18, 2004, in connection with the completion of our IPO and the Hometown acquisition. It is an obligation of certain real property subsidiaries of the OP and is collateralized by 26 manufactured home communities owned by these subsidiaries. The Senior Fixed Rate Mortgage due 2009 bears interest at a fixed rate of 5.05%, is being amortized based on a 30-year amortization schedule and matures on March 1, 2009. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2009 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Fixed Rate Mortgage Due 2012

We entered into the Senior Fixed Rate Mortgage due 2012 on May 2, 2002. It is an obligation of certain of our special purpose real property subsidiaries and is collateralized by 98 manufactured home

communities. The Senior Fixed Rate Mortgage due 2012 bears interest at a fixed rate of 7.35% per annum, is amortized based on a 30-year schedule and matures on May 1, 2012. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2012 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Fixed Rate Mortgage Due 2014

We entered into the Senior Fixed Rate Mortgage due 2014 on February 18, 2004 in connection with the completion of our IPO and the Hometown acquisition. It is an obligation of certain real property subsidiaries of the OP and is collateralized by 43 manufactured home communities owned by these subsidiaries. The Senior Fixed Rate Mortgage due 2014 bears interest at a fixed rate of 5.53% per annum, is amortized based on a 30-year schedule and matures on March 1, 2014. Pursuant to the terms of the mortgage agreement, we have established reserves relating to the mortgaged properties for real estate taxes, insurance, capital spending and property operating expenditures. The Senior Fixed Rate Mortgage due 2014 contains customary defeasance-based prepayment penalties for repayments made prior to maturity.

Senior Fixed Rate Mortgage Due 2016; Senior Variable Rate Mortgage Due 2009 (repaid and terminated Senior Variable Rate Mortgage Due 2007 and Revolving Credit Mortgage Facility)

On July 11, 2006, we entered into a $230 million mortgage debt facility. Approximately $116.8 million of the proceeds were used to repay and terminate our Senior Variable Rate Mortgage and approximately $58.8 million of the proceeds were used to repay and terminate our Revolving Credit Mortgage Facility. The Loan Agreement is comprised of two components (collectively, the Loan): a $170 million 10-year fixed rate mortgage debt component and a $60 million 3-year floating rate mortgage debt component with two one-year (no-fee) extension options. The fixed rate component bears interest at 6.239% and requires interest-only payments for the term of the loan. The floating rate component is adjusted monthly, bears interest at one-month LIBOR plus 80 basis points (6.12% at June 30, 2007 and capped at 7.3%) and requires interest-only payments for the term of the loan. The loan is secured by 59 manufactured housing communities located in 18 states as well as an assignment of leases and rents associated with the mortgaged property. The loan is non-recourse with the exception that the repayment of the indebtedness is guaranteed by the OP pursuant to a guaranty of non-recourse obligations in the event of declaration of bankruptcy; interference with any of the lenders rights, and asset transfers and other activities in violation of the loan documents. Under the provisions of the loan agreement, we have the right to prepay any portion of the floating rate component, with or without release of the mortgaged property, without penalty. Subsequent to a prepayment of the entire floating rate component of the loan, we have the option to prepay a fixed portion of the loan subject to prepayment fees, yield maintenance or defeasance in accordance with the terms of the loan agreement.

Various Individual Fixed Rate Mortgages

We have assumed various individual fixed rate mortgages in connection with the acquisition of various properties that were encumbered at the time of acquisition as follows:

a) Mortgages assumed as part of individual property purchases. These notes total approximately $31.5 million at June 30, 2007, mature from 2008 through 2028 and have an average effective interest rate of 7.11%. These mortgages are secured by 10 specific manufactured home communities.

b) Mortgages assumed in conjunction with the Hometown acquisition. These notes total approximately $66.4 million, mature from 2008 through 2031 and carry an average effective interest rate of 7.12%. These mortgages are secured by 12 specific manufactured home communities and are subject to early pre-payment penalties, the terms of which vary from mortgage to mortgage.

c) Notes assumed in conjunction with the D.A.M. portfolio purchase. These notes total approximately $26.7 million, mature in 2008 and carry an average effective annual interest rate of 7.18%. These mortgages are secured by 23 specific manufactured home communities.

Floorplan Lines of Credit

On November 11, 2005, we amended our floorplan line of credit to provide borrowings of up to $35.0 million, secured by manufactured homes in inventory. Under the amended lines of credit, the lender will advance 75% of the cost of manufactured homes. Repayments of borrowed amounts are due upon sale or lease of the related manufactured home. Advances under the amended lines of credit will bear interest ranging from the prime rate plus 0.75% to the prime rate plus 4.00% (averaging 9.00% at June 30, 2007) based on the length of time each advance has been outstanding. Monthly curtailment payments are required for unsold homes beginning 360 days following the purchase of the home. The required curtailment payment will be between 3.00% and 5.00% of the home s original invoice amount depending on the type of home and the number of months since the home s purchase. The amended lines of credit require us to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of $15.0 million, all as defined in the agreement. As amended, the minimum tangible net worth required is $385.0 million from January 1, 2007 through September 13, 2007, the due date of the line. We are in compliance with all financial covenants of the line of credit as of June 30, 2007. The line of credit is subject to a commitment fee of $250,000, an unused line fee of .25% per annum and a termination fee of 1.00% to 3.00%, based on the termination date.

Trust Preferred Securities Due 2035

On March 15, 2005, the Company issued $25.8 million in unsecured trust preferred securities. The $25.8 million trust preferred securities bear interest at three-month LIBOR plus 3.25% (8.61% at June 30, 2007). Interest on the securities is paid on the 30th of March, June, September and December of each year. The Company may redeem these securities on or after March 30, 2010 in whole or in part at principal amount plus accrued interest. The securities are mandatorily redeemable on March 15, 2035 if not redeemed sooner.

Consumer Finance Facility

We entered into the Retail Home Sales and Consumer Finance Debt Facility (the Consumer Finance Facility) on February 18, 2004, in connection with the completion of our IPO and the Hometown acquisition and amended it in April 2005 in connection with entering into a two-year, $75.0 million secured revolving lease receivables credit facility (see Lease Receivables Facility below). The Consumer Finance Facility has a total commitment of $125.0 million and a term of four years. This facility is an obligation of a subsidiary of our OP, and borrowings under this facility are secured by manufactured housing conditional sales contracts. Borrowings under the facility are limited by specified borrowing base requirements related to the value of the collateral securing the facility ($13.4 million at June 30, 2007). The facility bears interest at a variable rate based upon a spread of 3.00% over the one-month LIBOR (8.32% at June 30, 2007). Advances under the facility are subject to a number of conditions, including certain underwriting and credit screening guidelines and the conditions that the home must be located in one of our communities, the loan term may not exceed 12 years for a single-section home or 15 years for a multi-section home and the loan amount shall not exceed 90% of the value of the home securing the conditional sales contract.

The Consumer Finance Facility was amended for financial covenants in October 2005. The amended line of credit requires the OP to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of $15.0 million, all as defined in the agreement. As amended, the minimum tangible net worth required is $385.0 million from January 1, 2007 through December 31, 2007, and $355.0 million from January 1, 2008 through February 18, 2008. We were in compliance as of June 30, 2007 with all financial covenants under the amended line of credit.

The availability of advances under the Consumer Finance Facility is subject to certain conditions that are beyond our control. Conditions that could result in our inability to draw on these facilities include a downgrade in the credit rating of the lender and the absence of certain markets for financing debt obligations secured by securities or mortgage loans. Funding under this facility may also be denied if the lender determines that the value of the assets serving as collateral would be insufficient to maintain the required 75% loan-to-value ratio upon giving effect to a request for funding. The lender can also at any time require that we prepay amounts funded or provide additional collateral if, in its judgment, this is necessary to maintain the 75% loan-to-value ratio.

Lease Receivables Facility

On April 6, 2005, the Company entered into a two-year, $75.0 million secured revolving credit facility (the Lease Receivables Facility) with Merrill Lynch Mortgage Capital Inc. to be used to finance the purchase of manufactured homes and for general corporate purposes. In October 2005, we amended our lease receivables facility to increase the size of the facility from $75 million to $150 million. The amendment also (i) increased the limit on borrowings under the lease receivables facility from an amount equal to approximately 55% of the net book value of the eligible manufactured housing units owned by two of our indirect wholly owned subsidiaries, HTH Housing LLC and HTH HousingTX LP (collectively, Housing) and located in HTH s communities, to 65%, subject to certain other applicable borrowing base requirements, (ii) increased the interest rate on borrowings under the facility from 3.25% plus one-month LIBOR to 4.125% plus one-month LIBOR (9.445% at June 30, 2007), and (iii) extended the maturity of the facility from March 31, 2007 to September 30, 2008.

The amended line of credit requires the OP to maintain a minimum tangible net worth, a maximum debt to tangible net worth ratio of 3 to 1, and minimum cash and cash equivalents of $15.0 million, all as defined in the agreement. As amended, the minimum tangible net worth required is $385.0 million from January 1, 2007 through December 31, 2007, and $355.0 million from January 1, 2008 through September 30, 2008. We were in compliance as of June 30, 2007 with all financial covenants under the amended line of credit. Borrowings under the Lease Receivables Facility are secured by an assignment of all lease receivables and rents, an assignment of the underlying manufactured homes and a pledge by ARCHC LLC and HTH Housing GP LLC of 100% of the outstanding equity in Housing. Interest is payable monthly.

Senior Exchangeable Notes Due 2025

In August 2005, our OP issued $96.6 million aggregate principal amount of 7.50% senior exchangeable notes due 2025 to qualified institutional buyers in a private transaction. The notes are senior unsecured obligations of the OP and are exchangeable, at the option of the holders, into shares of HTH common stock at an initial exchange rate of 69.8812 shares per $1,000 principal amount of the notes (equal to an initial exchange price of approximately $14.31 per share), subject to adjustment and, in the event of specified corporate transactions involving HTH or the OP, an additional make-whole premium. Upon exchange, the OP shall have the option to deliver, in lieu of shares of HTH common stock, cash or a combination of cash and shares of HTH common stock.

According to the terms of the notes, their initial exchange rate is adjusted for certain events, including the issuance to all holders of HTH common stock of rights entitling them to purchase HTH common stock at less than their current market price. Accordingly, as a result of our rights offering in January 2007, in which we offered all holders of HTH common stock the right to purchase shares at $8.00 per share, the initial exchange rate of the notes was adjusted to 73.95 shares per $1,000 principal amount of the notes (equal to an initial exchange rate of $13.52 per share).

Prior to August 20, 2010, the notes are not redeemable at the option of the OP. After August 20, 2010, the OP may redeem all or a portion of the notes at a redemption price equal to the principal amount plus accrued and unpaid interest, if any, on the notes, if the closing price of HTH common stock has exceeded 130% of the exchange price for at least 20 trading days in any consecutive 30-trading day period.

Holders of the notes may require the OP to repurchase all or a portion of the notes at a purchase price equal to the principal amount plus accrued and unpaid interest, if any, on the notes on each of August 15, 2010, August 15, 2015, and August 15, 2020, or after the occurrence of certain corporate transactions involving HTH or the OP.

Insurance Company Line of Credit

Our insurance subsidiary has a line of credit with a financial institution. The line allows for borrowings by NLASCO up to $5 million and is secured by substantially all of NLASCO s assets. The line of credit bears interest equal to a base rate less 0.5% (7.75% at June 30, 2007) which is due monthly. The line matures in October 2007.

NLIC Surplus Notes Payable

NLIC has two unsecured $10 million surplus notes payable to unaffiliated companies. The surplus notes payable bear interest at three-month LIBOR plus 4.05% and three-month LIBOR plus 4.10% (9.41% and 9.46% at June 30, 2007). Interest is due quarterly and principal is due at maturity in September 2033 and May 2033, respectively. The surplus notes are subordinated in right of payment to all policy claims and other indebtedness of NLIC. Further, all payments of principal and interest require the prior approval of the Insurance Commissioner of the State of Texas and are only payable to the extent that the surplus of NLIC exceeds $30 million.

ASIC Surplus Note Payable

ASIC has an unsecured surplus note payable to an unaffiliated company. The surplus note payable bears interest at three-month LIBOR plus 4.05% (9.41% at June 30, 2007). Interest is due quarterly and principal is due at maturity. The surplus note is subordinated in right of payment to all policy claims and other indebtedness of ASIC. Further, all payments of principal and interest require the prior approval of the Insurance Commissioner of the State of Texas and are only payable to the extent that the surplus of ASIC exceeds $15 million. The note matures in April 2034.

Insurance Company Notes Payable

NLASCO has an unsecured $20 million note payable to an unaffiliated company which bears interest equal to the three-month LIBOR plus 3.40% (8.76% at June 30, 2007). Interest is due quarterly and the principal is due at maturity in March 2035.

NLASCO s loan agreements relating to the notes payable contain various covenants pertaining to limitations on additional debt, dividends, and officer and director compensation, and minimum capital requirements. The Company was in compliance with the covenants as of June 30, 2007.

8. Reserve for Unpaid Losses and Loss Adjustment Expenses

A roll-forward of the reserve for unpaid losses and loss adjustment expenses for the five months ended June 30, 2007 is as follows (in thousands).

Balance February 1, 2007*	$ 18,664
Less reinsurance recoverables	(1,509)
Net balance at February 1, 2007	17,155
Losses and loss adjustment expenses incurred	27,515
Loss payments	(26,900)
Net balance at June 30, 2007	17,770
Plus reinsurance recoverables	3,984
Balance at June 30, 2007	$ 21,754

* Includes purchase price adjustment of $2.9 million.

The reserve for losses and loss adjustment expenses includes amounts that may be due to or from the sellers of NLASCO by January 2010 based on actual losses incurred applicable to the reserve as of the acquisition date.

9. Equity and Minority Interest Related Transactions

At June 30, 2007, minority interest consisted of 1,411,350 OP Units that were issued to various limited partners. Each OP Unit outstanding is paired with 1.9268 shares of our special voting stock (each a Paired Equity Unit) that allows each holder to vote an OP Unit on matters as if it were a common share of our stock. Each OP Unit is redeemable for cash, or at our election, 1.06 shares of our common stock. During the second quarter of 2007, there were no OP Unit redemptions for our common stock.

The PPUs outstanding as of December 31, 2006 consisted of 705,688 Series C units. The Series C PPUs carried a liquidation preference of $25 per unit and earned cash distributions at the rate of 6.25% per annum, payable quarterly. In January 2007, all 705,688 units of our Series C PPUs were redeemed according to their terms for 1,628,410 shares of HTH common stock.

We recorded an equity transfer adjustment between additional paid-in capital and the minority interest in our consolidated balance sheet as of June 30, 2007 to account for changes in the respective ownership in the underlying equity of the Operating Partnership.

All retained earnings of our insurance subsidiary are unappropriated.

On March 14, 2007, the board of directors declared a quarterly cash dividend of $0.515625 per share for its Series A Cumulative Redeemable Preferred Stock. The dividend was paid on April 30, 2007 to shareholders of record on April 13, 2007. On April 26, 2007, the board of directors declared a quarterly cash dividend of $0.515625 per share for its Series A Cumulative Redeemable Preferred Stock. The dividend was paid on July 30, 2007 to shareholders of record on July 13, 2007. The Board reviews the payment of dividends on a quarterly basis.

In March 2007, four senior executives of HTH were granted options to acquire a total of 25,000 shares of common stock at $11.28 per share to compensate for dilution from the rights offering.

The following summarizes the activity of the minority interest in the Operating Partnership (in thousands):

Minority interest at December 31, 2006	$ 28,142
Minority interest allocation.	(535)
Transfer from stockholders equity	1,373
Redemption of OP Units	(559)
Distributions to PPU holders	(67)
Redemption of Series C PPUs	(17,642)
Minority interest at June 30, 2007	$ 10,712

10. Reinsurance Activity

NLASCO limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risk. Substantial amounts of business are ceded, and these reinsurance contracts do not relieve NLASCO from its obligations to policyholders. Such reinsurance includes quota share, excess of loss, catastrophe, and other forms of reinsurance on essentially all property and casualty lines of insurance. Failure of reinsurers to honor their obligations could result in losses to NLASCO; consequently, allowances are established for amounts deemed uncollectible. NLASCO evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. At June 30, 2007, reinsurance receivables with a carrying value of approximately $2.8 million were associated with a single reinsurer.

The effect of reinsurance on premiums written and earned for the five months ended June 30, 2007 is as follows (in thousands):

	Six Months Ended June 30, 2007	
	Written	**Earned**
Premiums from direct business	$62,150	$50,166
Reinsurance assumed.	6,028	3,575
Reinsurance ceded	(10,635)	(10,544)
	$57,543	$ 43,197

11. Property Operations Expense

During the three and six months ended June 30, 2007 and 2006, we incurred property operations expense as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Utilities and telephone	$ 6,930	$ 7,062	$ 14,490	$ 14,202
Salaries and benefits	5,687	4,893	11,198	9,863
Repairs and maintenance	3,040	2,155	5,443	3,978
Insurance	697	819	1,422	1,681
Bad debt expense	310	293	565	693
Professional services	271	298	489	609
Office supplies	171	151	333	311
Advertising	11	26	30	52
Other operating expense	756	559	1,491	1,289
	$ 17,873	$ 16,256	$ 35,461	$ 32,678

12. Retail Home Sales, Finance and Other Operating Expense

During the three and six months ended June 30, 2007 and 2006, we incurred retail home sales, finance, insurance and other operating expense as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Salaries and benefits	$ 828	$ 697	$ 1,643	$ 1,358
Commissions	511	1,140	852	1,721
Travel	139	117	239	166
Insurance	32	47	40	98
Professional services	189	195	399	428
Advertising	310	297	551	465
Other operating expense	85	337	234	492
	$ 2,094	$ 2,830	$ 3,958	$ 4,728

13. General and Administrative Expense

During the three and six months ended June 30, 2007 and 2006, we incurred general and administrative expense as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Salaries and benefits	$ 3,603	$ 2,866	$ 6,897	$ 5,609
Travel	241	188	552	321
Professional services	750	880	1,594	1,511
Telephone	74	134	146	199
Office supplies	65	108	118	224
Insurance	245	309	464	566
Rent	143	136	298	200
Other administrative expense	476	370	913	782
	$ 5,597	$ 4,991	$ 10,982	$ 9,412

14. Discontinued Operations

As of December 31, 2005, the Company held 41 communities as discontinued operations and as of June 30, 2006 had closed sales for 36 of these communities comprising $77.0 million of cash proceeds net of related debt, defeasance and other closing costs of $59.6 million. Subsequent to June 30, 2006, we closed an additional four communities for $8.4 million of cash proceeds net of related debt, defeasance and other closing costs of $15.4 million. The remaining sales transaction is expected to close in 2008. There can be no assurance, however, that the Company will close the remaining community sale, or, if it closes, that it will close on the terms set forth in its contract.

In accordance with the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-lived Assets, each of the communities designated as held for sale and not sold have been classified as discontinued operations as of June 30, 2007 and December 31, 2006. We have included $15.4 million and $15.3 million of net assets related to these communities as assets held for sale in the accompanying consolidated balance sheets as of June 30, 2007 and December 31, 2006, respectively, and $0.1 million and $0.2 million, respectively, of accounts payable and other obligations related to these communities as liabilities related to assets held for sale. In addition,

we have recast the operations of each of these communities as discontinued operations in the accompanying statements of operations for the three and six months ended June 30, 2007 and 2006 and recorded no gains or losses in the three or six months ended June 30, 2007, and gains of $15.6 million and 25.9 million for the three and six months ended June 30, 2006.

We consider a community to be a discontinued when: (i) management commits to a plan to sell the asset, supported by a Board resolution granting approval to proceed with the sale; (ii) the asset is available for immediate sale in its present condition subject only to terms that are unusual and customary for sales of such assets; (iii) an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated; (iv) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year; (v) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and (vi) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. In accordance with the guidance provided by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* we measure each of our assets held for sale at the lower of its carrying amount or fair value, less cost to sell at the balance sheet date and re-cast any applicable balances and corresponding liabilities related to the communities identified in all comparable periods presented. Depreciation of the assets held for sale, if applicable, is suspended at the date of the determination of discontinuance. Interest and other expenses attributable to the liabilities of the communities classified as held for sale continues to be accrued. The results of operations and cash flows of the assets sold and those classified as held for sale are reported as discontinued operations for all periods presented. We recognize any estimated losses on the sales of communities in the period in which the properties are discontinued and recognize any resulting gains on the sales of communities when realized. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the balance sheet, the carrying amounts of the major classes of assets and liabilities included as part of the disposal group is disclosed in the notes to the financial statements. We disclose in the notes to our financial statements (and on the face of the income statement) the gain or loss recognized in accordance with SFAS No. 144 and, if applicable, the amounts of revenue and pretax profit or loss reported in discontinued operations. We disclose, if applicable, in the notes to our financial statements the segment under which the long-lived asset is reported. If circumstances arise that previously were considered unlikely and, as a result, we decide not to sell a community previously classified as held for sale, the community will be reclassified as held and used. A community that is reclassified shall be measured at the lower of its (a) carrying amount before the community was classified as held for sale, adjusted for any depreciation expense that would have been recognized had the community been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

The following table summarizes combined balance sheet and income statement information for the discontinued operations noted above (in thousands):

	June 30, 2007	**December 31, 2006**
Assets Held for Sale		
Rental and other property, net	$ 13,265	$ 13,362
Goodwill	754	754
Prepaid expenses and other assets	1,416	1,210
	$ 15,435	$ 15,326
Liabilities Related to Assets Held for Sale		
Accounts payable and accrued expenses	$ 124	$ 236
Tenant deposits and other liabilities	10	11
	$ 134	$ 247

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Statement of Operations				
Revenue	$ 3	$ 2,761	$ 3	$ 8,201
Operating expenses	19	(2,072)	(109)	(5,820)
Income (loss) from discontinued operations	$ 22	$ 689	$ (106)	$ 2,381

15. Income Taxes

At June 30, 2007, the Company has net operating loss carry-forwards for Federal income tax purposes, subject to certain limitations, of approximately $392 million and $379 million for regular income tax and alternative minimum tax, respectively. These net operating loss carry-forwards expire in 2018 through 2025. Losses from continuing operations during the quarter only partially offset the regular taxable earnings from discontinued operations for the quarter ending June 30, 2006 due to the allocation of intra-period taxes as discussed below. The net operating loss carry-forwards for alternative minimum Federal income taxes generally are limited to offsetting 90% of the alternative minimum taxable earnings for a given period.

Based on our estimated composite Federal and state tax rate of 40% for our real estate business and 35% for our retail home, finance and insurance businesses, we recorded as of June 30, 2007, a deferred tax asset of approximately $169.9 million less a valuation allowance reserve of approximately $68.7 million and deferred tax liabilities of approximately $74.7 million. The 35% rate reflects a change from 40% due to the expectation that future taxable income of our insurance business will primarily be subject to Federal but not state income taxes. Insurance companies are generally not taxed in most states on income taxes as they pay premium taxes in states where they generate premium revenue. We experienced a reduction in our valuation allowance of $15.7 million due to the acquisition of NLASCO because the taxable income of this subsidiary will enable us to utilize $88.2 million of the net operating losses of an HTH subsidiary that is the parent of NLASCO, subject to limitation. We could experience circumstances in the future that result in a non-cash income tax benefit based on the timing of recognition of the tax benefit of our operating losses carried forward from prior years. Under current IRS rules, we can elect to return to REIT status after five years. There can be no assurances that the tax laws and regulations will not change or that we will change our REIT election status in five years.

The Company did not have aggregate income tax benefits or expense for the year ended December 31, 2006. 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 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)

Effective January 1, 2007, we adopted FIN 48 which required the measurement of unrecognized tax benefits. Unrecognized tax benefits are the difference between a tax position taken, or expected to be taken in a tax return, and the benefit recognized for accounting purposes. For the period ending June 30, 2007 we have no unrecognized tax benefits.

We file tax returns as prescribed by the tax laws of the jurisdictions in which we operate. We are subject to tax audits in numerous jurisdictions in the U.S. until the applicable statute of limitations expires. The following is a summary of the tax years open to examination:

U.S. Federal 2003 through 2006
U.S. States 2002 through 2006

There are currently no U.S. Federal or state tax audits in process.

Under special IRS rules (the Section 382 Limitation), cumulative stock purchases by material shareholders exceeding 50% during a three year period can limit a company s future use of net operating losses (NOL s). We had a Section 382 ownership change in February 2004 at the time of the IPO. Due to section 382-limited NOLs expiring before they can be utilized, there is a potential loss of $11.5 million of NOLs. The deferred tax valuation allowance fully reserves for the tax effected amount.

The significant components of the provision for income taxes are as follows (in thousands):

	Three Months Ended June 30, 2007			**Six Months Ended June 30, 2007**		
	Continuing Operations	**Discontinued Operations**	**Total**	**Continuing Operations**	**Discontinued Operations**	**Total**
Current tax expense	$ (100)	$	$ (100)	$ (100)	$	$ (100)
Deferred tax expense	(156)		(156)	(843)		(843)
Income tax (expense) benefit	$ (256)	$	$ (256)	$ (943)	$	$ (943)

	Three Months Ended June 30, 2006			**Six Months Ended June 30, 2006**		
	Continuing Operations	**Discontinued Operations**	**Total**	**Continuing Operations**	**Discontinued Operations**	**Total**
Current tax expense	$	$	$	$	$	$
Deferred tax expense						
Intra-period tax benefit (expense)	3,372	(6,521)	(3,149)	4,571	(11,316)	(6,745)
Income tax (expense) benefit	$ 3,372	$ (6,521)	$ (3,149)	$ 4,571	$ (11,316)	$ (6,745)

The provision for income taxes differs from the amount that would be computed by applying the statutory Federal income tax rate of 35% to income before income taxes as a result of the following (in thousands):

	Three Months Ended June 30, 2007			**Six Months Ended June 30, 2007**		
	Continuing Operations	**Discontinued Operations**	**Total**	**Continuing Operations**	**Discontinued Operations**	**Total**
Tax at statutory rate	$ 2,582	$ (8)	$ 2,574	$ 4,629	$ 37	$ 4,666
Permanent differences	(16)		(16)	(101)		(101)
Increase in valuation allowance	(2,822)	8	(2,814)	(5,471)	(37)	(5,508)
Income tax (expense) benefit	$ (256)	$	$ (256)	$ (943)	$	$ (943)

	Three Months Ended June 30, 2006			**Six Months Ended June 30, 2006**		
	Continuing Operations	**Discontinued Operations**	**Total**	**Continuing Operations**	**Discontinued Operations**	**Total**
Tax at statutory rate	$ 4,492	$ (5,506)	$ (1,014)	$ 8,893	$ (9,558)	$ (665)
Permanent differences	107	(228)	(121)	(453)	(392)	(845)
State taxes	642	(787)	(145)	1,271	(1,366)	(95)
Intra-period tax limitation	(3,075)		(3,075)	(6,300)		(6,300)
Decrease in valuation allowance	1,206		1,206	1,160		1,160
Income tax (expense) benefit	$ 3,372	$ (6,521)	$ (3,149)	$ 4,571	$ (11,316)	$ (6,745)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of significant temporary differences that give rise to the net deferred tax assets and liabilities are as follows (in thousands):

	June 30, 2007	December 31, 2006
Deferred Tax Assets		
Net operating loss carryforwards	$ 157,169	$ 150,834
Prepaid rent	255	249
Allowance for doubtful accounts and loan loss reserve	823	977
Goodwill	2,844	3,606
Notes payable	1,663	1,834
Accrued liabilities and other	1,923	1,533
Deferred revenue	454	340
Loss and loss adjustment expense discounting	694	
Securities available for sale	1,063	
Unearned premiums	1,468	
Deferred compensation	1,093	
Loan origination costs	448	
Valuation allowance	(68,684)	(84,383)
Total gross deferred tax assets	$ 101,213	$ 74,990
Deferred Tax Liabilities		
Rental and other property, net	$ 64,251	$ 71,941
Intangible assets	7,567	2,583
Deferred commissions	319	466
Deferred policy acquisition costs	2,545	
Total gross deferred tax liabilities	$ 74,682	$ 74,990
Net Deferred Tax Asset	$ 26,531	$

16. Statutory Net Income and Capital and Surplus

The Company s insurance subsidiaries, which are domiciled in the State of Texas, prepare their statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the Texas Department of Insurance, which Texas recognizes for determining solvency under Texas State Insurance Law. The Commissioner of the Texas Department of Insurance has the right to permit other practices that may deviate from prescribed practices. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in Texas. Permitted statutory accounting practices encompass all accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future.

The Company s insurance subsidiaries statutory financial statements are presented on the basis of accounting practices prescribed or permitted by the Texas Department of Insurance. Texas had adopted the National Association of Insurance Commissioners statutory accounting practices as the basis of its statutory accounting practices with certain differences which are not significant to the companies statutory equity.

In addition, the Commissioner of the Texas Department of Insurance has the right to permit other specific practices that may deviate from prescribed practices. The Company s insurance subsidiaries have no such permitted statutory accounting practices.

Following is a summary of statutory capital and surplus as of June 30, 2007 and statutory net income of each insurance subsidiary for the three and five months ended June 30, 2007 (in thousands).

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
National Lloyds Insurance Company		
Surplus	$ 87,540	$ 87,540
Statutory net income	$ 464	$ 2,095
American Summit Insurance Company		
Capital and surplus	$ 23,146	$ 23,146
Statutory net income	$ 1,013	$ 1,280

17. Capital and Dividend Restrictions

The funding of the cash requirements (including debt service) of NLASCO is primarily provided by cash dividends from NLASCO s wholly-owned insurance subsidiaries. Dividends paid by the insurance subsidiaries are restricted by regulatory requirements of the Texas Department of Insurance. Under Texas State Insurance Law for property and casualty companies, all dividends must be distributed out of earned surplus only. Furthermore, without the prior approval of the Commissioner, dividends cannot be declared or distributed which exceed the greater of ten percent of the Company s surplus, as shown by its last statement on file with the Commissioner, or one hundred percent of net income for such period. The subsidiaries paid no dividends to NLASCO during the five months ended June 30, 2007. At June 30, 2007, the maximum dividend that may be paid to NLASCO in 2007 without regulatory approval is approximately $21.3 million.

Regulations of the Texas Department of Insurance require insurance companies to maintain minimum levels of statutory surplus to ensure their ability to meet their obligations to policyholders. At June 30, 2007, the Company s insurance subsidiaries had statutory surplus in excess of the minimum required.

Also, the NAIC has adopted the RBC formula for insurance companies that establishes minimum capital requirements relating to insurance risk, asset credit risk, interest rate risk and business risk. The formula is used by the NAIC and certain state insurance regulators as an early warning tool to identify companies that require additional scrutiny or regulatory action. At June 30, 2007, the Company s insurance subsidiaries RBC ratio exceeded the level at which regulatory action would be required.

18. Loss per share

In accordance with SFAS No. 128, Earnings per Share, our historical basic and diluted weighted average shares outstanding have been increased by a factor of approximately 1.06 to reflect the 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. The following reflects the calculation of income (loss) per share on a basic and diluted basis (in thousands, except per share information).

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Loss per share from continuing operations:				
Loss from continuing operations	$ (7,376)	$ (9,580)	$ (13,639)	$ (20,999)
Preferred stock dividends	(2,578)	(2,578)	(5,156)	(5,156)
Net loss from continuing operations	$ (9,954)	$ (12,158)	$ (18,795)	$ (26,155)
Weighted average share information:				
Common shares outstanding	56,394	43,696	54,372	43,632
Basic loss per share from continuing operations	$ (0.18)	$ (0.28)	$ (0.35)	$ (0.60)
Diluted loss per share from continuing operations	$ (0.18)	$ (0.28)	$ (0.35)	$ (0.60)
Income (loss) per share from discontinued operations:				
Income (loss) from discontinued operations	$ 22	$ 689	$ (106)	$ 2,381
Gain on sale of discontinued operations		15,613		25,909
Income tax expense on discontinued operations		(6,521)		(11,316)
Minority interest in discontinued operations	(1)	(343)	3	(596)
Net income (loss) from discontinued operations	$ 21	$ 9,438	$ (103)	$ 16,378
Basic income per share from discontinued operations	$	$ 0.22	$	$ 0.38
Diluted income per share from discontinued operations	$	$ 0.22	$	$ 0.38
Loss per share to common stockholders:				
Net loss to common stockholders	$ (9,933)	$ (2,720)	$ (18,898)	$ (9,777)
Basic loss per share to common stockholders	$ (0.18)	$ (0.06)	$ (0.35)	$ (0.22)
Diluted loss per share to common stockholders	$ (0.18)	$ (0.06)	$ (0.35)	$ (0.22)
Weighted average equivalent shares excluded from diluted loss per share because they would be anti-dilutive:				
Operating partnership units(a)	1,493	1,600	1,507	1,656
Preferred partnership units(b)		1,737		1,737
Stock options	35		34	
Restricted stock	6	10	7	10
Total	1,534	3,347	1,548	3,403

(a) From June 30, 2006 through June 30, 2007, we redeemed approximately 94,000 OP units.

(b) In January 2007 we redeemed all of the Series C preferred partnership units.

19. Commitments and Contingencies

In the normal course of business, from time to time we are involved in legal actions relating to the ownership and operations of our properties. In our opinion, the liabilities, if any, which may ultimately result from such legal actions, will not have a material adverse effect on our financial position, results of

operations or cash flows. In the normal course of business, from time to time we incur environmental obligations relating to the ownership and operation of our properties. In our opinion, the liabilities, if any, which may ultimately result from such environmental obligations, will not have a material adverse effect on our financial position, results of operations or cash flows.

20. Segment Information

We operate in four business segments real estate, property and casualty insurance, retail home sales, and finance and other. A summary of our business segment information for the three and six months ended June 30, 2007 is shown below (in thousands). The 2007 business segment information has been segregated into the operations related to the manufactured housing business and the operations related to NLASCO property and casualty insurance. Insurance figures are for the three and five months ended June 30, 2007.

Results for the three months ended June 30, 2007 are as follows:

	Three Months Ended June 30, 2007
	Mfg.