

Howard Hughes Corp
Form 10-Q
November 10, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

or

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

Commission file number 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-4673192
(I.R.S. employer
identification number)

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

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(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of common stock, \$0.01 par value, outstanding as of November 5, 2014 was 39,638,094.

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	September 30, 2014	December 31, 2013
	(In thousands, except share amounts)	
Assets:		
Investment in real estate:		
Master Planned Community assets	\$ 1,605,814	\$ 1,537,758
Land	263,032	244,041
Buildings and equipment	907,283	754,878
Less: accumulated depreciation	(138,176)	(111,728)
Developments	899,827	488,156
Net property and equipment	3,537,780	2,913,105
Investment in Real Estate and Other Affiliates	85,344	61,021
Net investment in real estate	3,623,124	2,974,126
Cash and cash equivalents	805,606	894,948
Accounts receivable, net	25,827	21,409
Municipal Utility District receivables, net	122,515	125,830
Notes receivable, net	12,724	20,554
Tax indemnity receivable, including interest	333,877	320,494
Deferred expenses, net	73,230	36,567
Prepaid expenses and other assets, net	314,266	173,940
Total assets	\$ 5,311,169	\$ 4,567,868
Liabilities:		
Mortgages, notes and loans payable	\$ 1,880,916	\$ 1,514,623
Deferred tax liabilities	41,038	89,365
Warrant liabilities	444,680	305,560
Uncertain tax position liability	231,904	129,183
Accounts payable and accrued expenses	516,461	283,991
Total liabilities	3,114,999	2,322,722
Commitments and Contingencies (see Note 15)		
Equity:		
Preferred stock: \$.01 par value; 50,000,000 shares authorized, none issued		
Common stock: \$.01 par value; 150,000,000 shares authorized, 39,638,094 shares issued and outstanding as of September 30, 2014 and 39,576,344 shares issued and outstanding as of December 31, 2013	396	396
Additional paid-in capital	2,835,753	2,829,813
Accumulated deficit	(638,864)	(583,403)
Accumulated other comprehensive loss	(7,677)	(8,222)
Total stockholders' equity	2,189,608	2,238,584
Noncontrolling interests	6,562	6,562
Total equity	2,196,170	2,245,146

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Total liabilities and equity	\$	5,311,169	\$	4,567,868
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See Notes to Condensed Consolidated Financial Statements.

Table of Contents**THE HOWARD HUGHES CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****UNAUDITED**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	\$ 59,351	\$ 53,734	\$ 260,186	\$ 166,981
Builder price participation	5,311	2,002	13,251	5,703
Minimum rents	24,380	21,538	66,929	60,598
Tenant recoveries	7,601	5,291	20,509	15,681
Condominium rights and unit sales	4,032	810	11,516	31,191
Resort and conference center revenues	8,150	8,169	27,198	30,543
Other land revenues	4,112	3,579	9,322	10,211
Other rental and property revenues	6,291	4,492	18,601	14,557
Total revenues	119,228	99,615	427,512	335,465
Expenses:				
Master Planned Community cost of sales	27,743	27,063	93,540	82,616
Master Planned Community operations	10,995	9,764	31,645	28,054
Other property operating costs	15,198	20,329	45,603	52,126
Rental property real estate taxes	4,559	3,698	12,540	10,814
Rental property maintenance costs	2,313	2,048	6,402	5,996
Condominium rights and unit cost of sales	2,026	406	5,788	15,678
Resort and conference center operations	8,910	7,381	22,833	22,537
Provision for doubtful accounts	119	204	293	910
Demolition costs	760	1,386	6,711	1,386
Development-related marketing costs	6,387	1,050	15,909	1,771
General and administrative	14,759	11,914	49,138	34,310
Other income, net	(11,409)	(6,314)	(27,468)	(11,727)
Depreciation and amortization	13,018	9,986	35,000	23,210
Total expenses	95,378	88,915	297,934	267,681
Operating income	23,850	10,700	129,578	67,784
Interest income	(1,162)	2,061	19,651	6,484
Interest expense	(12,136)	(1)	(28,354)	(144)
Warrant liability gain (loss)	24,690	(4,479)	(139,120)	(148,706)
Increase (reduction) in tax indemnity receivable	5,454	730	(5,473)	(8,673)
Equity in earnings from Real Estate and Other Affiliates	5,509	3,594	18,164	12,034
Income (loss) before taxes	46,205	12,605	(5,554)	(71,221)
Provision for income taxes	590	5,172	49,895	21,012
Net income (loss)	45,615	7,433	(55,449)	(92,233)
Net income attributable to noncontrolling interests		(98)	(12)	(110)
	\$ 45,615	\$ 7,335	\$ (55,461)	\$ (92,343)

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Net income (loss) attributable to common
stockholders

Basic income (loss) per share:	\$	1.16	\$	0.19	\$	(1.41)	\$	(2.34)
Diluted income (loss) per share:	\$	0.48	\$	0.17	\$	(1.41)	\$	(2.34)

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**THE HOWARD HUGHES CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****UNAUDITED**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)			
Comprehensive income (loss), net of tax:				
Net income (loss)	\$ 45,615	\$ 7,433	\$ (55,449)	\$ (92,233)
Other comprehensive income (loss):				
Interest rate swaps (a)	784	(413)	902	2,120
Capitalized swap interest (b)	(180)	(293)	(357)	(1,024)
Other comprehensive income (loss)	604	(706)	545	1,096
Comprehensive income (loss)	46,219	6,727	(54,904)	(91,137)
Comprehensive income attributable to noncontrolling interests		(98)	(12)	(110)
Comprehensive income (loss) attributable to common stockholders	\$ 46,219	\$ 6,629	\$ (54,916)	\$ (91,247)

(a) Net of deferred tax expense of \$0.1 million and \$0.2 million for the three months and nine months ended September 30, 2014, respectively. Net of deferred tax expense of \$0.4 million for both the three and nine months ended September 30, 2013.

(b) Net of deferred tax benefit of \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2014, respectively. Net of deferred tax benefit of \$0.2 million and \$0.5 million for the three and nine months ended September 30, 2013, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**THE HOWARD HUGHES CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY****UNAUDITED**

		Common	Additional Paid-In	Accumulated	Accumulated Other Comprehensive	Noncontrolling	Total
Balance, January 1, 2013	39,498,912	\$ 395	\$ 2,824,031	\$ (509,613)	\$ (9,575)	\$ 5,759	\$ 2,310,997
Net income (loss)				(92,343)		110	(92,233)
Adjustment to noncontrolling interest						1,616	1,616
Preferred dividend payment on behalf of REIT subsidiary						(12)	(12)
Interest rate swaps, net of tax of (\$376)					2,120		2,120
Capitalized swap interest, net of tax of \$542					(1,024)		(1,024)
Stock plan activity	77,432	1	4,111				4,112
Balance, September 30, 2013	39,576,344	\$ 396	\$ 2,828,142	\$ (601,956)	\$ (8,479)	\$ 7,473	\$ 2,225,576
Balance, January 1, 2014	39,576,344	\$ 396	\$ 2,829,813	\$ (583,403)	\$ (8,222)	\$ 6,562	\$ 2,245,146
Net income (loss)				(55,461)		12	(55,449)
Preferred dividend payment on behalf of REIT subsidiary						(12)	(12)
Interest rate swaps, net of tax of \$135					902		902
Capitalized swap interest, net of tax of \$126					(357)		(357)
Stock plan activity	61,750		5,940				5,940
Balance, September 30, 2014	39,638,094	\$ 396	\$ 2,835,753	\$ (638,864)	\$ (7,677)	\$ 6,562	\$ 2,196,170

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**THE HOWARD HUGHES CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****UNAUDITED**

	Nine Months Ended September 30,	
	2014	2013
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	\$ (55,449)	\$ (92,233)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation	31,330	20,197
Amortization	3,670	3,013
Amortization of deferred financing costs	2,927	1,060
Amortization of intangibles other than in-place leases	462	271
Straight-line rent amortization	1,113	(2,087)
Deferred income taxes	47,925	19,712
Restricted stock and stock option amortization	5,940	4,111
Gain on disposition of asset	(2,373)	
Warrant liability loss	139,120	148,706
Reduction in tax indemnity receivable	5,473	8,673
Interest income related to tax indemnity	(18,856)	(5,555)
Equity in earnings from Real Estate and Other Affiliates, net of distributions	(14,666)	(5,408)
Provision for doubtful accounts	293	910
Master Planned Community land acquisitions	(69,930)	(5,667)
Master Planned Community development expenditures	(93,080)	(95,061)
Master Planned Community cost of sales	86,044	73,201
Condominium development expenditures	(34,358)	(10,891)
Condominium and other cost of sales	5,788	15,678
Proceeds from sale of condominium rights		47,500
Percentage of completion revenue recognition from sale of condominium rights	(11,516)	(31,191)
Non-monetary consideration relating to land sale	(13,789)	
Net changes:		
Accounts and notes receivable	26,188	1,850
Prepaid expenses and other assets	(3,436)	12,143
Condominium deposits received	125,002	
Deferred expenses	(32,028)	(7,156)
Accounts payable and accrued expenses	18,055	5,773
Condominium deposits held in escrow	(125,002)	
Other, net	(8,888)	1,217
Cash provided by operating activities	15,959	108,766
Cash Flows from Investing Activities:		
Property and equipment expenditures	(6,213)	(26,527)
Operating property improvements	(3,581)	(22,623)
Property developments and redevelopments	(467,497)	(126,819)
Proceeds from insurance claims	12,901	
Proceeds from dispositions	11,953	10,831

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Acquisition of 1701 Lake Robbins	(1,484)	
Investment in Summerlin Las Vegas Baseball Club, LLC		(10,350)
Investment in KR Holdings, LLC		(16,750)
Investments in Real Estate and Other Affiliates, net	(3,929)	(1,031)
Change in restricted cash	(8,136)	(18,268)
Cash used in investing activities	(465,986)	(211,537)
Cash Flows from Financing Activities:		
Proceeds from issuance of mortgages, notes and loans payable	414,046	360,788
Principal payments on mortgages, notes and loans payable	(45,443)	(271,871)
Deferred financing costs	(7,906)	(2,437)
Preferred dividend payment on behalf of REIT subsidiary	(12)	(12)
Distributions to noncontrolling interests		(2,134)
Cash provided by financing activities	360,685	84,334
Net change in cash and cash equivalents	(89,342)	(18,437)
Cash and cash equivalents at beginning of period	894,948	229,197
Cash and cash equivalents at end of period	\$ 805,606	\$ 210,760

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	Nine Months Ended September 30,	
	2014	2013
	(In thousands)	
Supplemental Disclosure of Cash Flow Information:		
Interest paid	\$ 49,617	\$ 23,228
Interest capitalized	34,760	26,537
Income taxes paid	1,487	2,127
Non-Cash Transactions:		
Special Improvement District bond transfers associated with land sales	7,496	11,549
Property developments and redevelopments	59,819	56,763
Acquisition of 1701 Lake Robbins		
Land	(1,663)	
Building	(3,725)	
Other assets and deferred expenses	(848)	
Mortgages, notes and loans payable	4,600	
Other liabilities	152	
Non-cash increase in Property due to consolidation of Real Estate Affiliate		3,750
Transfer of condominium buyer deposits to Real Estate Affiliate		34,220

See Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the Securities and Exchange Commission (the SEC). Such condensed consolidated financial statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (Quarterly Report) should refer to The Howard Hughes Corporation s (HHC or the Company) audited Consolidated Financial Statements which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2013. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods have been included. The results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for the full fiscal year.

Certain amounts in 2013 have been reclassified to conform to 2014 presentation. As a result of the increasing significance of development-related marketing costs in our operations, we have chosen to present, as a separate line item in the Condensed Consolidated Statements of Operations, the amount of development-related marketing costs expensed. Previously, these expenses were included in the line item Other property operating costs. Development-related marketing costs include salaries, benefits, agency fees, events, advertising, online hosting, marketing-related travel and other costs that we incur for the benefit of our developments and re-developments.

Management has evaluated for disclosure or recognition all material events occurring subsequent to the date of the Condensed Consolidated Financial Statements up to the date and time this Quarterly Report was filed.

NOTE 2 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In August, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, *Presentation of Financial Statements - Going Concern: Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern*. Before the issuance of this ASU, there was no guidance in U.S. GAAP about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern or to provide related footnote disclosures. This guidance is expected to reduce the diversity in the timing and content of footnote disclosures. This ASU requires management to assess an entity s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. This ASU becomes effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of this ASU to have an impact on the Company s Consolidated Financial Statements.

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In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU states that entities should recognize revenue to properly depict the transfer of negotiated goods or services to customers in an amount that properly reflects the agreed upon consideration which the entity expects to be exchanged. The standard is effective for interim and annual periods beginning after December 15, 2016 and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The Company is evaluating the impact of the adoption of this ASU on the Company's Consolidated Financial Statements.

In April 2014, the FASB issued ASU 2014-08, *Presentation of Financial Statements and Property, Plant, and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The amendments in the ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective in the first quarter of 2015 for public organizations with calendar year ends. Early adoption is permitted. The

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

Company has adopted this guidance. There is no impact of the adoption on the Company's Consolidated Financial Statements because the Company does not have any discontinued operations.

NOTE 3 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010 (the Effective Date), we issued warrants to purchase 8.0 million shares of our common stock to certain of our sponsors (the Sponsors Warrants) of which 1.9 million remain outstanding. The initial exercise price for the warrants of \$50.00 per share and the number of shares of common stock underlying each warrant are subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. The Sponsors Warrants expire on November 9, 2017.

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

As of September 30, 2014, the estimated \$195.0 million fair value of the Sponsors Warrants representing warrants to purchase 1,916,667 shares and the estimated \$249.7 million fair value of the Management Warrants representing warrants to purchase 2,862,687 shares have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsors Warrants and Management Warrants were \$141.8 million and \$163.8 million, respectively, as of December 31, 2013. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 7 *Fair Value of Financial Instruments*. Decreases and increases in the fair value of the Sponsors Warrants and the Management Warrants are recognized as either warrant liability gains or losses, respectively, in the Condensed Consolidated Statements of Operations.

NOTE 4 EARNINGS PER SHARE

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Information related to our EPS calculations is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Basic EPS:				
Numerator:				
Net income (loss)	\$ 45,615	\$ 7,433	\$ (55,449)	\$ (92,233)
Net income attributable to noncontrolling interests		(98)	(12)	(110)
Net income (loss) attributable to common stockholders	\$ 45,615	\$ 7,335	\$ (55,461)	\$ (92,343)
Denominator:				
Weighted average basic common shares outstanding	39,465	39,454	39,459	39,447
Diluted EPS:				
Numerator:				
Net income (loss) attributable to common stockholders	\$ 45,615	\$ 7,335	\$ (55,461)	\$ (92,343)
Less: Warrant liability gain	(24,690)			
Adjusted net income (loss) attributable to common stockholders	\$ 20,925	\$ 7,335	\$ (55,461)	\$ (92,343)
Denominator:				
Weighted average basic common shares outstanding	39,465	39,454	39,459	39,447
Restricted stock and stock options	405	253		
Warrants	3,301	2,732		
Weighted average diluted common shares outstanding	43,171	42,439	39,459	39,447
Basic earnings (loss) per share:	\$ 1.16	\$ 0.19	\$ (1.41)	\$ (2.34)
Diluted earnings (loss) per share:	\$ 0.48	\$ 0.17	\$ (1.41)	\$ (2.34)

The diluted EPS computation for the nine months ended September 30, 2014 excludes 1,037,740 stock options, 172,690 shares of restricted stock, 1,916,667 shares of common stock underlying the Sponsors Warrants and 2,862,687 shares of common stock underlying the Management Warrants because their inclusion would have been anti-dilutive.

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The diluted EPS computations for the nine months ended September 30, 2013 excludes 930,940 stock options, 122,332 shares of restricted stock, 1,916,667 shares of common stock underlying the Sponsor Warrants and 2,862,687 shares of common stock underlying the Management Warrants because their inclusion would have been anti-dilutive.

NOTE 5 RECENT TRANSACTIONS

In May 2014, we purchased 1,343 acres of undeveloped land located 13 miles north of The Woodlands for \$67.2 million. On October 31, 2014, we purchased an additional 653 adjacent acres from a different seller. We have preliminarily planned for 1,835 acres of residential and 161 acres of commercial development on the combined sites, and estimate that the residential acres will yield over 4,600 lots. The first lots are expected to be finished and sold in 2016. This land acquisition will be developed by The Woodlands management team and is included in our Master Planned Communities segment.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

NOTE 6 IMPAIRMENT

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

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

No impairment charges were recorded during the three or nine months ended September 30, 2014 or 2013. We continually evaluate our strategic alternatives with respect to each of our properties and may revise our strategy from time to time, including our intent to hold the asset on a long-term basis or the timing of potential asset dispositions. For example, we may decide to sell property that is held for use and the sale price may be less than the carrying amount. As a result, these changes in strategy could result in impairment charges in future periods.

NOTE 7 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

September 30, 2014			December 31, 2013		
Fair Value Measurements Using			Fair Value Measurements Using		
Quoted Prices	Significant		Quoted Prices	Significant	
in Active	Other	Significant	in Active	Other	Significant
Markets for	Observable	Unobservable	Markets for	Observable	Unobservable

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	Total	Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	Total	Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
Assets:								
Cash equivalents	\$ 200,014	\$ 200,014	\$	\$	\$	\$	\$	\$
Liabilities:								
Warrants	444,680			444,680	305,560			305,560
Interest rate swaps	3,195		3,195		4,164		4,164	

Cash equivalents consist primarily of two registered money market mutual funds which invest in United States treasury securities that are valued at the net asset value of the underlying shares in the funds as of the close of business at the end of each period. The fair value approximates carrying value.

The valuation of warrants is based on an option pricing valuation model. The inputs to the model include the fair value of the stock related to the warrants, exercise price of the warrants, term, expected volatility, risk-free interest rate and dividend yield and with respect to the Management Warrants, a discount for lack of marketability.

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

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

	2014	2013
	(In thousands)	
Balance as of January 1,	\$ 305,560	\$ 123,573
Warrant liability loss	139,120	148,706
Balance as of September 30,	\$ 444,680	\$ 272,279

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

Significant unobservable inputs used in the fair value measurement of our warrants designated as Level 3 as of September 30, 2014 is as follows:

Warrants	\$ 444,680	Option Pricing Valuation Model	23.0%	20.0% - 22.0%

(a) Based on our implied equity volatility.

(b) Represents the discount rate for lack of marketability of the Management Warrants. The discount rates ranged from 29.0%-30.0% at December 31, 2013.

The expected volatility and marketability discount in the table above are significant unobservable inputs used to estimate the fair value of our warrant liabilities. An increase in expected volatility would increase the fair value of the liability, while a decrease in expected volatility would decrease the fair value of the liability. As the period of restriction lapses, the marketability discount reduces to zero and increases the fair value of the warrants.

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

	September 30, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(In thousands)				
Assets:				
Cash and cash equivalents (a)	\$ 605,592	\$ 605,592	\$ 894,948	\$ 894,948
Notes receivable, net	12,724	12,724	20,554	20,554
Tax indemnity receivable, including interest	333,877	(b)	320,494	(b)
Liabilities:				
Fixed-rate debt	\$ 956,739	\$ 979,836	\$ 971,786	\$ 1,012,461
Variable-rate debt (c)	899,623	899,623	509,737	509,737
SID bonds	24,554	24,399	33,100	32,837
Total mortgages, notes and loans payable	\$ 1,880,916	\$ 1,903,858	\$ 1,514,623	\$ 1,555,035

(a) Consists of bank deposits with original maturities of 90 days or less.

(b) It is not practicable to estimate the fair value of the tax indemnity receivable, including interest, as the timing and ultimate amount received under the agreement is highly dependent on numerous future events that cannot be reliably predicted.

(c) \$172.0 million of variable-rate debt has been swapped to a fixed rate for the term of the related debt.

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

The fair value of debt in the table above, not including our Senior Notes (as defined below), was estimated based on a discounted future cash payment model using Level 2 inputs, which includes risk premiums for loans of comparable quality and a risk free rate derived from the current London Interbank Offered Rate (LIBOR) or U.S. Treasury obligation interest rates. The discount rates reflect our judgment as to what the approximate current lending rates for loans or groups of loans with similar maturities and credit quality would be if credit markets were operating efficiently and assuming that the debt is outstanding through maturity.

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The fair value of our Senior Notes included in Fixed-rate debt in the table above was estimated based on quoted market prices for similar issues.

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

NOTE 8 REAL ESTATE AND OTHER AFFILIATES

In the ordinary course of business, we enter into partnerships or joint ventures primarily for the development and operations of real estate assets which are referred to as Real Estate Affiliates . These partnerships or joint ventures are accounted for in accordance with FASB ASC 810 *Consolidation*.

In accordance with ASC 810, we assess our joint ventures at inception to determine if any meet the qualifications of a variable interest entity (VIE). We consider a partnership or joint venture a VIE if: (a) the total equity investment is not sufficient to permit the entity to finance its activities without additional subordinated financial support; (b) characteristics of a controlling financial interest are missing (either the ability to make decisions through voting or other rights, the obligation to absorb the expected losses of the entity or the right to receive the expected residual

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returns of the entity); or (c) the voting rights of the equity holders are not proportional to their obligations to absorb the expected losses of the entity and/or their rights to receive the expected residual returns of the entity, and substantially all of the entity's activities either involve or are conducted on behalf of an investor that has disproportionately few voting rights. Upon the occurrence of certain events outlined in ASC 810, we reassess our initial determination of whether the partnership or joint venture is a VIE.

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

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

Our investment in real estate and other affiliates which are reported on the equity and cost methods are as follows:

	Economic/ Legal Ownership		Carrying Value		Share of Earnings/Dividends			
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013	2014	2013	2014	2013
Equity Method Investments:								
Circle T Ranch and Power Center	50.00%	50.00%	\$ 9,005	\$ 9,004	\$	\$	\$	\$
HHMK Development (a)	50.00%	50.00%	110	13	386	290	869	443
KR Holdings (a)	50.00%	50.00%	41,171	19,764	5,066	2,716	14,801	7,907
Millennium Phase II (a) (b)	81.43%	81.43%	1,937	2,174	(243)	(59)	(378)	(59)
Parcel C (a)	50.00%	50.00%	7,638	5,801				

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Stewart Title	50.00%	50.00%	3,770	3,843	383	382	901	899
Summerlin Apartments, LLC (a)	50.00%							
Summerlin Las Vegas Baseball Club, LLC (a)	50.00%	50.00%	10,835	10,636	22	220	198	220
Parcel D	50.00%	50.00%	4,362	3,461				
Woodlands Sarofim	20.00%	20.00%	2,600	2,579	27	45	124	121
			81,428	57,275	5,641	3,594	16,515	9,531
Cost basis investments			3,916	3,746	(132)		1,649	2,503
Investment in Real Estate and Other Affiliates			\$ 85,344	\$ 61,021	\$ 5,509	\$ 3,594	\$ 18,164	\$ 12,034

(a) Equity method variable interest entities.

(b) Millennium Phase II was placed into service in the beginning of the third quarter of 2014 and moved from the Strategic Developments segment to the Operating Assets segment.

We are not the primary beneficiary of any of the VIEs listed above because we do not have the power to direct activities that most significantly impact the economic performance of such joint ventures and therefore we report our interests on the equity method. Our maximum exposure to loss as a result of these investments is limited to the aggregate carrying value of the investment as we have not provided any guarantees or otherwise made firm commitments to fund amounts on behalf of these VIEs. The aggregate carrying value of the unconsolidated VIEs was \$61.7 million and \$38.4 million as of September 30, 2014 and December 31, 2013, respectively. As of September 30, 2014, approximately \$194.4 million of indebtedness was secured by the properties owned by our Real Estate Affiliates of which our share was approximately \$106.0 million based upon our economic ownership. All of this debt is without recourse to us.

At September 30, 2014, the Company was the primary beneficiary of one VIE, which we therefore consolidated. The creditors of the consolidated VIE do not have recourse to the Company's general credit. As of September 30,

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2014, the carrying values of the assets and liabilities associated with the operations of the consolidated VIE were \$20.7 million and \$0.2 million, respectively. As of December 31, 2013, the carrying values of the assets and liabilities associated with the operations of the consolidated VIE were \$20.6 million and \$0.1 million, respectively. The assets of the VIE are restricted for use only by the particular VIE and are not available for our general operations.

Our recent and more significant investments in Real Estate Affiliates and the related accounting considerations are described below.

ONE Ala Moana Condominium Project

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

On September 17, 2012, KR Holdings closed on two \$20.0 million non-recourse mezzanine loan commitments with List Island Properties, LLC and A & B Properties, Inc. These loans have a blended interest rate of 12.00%, were drawn in full on May 15, 2013 and mature on April 30, 2018 with the option to extend for one year. In addition to the mezzanine loans, A & B Properties and List Island Properties, LLC both have profit interests in KR Holdings, which entitles them to receive a share of the profits, after a return of our capital plus a 13% preferred return on our capital. A & B Properties' participation is capped at \$3.0 million.

KR Holdings closed on a \$132.0 million first mortgage construction loan on May 15, 2013 of which \$79.7 million is outstanding as of September 30, 2014. Upon closing and under the terms of the venture agreement, we sold to KR Holdings our interest in the condominium rights for net cash proceeds of \$30.8 million and a 50% equity interest in KR Holdings. Our partner contributed \$16.8 million of cash for their 50% equity interest. The construction loan will be drawn over the course of construction, is secured by the condominium rights and buyers' deposits, has no recourse to us, matures on May 15, 2016, and bears interest at one-month LIBOR plus 3.00%. Summarized financial information for KR Holdings as of September 30, 2014 includes total assets of \$253.0 million, total liabilities of \$170.2 million, gross sales of \$163.9 million and net income of \$29.6 million. The venture uses the percentage of completion method to recognize earnings and we recorded \$5.1 million and \$14.8 million in equity in earnings from Real Estate Affiliates related to KR Holdings in the Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2014, respectively. Our investment balance includes deferred profit of \$1.5 million which is being recognized on the same percentage of completion basis as KR Holdings. We expect to complete the project and close on the sales of the units under contract in the fourth quarter 2014.

Millennium Woodlands Phase II, LLC

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

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Parcel C

On October 4, 2013, we entered into a joint venture agreement with a local developer, Kettler, Inc. (Kettler), to construct a 437-unit, Class A apartment building with 31,000 square feet of ground floor retail on Parcel C in downtown Columbia, Maryland. We contributed approximately five acres of land having an approximate book value of \$4.0 million to the joint venture. Our land was valued at \$23.4 million or \$53,500 per constructed unit. When the venture closes on the construction loan and upon completion of certain other conditions, including obtaining completed site development and construction plans and an approved project budget, our partner will be required to contribute cash to the venture.

Summerlin Apartments, LLC

On January 24, 2014, we entered into a joint venture with a national multi-family real estate developer, The Calida Group (Calida), to construct, own and operate a 124-unit gated luxury apartment development. We and our partner each own 50% of the venture, and unanimous consent of the partners is required for all major decisions. This project represents the first residential development in Summerlin s 400-acre downtown. We will contribute a 5.5-acre parcel of land with an agreed value of \$3.2 million in exchange for a 50% interest in the venture when construction financing closes. Our partner will contribute cash for their 50% interest, act as the development manager, fund all pre-development activities, obtain construction financing and provide any guarantees required by the lender. Upon a sale of the property, we are entitled to our 50% share of proceeds and 100% of the proceeds in excess of an amount determined by applying a 7.0% capitalization rate to net operating income (NOI). The venture is expected to begin construction in the fourth quarter of 2014 with the first units available for rent by the fourth quarter of 2015.

Summerlin Las Vegas Baseball Club, LLC

On August 6, 2012, we entered into a joint venture for the purpose of acquiring 100% of the operating assets of the Las Vegas 51s, a Triple-A baseball team which is a member of the Pacific Coast League. We own 50% of the venture and our partners jointly own the remaining 50%. Unanimous consent of the partners is required for all major decisions. As of the date the joint venture acquired the baseball team, we had funded our capital contribution of \$10.5 million. Our strategy in owning an interest is to pursue a potential relocation of the team to a to-be-built stadium in our Summerlin master planned community. Efforts to re-locate the team are ongoing and there can be no assurance that such a stadium will ultimately be built.

The Metropolitan Downtown Columbia Project

On October 27, 2011, we entered into a joint venture, Parcel D Development, LLC (Parcel D), with Kettler to construct a Class A apartment building with ground floor retail space in downtown Columbia, Maryland. We and our partner each own 50% of the venture, and unanimous consent of the partners is required for all major decisions. On July 11, 2013, the joint venture closed a \$64.1 million construction loan which is non-recourse to us. The loan bears interest at one-month LIBOR plus 2.40% and matures in July 2020. At loan closing, our land contribution was valued at \$53,500 per unit, or \$20.3 million, and Kettler contributed \$13.3 million in cash, of which \$7.0 million was distributed to us. Both we and Kettler made additional contributions of \$3.1 million to the joint venture in accordance with the loan agreement, thus increasing our total capital account to \$16.4 million. This transaction was accounted for as a partial sale of land for which we recognized a net profit of \$0.7 million. We expect the project to be substantially completed by the fourth quarter of 2014.

Upon formation of the joint venture, we determined that Parcel D was a VIE, and that we were not the primary beneficiary. Accordingly, we accounted for our investment in Parcel D using the equity method. Upon closing of the first mortgage construction loan, the entity was recapitalized resulting in a reconsideration of the initial determination of VIE status. As a result of the reconsideration, we determined that Parcel D was no longer considered a VIE. We continue to account for our investment in Parcel D using the equity method.

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Mortgages, notes and loans payable are summarized as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Fixed-rate debt:		
Collateralized mortgages, notes and loans payable	\$ 956,739	\$ 971,786
Special Improvement District bonds	24,554	33,100
Variable-rate debt:		
Collateralized mortgages, notes and loans payable (a)	899,623	509,737
Total mortgages, notes and loans payable	\$ 1,880,916	\$ 1,514,623

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

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

\$ In thousands	Maturity (a)	Interest Rate	Maximum Facility	Carrying Value	
				September 30, 2014	December 31, 2013
Master Planned Communities					
Bridgeland Land Loan	June 2022	5.50%		\$ 15,874	\$ 18,066
Bridgeland Development Loan	June 2015	5.00%(d)	\$ 30,000	24,200	
Summerlin South SID Bonds - S108	December 2016	5.95%		694	823
Summerlin South SID Bonds - S124	December 2019	5.95%		256	285
Summerlin South SID Bonds - S128	December 2020	7.30%		665	707
Summerlin South SID Bonds - S128C	December 2030	6.05%		5,392	5,511
Summerlin South SID Bonds - S132	December 2020	6.00%		3,232	3,962
Summerlin South SID Bonds - S151	June 2025	6.00%		6,421	6,623
Summerlin West SID Bonds - S808/S810	April 2031	7.13%		4,000	11,168
The Woodlands Master Credit Facility	August 2018	2.90%(d)	250,000	176,663	176,663
Master Planned Communities Total				237,397	223,808
Operating Assets					
70 Columbia Corporate Center (b)	June 2019	2.40%(d)		20,000	16,287
Columbia Regional Building	March 2018	2.15%(d)	23,008	18,960	9,207
One Hughes Landing	November 2017	2.80%(d)	38,000	34,417	19,128
Two Hughes Landing	September 2018	2.80%(d)	41,230	17,828	10
1701 Lake Robbins	April 2017	5.81%		4,600	
Millennium Waterway Apartments	June 2022	3.75%		55,584	55,584
110 N. Wacker (c)	October 2019	5.21%(d)		29,000	29,000
9303 New Trails	December 2023	4.88%		13,157	13,398
Outlet Collection at Riverwalk	October 2018	2.90%(d)	64,400	44,703	
The Woodlands Resort & Conference Center	February 2019	3.65%(d)	95,000	66,177	36,100
Victoria Ward	September 2016	3.34%(d)	250,000	238,716	238,716
20/25 Waterway Avenue	May 2022	4.79%		14,383	14,450
3 Waterway Square	August 2028	3.94%		52,000	52,000
4 Waterway Square	December 2023	4.88%		38,530	39,237
Capital lease obligations	various	3.60%		156	205
Operating Assets Total				648,211	523,322
Strategic Developments					
Downtown Summerlin	July 2019	2.40%(d)	311,800	172,913	
	December 2016	5.95%		388	452

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Downtown Summerlin SID Bonds -
S108

Downtown Summerlin SID Bonds - S128	December 2030	6.05%		3,506	3,569
ExxonMobil	June 2019	2.05%(d)	143,000	23,702	
Hughes Landing Retail	December 2018	2.10%(d)	36,575	14,259	913
One Lake s Edge	November 2018	2.65%(d)	73,525	18,085	
Waterway Hotel	August 2019	2.80%(d)	69,300		
Strategic Developments Total				232,853	4,934
Other Corporate Financing Arrangements	July 2018	3.00%	22,700	20,434	21,309
Senior Notes	October 2021	6.88%		750,000	750,000
Unamortized underwriting fees				(7,979)	(8,750)
			\$	1,880,916	\$ 1,514,623

- (a) Maturity date includes any extension periods which can be exercised at our option.
- (b) The note we assumed on August 15, 2012 was fully paid with cash on hand on April 15, 2014. On June 30, 2014, we entered into a new \$20.0 million mortgage loan at one-month LIBOR plus 2.25%.
- (c) The \$29.0 million outstanding principal balance is swapped to a 5.21% fixed rate through maturity.
- (d) The interest rate presented is based on the one or three month LIBOR rate, as applicable, at September 30, 2014.

The weighted average interest rate on our mortgages, notes and loans payable was 4.73% and 5.25% as of September 30, 2014 and December 31, 2013, respectively.

As of September 30, 2014, we had \$1.9 billion of mortgages, notes and loans payable. All of the mortgage debt is secured by the individual properties as listed in the table above and is non-recourse to HHC, except for:

- (i) \$750.0 million of Senior Notes;
- (ii) \$311.8 million financing for the Downtown Summerlin development which has a maximum recourse to us of 35.0% assuming the loan is fully drawn;
- (iii) \$64.4 million of construction financing for the Outlet Collection at Riverwalk with an initial maximum recourse of 50%, which will be reduced to 25.0% upon completion of the project and the achievement of an 11.0% debt yield and a minimum level of tenant sales per square foot for twelve months,
- (iv) \$20.4 million of Other Corporate Financing Arrangements; and
- (v) \$7.0 million parent guarantee associated with the 110 N. Wacker mortgage.

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The Woodlands Master Credit Facility and The Woodlands Resort & Conference Center loans are recourse to the entities that directly own The Woodlands operations. Certain of our loans contain provisions which grant the lender a security interest in the operating cash flow of the property that represents the collateral for the loan. Such provisions are not expected to impact our operations in 2014. Certain mortgage notes may be prepaid, but may be subject to a prepayment penalty equal to a yield-maintenance premium, defeasance, or a percentage of the loan balance. As of September 30, 2014, land, buildings and equipment and developments in progress with a cost basis of \$2.5 billion have been pledged as collateral for our mortgages, notes and loans payable.

As of September 30, 2014, we were in compliance with all of the financial covenants related to our debt agreements.

Master Planned Communities

On August 8, 2013, The Woodlands refinanced its existing Master Credit Facility with a \$250.0 million credit facility consisting of a \$125.0 million term loan and a \$125.0 million revolver (together, the TWL Facility). The TWL Facility bears interest at one-month LIBOR plus 2.75% and has an initial three-year term through August 2016 with two, one-year extension options. The extension options require a reduction of the total commitment to \$220.0 million for the first extension and \$185.0 million for the second extension. The TWL Facility also contains certain covenants that, among other things, require the maintenance of specified financial ratios, limit the incurrence of additional recourse indebtedness at The Woodlands, and limit distributions from The Woodlands to us based on a loan-to-value test. There was \$73.3 million of undrawn capacity and \$47.1 million of available borrowing capacity under the TWL Facility based on the collateral underlying the facility and loan covenants as of September 30, 2014.

During the second quarter of 2012, we refinanced \$18.1 million of existing debt related to our Bridgeland Master Planned Community with a ten-year term loan facility at a fixed interest rate of 5.50% for the first five years and three-month LIBOR plus 2.75% for the remaining term and maturing on June 29, 2022. Beginning on June 29, 2014, annual principal payments are required in the amount of 5.00% of the then outstanding principal balance. In addition, we simultaneously entered into a three-year revolving credit facility with aggregate borrowing capacity of \$140.0 million of which \$83.9 million has been utilized as of September 30, 2014 and which has a \$30.0 million maximum outstanding loan balance at any time. The revolving loan bears interest at the greater of 5.00% or one-month LIBOR plus 3.25% and matures on June 29, 2015. This loan is intended to provide working capital at Bridgeland to accelerate development efforts to meet the demand of homebuilders for finished lots in the community. The Bridgeland loans are cross-collateralized and cross-defaulted and the Bridgeland Master Planned Community serves as collateral for the loans. The loans also require that Bridgeland maintain a minimum \$3.0 million cash balance and a minimum net worth of \$250.0 million. Additionally, we are restricted from making cash distributions from Bridgeland unless the revolving credit facility has no outstanding balance and one year of real estate taxes and debt service on the term loan have been escrowed with the lender.

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The Summerlin Master Planned Community uses Special Improvement District (SID) bonds to finance certain common infrastructure improvements. These bonds are issued by the municipalities and, although unrated, are secured by the assessments on the land. The majority of proceeds from each bond issued is held in a construction escrow and disbursed to us as infrastructure projects are completed, inspected by the municipalities and approved for reimbursement. Accordingly, the SID bonds have been classified as debt, and the Summerlin Master Planned Community pays the debt service on the bonds semi-annually. As Summerlin sells land, the buyers assume a proportionate share of the bond obligation at closing, and the residential sales contracts provide for the reimbursement of the principal amounts that we previously paid with respect to such proportionate share of the bond.

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Operating Assets

On July 18, 2014, we assumed a \$4.6 million non-recourse mortgage loan at 1701 Lake Robbins. The loan bears fixed interest at 5.81% and has a maturity date of April 2017.

On April 15, 2014, we paid \$17.0 million cash in full satisfaction of the \$16.0 million participating loan that we assumed as part of the acquisition of 70 Columbia Corporate Center (70 CCC) in August 2012. The non-recourse, interest only promissory note was due to mature on August 31, 2017 and included a participation right to the lender for 30.0% of the appreciation in the market value of the property after our 10.0% cumulative preferred return and repayment of the outstanding debt and our contributed equity. The final payment included approximately \$0.7 million for this participation right based upon the appraised value of the property. On June 27, 2014, we closed on a new \$20.0 million loan for 70 CCC that bears interest at one-month LIBOR plus 2.25% and has an initial maturity date of July 2017 with two, one-year extension options.

On October 24, 2013, we closed on a \$64.4 million partial recourse construction loan for the Outlet Collection at Riverwalk. The loan bears interest at one-month LIBOR plus 2.75%, with an initial maturity date of October 24, 2016 with two, one-year extension options. The initial recourse amount of 50.0% will be reduced to 25.0% upon completion of the project and the achievement of an 11.0% debt yield and a minimum level of tenant sales per square foot for 12 months.

On September 11, 2013, we closed on a non-recourse financing totaling \$41.2 million for the construction of Two Hughes Landing, the second Class A office building in the 66-acre mixed-use development of Hughes Landing on Lake Woodlands, located in The Woodlands. Two Hughes Landing will be a 197,000 square foot, eight-story office building with an adjacent parking garage containing approximately 630 spaces. The loan matures on September 11, 2016 and has two, one-year extension options. The loan bears interest at one-month LIBOR plus 2.65% due monthly.

On August 2, 2013, we refinanced the \$43.3 million construction loan with a non-recourse first mortgage financing totaling \$52.0 million on 3 Waterway Square, an 11-story, 232,000 square foot office building in The Woodlands. The loan bears interest at 3.94% and matures on August 11, 2028.

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

On February 8, 2013, we closed on a \$95.0 million non-recourse construction loan which repaid the existing \$36.1 million mortgage and provides funding for the redevelopment of The Woodlands Resort & Conference Center. The loan bears interest at one-month LIBOR plus 3.50% and has an initial maturity of February 8, 2016, with three, one-year extension options. The loan is currently secured by a 624-room (440 original rooms plus 184 newly built rooms), 40-acre conference center and resort located within The Woodlands and requires the maintenance of specified financial ratios after completion of construction. Beginning in the first quarter of 2015, the room count will reduce to 406 after 218 original cottage rooms that were built in 1974 are demolished.

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

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

On April 26, 2012, we closed on a \$14.5 million non-recourse financing secured by 20/25 Waterway Avenue, located within The Woodlands. The loan bears interest at 4.79% and matures on May 1, 2022.

On December 5, 2011, we obtained a \$41.0 million loan for 4 Waterway Square and a \$14.0 million loan for 9303 New Trails, both located within The Woodlands. These non-recourse mortgages mature on December 11, 2023 and

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have fixed interest rates of 4.88%.

On September 30, 2011, we closed on a \$250.0 million non-recourse first mortgage financing secured by Ward Village in Honolulu, Hawaii, that bears interest at one-month LIBOR plus 2.50%. The loan may be drawn to a maximum \$250.0 million to fund capital expenditures at the property, provided that the outstanding principal balance cannot exceed 65% of the property's appraised value, and the borrowers are required to have a minimum 10.0% debt yield to draw additional loan proceeds under the facility. The loan permits partial repayment during its term in connection with property releases for development. In the third quarter of 2013, certain properties securing the loan were approved for condominium development. As a result, the properties were removed from the collateral pool and a minor principal paydown of the loan was required. The loan matures on September 29, 2016, and \$143.0 million of the principal balance was swapped to a 3.80% fixed rate for the term of the loan. The unused portion of this mortgage was \$11.3 million as of September 30, 2014.

On May 10, 2011, we closed a \$29.0 million first mortgage financing secured by our office building located at 110 N. Wacker Drive in Chicago, IL. The loan term is coterminous with the expiration of the first term of the existing tenant's lease. The loan has an interest-only period through April 2015 and, thereafter, amortizes ratably to \$12.0 million through maturity on October 31, 2019. We provided a \$7.0 million repayment guarantee for the loan, which is reduced on a dollar for dollar basis during the amortization period.

Strategic Developments

On November 6, 2014 we closed on a \$600.0 million non-recourse construction loan for the Waiea and Anaha Condominium towers bearing interest at one-month LIBOR plus 6.75%. The loan has an initial maturity date of November 6, 2017, with two, one-year extension options.

On October 3, 2014, we closed on a \$37.1 million construction financing for our Hughes Landing Hotel. The loan bearing interest at one-month LIBOR plus 2.50%. The loan has an initial maturity of October 2018, with two, one-year extension options.

On August 6, 2014, we closed on a \$69.3 million non-recourse construction financing for the Waterway Hotel bearing interest at one-month LIBOR plus 2.65%. The loan has an initial maturity of August 2018, with a one-year extension option. The development will be a 302-room Westin-branded hotel that will be owned and managed by us.

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On July 15, 2014, we closed a \$311.8 million financing for the construction of Downtown Summerlin development bearing interest at one-month LIBOR plus 2.25%. The loan has an initial maturity date of July 15, 2017, with two, one-year extension options. The loan contains a maximum recourse to the Company of 35.0% of the outstanding principal plus all unpaid interest. Upon completion of the project and achievement of a 1.25x debt service coverage ratio, 90.0% occupancy and a minimum level of tenant sales per square foot for 12 months, the recourse amount will decrease to 10.0% of the outstanding principal. Due to the recent opening and its 50.7% occupancy as of November 1, 2014, we have not met this criteria.

On June 30, 2014, we closed on a \$143.0 million non-recourse construction financing for two office buildings bearing interest at one-month LIBOR plus 1.90%. The loan has an initial maturity date of June 30, 2018, with a one-year extension option. The office buildings are substantially pre-leased to ExxonMobil.

On December 20, 2013, we closed on a \$36.6 million non-recourse loan for the construction of Hughes Landing Retail, a 123,000 square foot retail component of Hughes Landing bearing interest at one-month LIBOR plus 1.95%. The loan has an initial maturity date of December 20, 2016, with two, one-year extension options.

On November 25, 2013, we closed on a \$73.5 million non-recourse loan for the construction of an eight-story, Class A, multi-family project within Hughes Landing called One Lake s Edge. One Lake s Edge will be comprised of 390

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multi-family units (averaging 984 square feet per unit), 22,289 square feet of retail and an approximately 750 space parking garage, all situated on 2.92 acres of land. The loan bears interest at one-month LIBOR plus 2.50% with an initial maturity date of November 25, 2016, with two, one-year extension options.

On September 11, 2013, we closed on a non-recourse financing totaling \$41.2 million for the construction of Two Hughes Landing, the second Class A office building in the 66-acre mixed-use development of Hughes Landing on Lake Woodlands, located in The Woodlands. Two Hughes Landing will be a 197,000 square foot, eight-story office building with an adjacent parking garage containing approximately 630 spaces. The loan matures on September 11, 2016 and has two, one-year extension options. The loan bears interest at one-month LIBOR plus 2.65% due monthly.

Corporate

On October 2, 2013, we issued \$750.0 million in aggregate principal amount of 6.875% Senior Notes due 2021 (the Senior Notes) and raised approximately \$741.3 million of net cash proceeds. Interest is payable semiannually, on April 1 and October 1 of each year starting in April 2014. At any time prior to October 1, 2016, we may redeem up to 35% of the Senior Notes at a price equal to 106.875% using the proceeds from equity offerings. We may redeem all or part of the Senior Notes at any time on or after October 1, 2016 with a declining call premium thereafter to maturity. The Senior Notes contain customary terms and covenants for non-investment grade senior notes and have no maintenance covenants.

NOTE 10 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income (AOCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the nine months ended September 30, 2014, the ineffective portion recorded in earnings was insignificant.

As of September 30, 2014, we had gross notional amounts of \$172.0 million for interest rate swaps and a \$100.0 million interest rate cap that were designated as cash flow hedges of interest rate risk. The fair value of the interest rate cap derivative was insignificant.

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

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

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

	September 30, 2014	December 31, 2013
	(In thousands)	
Interest Rate Swaps	\$ 3,195	\$ 4,164
Total derivatives designated as hedging instruments	\$ 3,195	\$ 4,164

The table below presents the effect of our derivative financial instruments on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2014 and 2013:

Cash Flow Hedges	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013		Location of Gain (Loss) Reclassified from AOCI into Earnings	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013	
	Amount of Gain Recognized in OCI (In thousands)	Amount of Loss Recognized in OCI (In thousands)	Amount of Loss Reclassified from AOCI into Earnings (In thousands)	Amount of Gain Reclassified from AOCI into Earnings (In thousands)					
Interest Rate Swaps	\$ 229	\$ (407)	\$ (555)	\$ 6	Interest Expense	\$ (555)	\$ 6		
	\$ 229	\$ (407)	\$ (555)	\$ 6		\$ (555)	\$ 6		

Cash Flow Hedges	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		Location of Loss Reclassified from AOCI into Earnings	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Amount of Loss Recognized in OCI (In thousands)	Amount of Gain Recognized in OCI (In thousands)	Amount of Loss Reclassified from AOCI into Earnings (In thousands)	Amount of Loss Reclassified from AOCI into Earnings (In thousands)					
Interest Rate Swaps	\$ (742)	\$ 1,079	\$ (1,644)	\$ (1,041)	Interest Expense	\$ (1,644)	\$ (1,041)		
	\$ (742)	\$ 1,079	\$ (1,644)	\$ (1,041)		\$ (1,644)	\$ (1,041)		

NOTE 11 INCOME TAXES

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Several of our subsidiaries are involved in a dispute with the IRS relating to years in which those subsidiaries were owned by General Growth Properties (GGP), and in connection therewith, GGP has provided us with an indemnity against certain potential tax liabilities. Pursuant to the Tax Matters Agreement, GGP has indemnified us from and against 93.75% of any and all losses, claims, damages, liabilities and reasonable expenses to which we become subject (the Tax Indemnity), in each case solely to the extent directly attributable to certain taxes related to sales of certain assets in our Master Planned Communities segment prior to March 31, 2010 (MPC Taxes), in an amount up to \$303.8 million, plus interest and penalties related to these amounts (the Indemnity Cap) so long as GGP controls the action in the United States Tax Court (the Tax Court) related to the dispute with the IRS as described below. We recorded the Tax Indemnity receivable at the Indemnity Cap amount as of the spinoff date. The unrecognized tax benefits and related accrued interest recorded through September 30, 2014 are primarily related to the taxes that are the subject of the Tax Indemnity. We have recorded interest income receivable on the Tax Indemnity receivable in the amounts of \$57.5 million and \$38.6 million as of September 30, 2014 and December 31, 2013, respectively.

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On May 6, 2011, GGP filed Tax Court petitions on behalf of the two former taxable REIT subsidiaries of GGP seeking a redetermination of federal income tax for the years 2007 and 2008. The petitions seek to overturn determinations by the IRS that the taxpayers were liable for combined deficiencies totaling \$144.1 million. On October 20, 2011, GGP filed a motion in the Tax Court to consolidate the cases of the two former taxable REIT subsidiaries of GGP subject to litigation with the Internal Revenue Service due to the common nature of the cases facts and circumstances and the issues being litigated. The Tax Court granted the motion to consolidate. The case was heard by the Tax Court in November 2012. The Tax Court filed their ruling in favor of the IRS on June 2, 2014. The Tax Court ruling may be appealed to the Fifth Circuit Court of Appeals. A decision whether to appeal has not yet been made. The time period to appeal will expire during the fourth quarter of 2014.

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

Unrecognized tax benefits recorded pursuant to uncertain tax positions were \$174.4 million and \$90.5 million as of September 30, 2014 and December 31, 2013, respectively, excluding interest, of which this entire amount would not impact our effective tax rate. Accrued interest related to these unrecognized tax benefits amounted to \$57.5 million and \$38.7 million as of September 30, 2014 and December 31, 2013, respectively. We recognized a decrease in interest expense related to the unrecognized tax benefits of \$1.4 million for the three months ended September 30, 2014. The decrease to interest expense recorded this quarter is mainly attributable to the statute of limitations expiring on an uncertain tax position. The increase in unrecognized tax benefits recorded this quarter is due to a change in method of accounting whereby the timing and recognition of certain Master Planned Community gains was modified.

During the nine months ended September 30, 2014, the tax indemnity receivable increased by \$13.4 million. This increase was due to the increase in the related interest income of \$18.9 million and a loss on remeasurement of \$5.5 million.

We have significant permanent differences, primarily from warrant liability gains and losses, interest income on the tax indemnity receivable, and changes in valuation allowances that cause our effective tax rates to deviate greatly from statutory rates. The effective tax rates based upon actual operating results were 1.3% and (896.5)% for the three and nine months ended September 30, 2014, respectively, compared to 41.4% and (29.5)% for the three and nine months ended September 30, 2013, respectively. The changes in the tax rates were primarily attributable to the changes in the warrant liability, the valuation allowance, unrecognized tax benefits and other permanent items.

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We file a consolidated corporate tax return which includes all of our subsidiaries with the exception of Victoria Ward, Limited (Ward), substantially all of which is owned by us. Ward elected to be taxed as a REIT, commencing with the taxable year beginning January 1, 2002. Ward has satisfied the REIT distribution requirements for 2013. In connection with the planned condominium development of Ward that was approved by the Hawaii Real Estate Commission during the fourth quarter of 2013, the Company now intends to revoke the REIT election during 2015, before future phases of condominium development commence. As a result of our intention to revoke REIT status, we recorded deferred tax liabilities in the fourth quarter 2013 of \$48.0 million for book and tax basis differences that we no longer expect to reverse while Ward is a REIT.

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Our stock based plans are described, and informational disclosures are provided, in the Notes to the Consolidated Financial Statements included in our Form 10-K for the year ended December 31, 2013.

Stock Options

The following table summarizes our stock option plan:

	Stock Options		Weighted Average Exercise Price
Stock Options outstanding at January 1, 2014	965,440	\$	64.57
Granted	105,000		146.00
Forfeited	(32,700)		85.27
Stock Options outstanding at September 30, 2014	1,037,740	\$	72.16

In February 2014, certain employees were granted stock options, half of which cliff vest on December 31, 2018. The remaining options also cliff vest on December 31, 2018, however, the amount of options are diminished if certain prescribed shareholder return hurdles are not met. Option grantees must be employed by the Company on the vesting date to be eligible to receive the award.

Restricted Stock

Restricted stock awards issued under The Howard Hughes Corporation 2010 Incentive Plan provide that shares awarded may not be sold or otherwise transferred until restrictions have lapsed as established by the Compensation Committee of our Board of Directors. For the three and nine months ended September 30, 2014, compensation expense of \$1.1 million and \$2.9 million, respectively, is included in general and administrative expense on our Condensed Consolidated Statements of Operations related to restricted stock awards. The balance of unamortized

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restricted stock awards as of September 30, 2014 was \$11.4 million, which is expected to be expensed over a weighted-average period of 3.5 years.

The following table summarizes restricted stock activity:

	Restricted Stock	Weighted Average Grant Date Fair Value
Restricted stock outstanding at January 1, 2014	122,332	\$ 75.21
Granted	61,750	126.38
Vested	(11,394)	97.72
Restricted Stock outstanding at September 30, 2014	172,688	\$ 92.02

In addition to the granting of restricted stock to certain members of management, we award restricted stock to our non-employee directors as part of their annual retainer. The restriction on the non-employee director shares lapse in May of each year. In February 2014, certain employees were granted restricted stock, half of which cliff vest on December 31, 2018. The remaining restricted stock awards also cliff vest on December 31, 2018, however, the amount of restricted stock awards are diminished if certain prescribed shareholder return hurdles are not met. Generally, upon termination of employment, the restricted shares that have not vested are forfeited.

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

	September 30, 2014	December 31, 2013
	(In thousands)	
Special Improvement District receivable	\$ 39,777	\$ 39,688
Equipment, net of accumulated depreciation of \$2.0 million and \$0.7 million, respectively	20,662	21,978
Tenant incentives and other receivables	6,361	6,757
Federal income tax receivable	5,809	6,053
Prepaid expenses	9,461	4,744
Below-market ground leases	19,748	20,002
Condominium deposits	137,407	12,405
Security and escrow deposits	38,577	28,082
Above-market tenant leases	941	1,095
Uncertain tax position asset	20,131	13,528
In-place leases	8,037	9,306
Intangibles	3,624	3,714
Other	3,731	6,588
	\$ 314,266	\$ 173,940

The \$140.3 million increase as of September 30, 2014 compared to December 31, 2013 primarily relates to the increase of \$125.0 million in restricted condominium cash deposits for the two new market rate towers at Ward Village for which we began public sales on February 1, 2014, a \$10.5 million increase in security and escrow deposits primarily related to the South Street Seaport project and the \$6.6 million increase in our uncertain tax position asset as more fully discussed in Note 11 *Income Taxes*.

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

	September 30, 2014	December 31, 2013
	(In thousands)	
Construction payables	\$ 194,197	\$ 106,741
Accounts payable and accrued expenses	34,687	46,998
Condominium deposits	137,407	12,405
Membership deposits	20,908	24,830
Above-market ground leases	2,312	2,431
Deferred income	33,044	18,963
Accrued interest	28,793	17,463
Accrued real estate taxes	9,860	8,581
Tenant and other deposits	16,768	9,490
Insurance reserve		1,417
Accrued payroll and other employee liabilities	16,151	15,666
Special assessment	2,603	2,603
Interest rate swaps	3,195	4,164
Other	16,536	12,239
	\$ 516,461	\$ 283,991

The \$232.5 million increase as of September 30, 2014 compared to December 31, 2013 is primarily due to the increase of \$125.0 million in condominium deposits for the two new market rate towers at Ward Village, a \$87.5 million increase in construction payables primarily due to increased development activities at Downtown Summerlin, The Woodlands Resort & Conference Center, Outlet Collection at Riverwalk, and Hughes Landing, a \$14.1 million increase in deferred income primarily due to increased land sales and the deferral of a portion of the income for post-sale land development obligations at our Summerlin MPC and an \$11.3 million increase in accrued interest relating to our Senior Notes.

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The following table summarizes AOCI for the period indicated:

Changes in Accumulated Other Comprehensive Income (Loss) by Component (a)**Gains and Losses on Cash Flow Hedges**

(In thousands)

		For the Three Months Ended September 30, 2014
Balance as of July 1, 2014	\$	(8,281)
Other comprehensive income before reclassifications		49
Amounts reclassified from accumulated other comprehensive loss		555
Net current-period other comprehensive income		604
Balance as of September 30, 2014	\$	(7,677)
		For the Nine Months Ended September 30, 2014
Balance as of January 1, 2014	\$	(8,222)
Other comprehensive income before reclassifications		(1,099)
Amounts reclassified from accumulated other comprehensive loss		1,644
Net current-period other comprehensive income		545
Balance as of September 30, 2014	\$	(7,677)

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

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The following table summarizes the amounts reclassified out of AOCI for the period indicated:

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

(In thousands)

Accumulated Other Comprehensive Income (Loss) Components	Amounts reclassified from Accumulated Other Comprehensive Income (Loss)		Affected line item in the Statement of Operations
	For the Three Months Ended September 30, 2014	For the Nine Months Ended September 30, 2014	
Gains and losses on cash flow hedges			
Interest rate swap contracts	\$ (631)	\$ (1,867)	Interest expense
	76	223	Provision for income taxes
Total reclassifications for the period	\$ (555)	\$ (1,644)	Net of tax

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

NOTE 15 COMMITMENTS AND CONTINGENCIES

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

We had outstanding letters of credit and surety bonds of \$61.2 million and \$58.7 million as of September 30, 2014 and December 31, 2013, respectively. These letters of credit and bonds were issued primarily in connection with insurance requirements, special real estate assessments and construction obligations.

On June 27, 2013, the City of New York executed the amended and restated ground lease for South Street Seaport. The restated lease terms provide for annual fixed rent of \$1.2 million starting July 1, 2013 with an expiration of December 30, 2072, including our option to extend. The annual rent escalates 3.0% compounded annually. In addition to the annual base rent of \$1.2 million, we are required to make annual payments of \$210,000 as additional rent through the term of the lease. The additional rent escalates annually based on the Consumer Price Index. We are

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entitled to a total rent credit of \$1.5 million, to be taken monthly over a 30-month period. Simultaneously with the execution of the lease, we executed a completion guaranty for the redevelopment of Pier 17. The completion guaranty requires us to perform certain obligations under the lease, including the commencement of construction by October 1, 2013 with a scheduled completion date in 2016.

In the fourth quarter of 2012, the Uplands portion of South Street Seaport suffered damage due to flooding as a result of Superstorm Sandy. Reconstruction efforts are ongoing and the property is only partially operating. We have received \$47.6 million in insurance proceeds through September 30, 2014 at South Street Seaport related to our claim. We have recognized a total of \$36.8 million in Other income to date, including \$11.5 million and \$24.6 million during the three and nine months ended September 30, 2014, respectively. We believe that our insurance will reimburse substantially all of the costs of repairing the property and will also compensate us for substantially all lost income resulting from the storm.

Please refer to Note 11 *Income Taxes* for additional contingencies related to our uncertain tax positions.

NOTE 16 SEGMENTS

We have three business segments which offer different products and services. Our three segments are managed separately because each requires different operating strategies or management expertise and are reflective of management's operating philosophies and methods. In addition, our segments or assets within such segments could change in the future as development of certain properties commences or other operational or management changes occur. We do not distinguish or group our combined operations on a geographic basis. Furthermore, all operations are within the United States. Our reportable segments are as follows:

- **Master Planned Communities (MPCs)** includes the development and sale of land in large-scale, long-term community development projects in and around Las Vegas, Nevada; Houston, Texas; and Columbia, Maryland. For the nine months ended September 30, 2014 one commercial land sales buyer represented 15.1% of total revenues.
- **Operating Assets** includes retail, office and industrial properties, a multi-family property, The Woodlands Resort & Conference Center and other real estate investments. These assets are currently generating revenues, and we believe there is an opportunity to redevelop or reposition many of these assets to improve operating performance.

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

Revenue recognition for individual units in a condominium project are accounted for under the percentage of completion method based on the ratio of total project costs incurred to total estimated costs when the following criteria are met: a) construction is beyond a preliminary stage; b) buyer is unable to require a refund of its deposit, except for non-delivery of the unit; c) sufficient units are sold to assure that it will not revert to a rental property; d) sales prices are collectible; and e) aggregate sales proceeds and costs can be reasonably estimated. Estimated revenue and costs are reviewed periodically, and any changes are applied prospectively.

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The assets included in each segment as of September 30, 2014, are contained in the following chart:

Master Planned Communities	Operating Assets		Strategic Developments	
	Retail	Office / Other	Under Construction	
<ul style="list-style-type: none"> • Bridgeland • Maryland Communities • Summerlin • The Woodlands - Hendricks parcel 	<ul style="list-style-type: none"> • Cottonwood Square • Landmark Mall • Outlet Collection at Riverwalk • Park West • South Street Seaport (under construction) • Ward Village • 20/25 Waterway Avenue • Waterway Garage Retail 	<ul style="list-style-type: none"> • Arizona 2 Lease * • 70 Columbia Corporate Center • Columbia Office Properties **** • Golf Courses at Summerlin and TPC Las Vegas (participation interest) • One Hughes Landing • Two Hughes Landing ***** • 1701 Lake Robbins • 2201 Lake Woodlands Drive • Millennium Waterway Apartments • Millennium Woodlands Phase II, LLC ** / ***** • 9303 New Trails Office • 110 N Wacker • Stewart Title of Montgomery County, TX ** • Summerlin Hospital Medical Center ** • Summerlin Las Vegas Baseball Club ** • The Club at Carlton Woods • The Woodlands Resort & Conference Center (under construction) • Waterway Square Garage • 3 Waterway Square Office • 4 Waterway Square Office • Woodlands Sarofim #1 ** • 1400 Woodloch Forest 	<ul style="list-style-type: none"> • Anaha Condominium Project • Creekside Village Green • Downtown Summerlin (opened October 9, 2014) • ExxonMobil • Hughes Landing Hotel (Embassy Suites) • Hughes Landing Retail • Three Hughes Landing • ONE Ala Moana *** • One Lake's Edge • The Metropolitan Downtown Columbia Project ** • 3831 Technology Forest Drive • Waiea Condominium Project • Waterway Square Hotel (Westin) 	<ul style="list-style-type: none"> • Alameda Plaza • AllenTowne • Bridges at Mint Hill • Century Plaza Mall • Circle T Ranch and Power Center ** • Cottonwood Mall • Elk Grove Promenade • 80% Interest in Fashion Show Air Rights • Hawaii Whole Foods Market Project • Kendall Town Center • Kewalo Basin Harbor • Lakeland Village Center • Lakemoor (Volo) Land • Maui Ranch Land • Parcel C ** • Summerlin Apartments, LLC ** • West Windsor • Workforce Housing Project

* Note receivable

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- ** An equity or cost method investment
- *** Asset consists of two equity method investments
- **** Includes Columbia Regional Building which was opened in August 2014
- ***** Asset was moved from Strategic Developments to Operating Assets during the quarter

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

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

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Segment operating results are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
Master Planned Communities				
Land sales	\$ 59,351	\$ 53,734	\$ 260,186	\$ 166,981
Builder price participation	5,311	2,002	13,251	5,703
Minimum rents	210	196	614	585
Other land revenues	4,103	3,579	9,296	10,211
Other rental and property revenues	198		373	
Total revenues	69,173	59,511	283,720	183,480
Cost of sales - land	27,743	27,063	93,540	82,616
Land sales operations	8,068	7,393	24,629	22,705
Land sales real estate and business taxes	2,927	2,370	7,016	5,348
Depreciation and amortization	101	10	304	25
Interest income	(17)		(96)	(16)
Interest expense (*)	(3,332)	(3,689)	(13,210)	(13,295)
Total expenses	35,490	33,147	112,183	97,383
MPC EBT	33,683	26,364	171,537	86,097
Operating Assets				
Minimum rents	24,035	21,160	65,853	59,427
Tenant recoveries	7,581	5,254	20,406	15,547
Resort and conference center revenues	8,150	8,169	27,198	30,543
Other rental and property revenues	6,076	4,493	17,756	14,538
Total revenues	45,842	39,076	131,213	120,055
Other property operating costs	14,116	17,640	42,782	48,436
Rental property real estate taxes	3,716	3,148	10,585	9,054
Rental property maintenance costs	2,154	1,906	5,962	5,594
Resort and conference center operations	8,910	7,381	22,833	22,537
Provision for doubtful accounts	103	201	277	907
Demolition costs	761	1,386	6,689	1,386
Development-related marketing costs	589	1,050	5,379	1,771
Depreciation and amortization	11,261	9,171	29,802	21,687
Interest income	(11)	(32)	(141)	(122)
Interest expense	4,917	4,017	10,889	14,715
Equity in Earnings from Real Estate and Other Affiliates	(202)	(647)	(2,774)	(3,743)

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Total expenses	46,314	45,221	132,283	122,222
Operating Assets EBT	(472)	(6,145)	(1,070)	(2,167)
Strategic Developments				
Minimum rents	137	182	473	586
Tenant recoveries	18	38	92	135
Condominium rights and unit sales	4,032	810	11,516	31,191
Other land revenues	9		26	
Other rental and property revenues	17	(2)	472	18
Total revenues	4,213	1,028	12,579	31,930
Condominium rights and unit cost of sales	2,026	406	5,788	15,678
Other property operating costs	1,083	2,691	2,821	3,692
Real estate taxes	843	549	1,955	1,759
Rental property maintenance costs	159	142	440	402
Provision for doubtful accounts	16	3	16	3
Demolition costs	(1)		22	
Development-related marketing costs	5,798		10,530	
Depreciation and amortization	445	48	1,483	139
Other income		(2,652)	(2,373)	(3,609)
Interest expense (*)	(3,198)	(401)	(9,828)	(1,363)
Equity in Earnings from Real Estate and Other Affiliates	(5,307)	(2,947)	(15,390)	(8,291)
Total expenses	1,864	(2,161)	(4,536)	8,410
Strategic Developments EBT	2,349	3,189	17,115	23,520
REP EBT	\$ 35,560	\$ 23,408	\$ 187,582	\$ 107,450

(*) Negative interest expense amounts are due to interest capitalized in our Master Planned Communities and Strategic Developments segments related to Operating Assets segment debt and the Senior Notes.

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

Reconciliation of REP EBT to GAAP-net income (loss)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
REP EBT	\$ 35,560	\$ 23,408	\$ 187,582	\$ 107,450
General and administrative	(14,759)	(11,914)	(49,138)	(34,310)
Interest (expense)/income, net *	(14,938)	1,955	(21,089)	6,259
Warrant liability gain (loss)	24,690	(4,479)	(139,120)	(148,706)
Provision for income taxes	(590)	(5,172)	(49,895)	(21,012)
Increase (reduction) in tax indemnity receivable	5,454	730	(5,473)	(8,673)
Other income, net *	11,409	3,662	25,095	8,118
Depreciation and amortization *	(1,211)	(757)	(3,411)	(1,359)
Net income (loss)	\$ 45,615	\$ 7,433	\$ (55,449)	\$ (92,233)

* Represents amounts not allocated to segments.

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

Reconciliation of Segment Basis Revenues to GAAP Revenues	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
Master Planned Communities	\$ 69,173	\$ 59,511	\$ 283,720	\$ 183,480
Operating Assets	45,842	39,076	131,213	120,055
Strategic Developments	4,213	1,028	12,579	31,930
Total revenues	\$ 119,228	\$ 99,615	\$ 427,512	\$ 335,465

The assets by segment and the reconciliation of total segment assets to the total assets in the Condensed Consolidated Balance Sheets are summarized as follows:

September 30,
2014

December 31,

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	2013	
	(In thousands)	
Master Planned Communities	\$ 1,855,671	\$ 1,760,639
Operating Assets (a)	1,351,090	1,158,337
Strategic Developments	1,068,491	462,525
Total segment assets	4,275,252	3,381,501
Corporate and other (b)	1,035,917	1,186,367
Total assets	\$ 5,311,169	\$ 4,567,868

(a) Certain assets included in our Operating Assets segment are in various stages of redevelopment and are included in Developments on our Condensed Consolidated Balance Sheets.

(b) Assets included in Corporate and other consist primarily of Cash and cash equivalents and the Tax Indemnity receivable, including accrued interest.

A portion of the tax indemnification asset in the amount of \$185.7 million was incorrectly included in the Operating Assets segment at December 31, 2013 rather than the Corporate segment. The amounts in the table above at December 31, 2013 have been corrected to appropriately include the entire tax indemnification asset of \$320.5 million in the Corporate segment.

The increase in the Strategic Developments segment's asset balance as of September 30, 2014 of \$605.9 million compared to December 31, 2013 is primarily due to development costs of \$190.5 million for Downtown Summerlin,

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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\$125.0 million of deposits collected on the sale of condominium units for both our market rate towers at Ward Village, \$60.4 million for the ExxonMobil office buildings, \$41.3 million for Hughes Landing multi-family, \$35.8 million for various other development projects at The Woodlands, \$41.2 million for Ward Village, \$21.4 million increase in the carrying value of our investment in the ONE Ala Moana project, \$21.6 million in buildings and equipment from the completion of the transformation of the IBM building at Ward Village into an information center and sales gallery, \$17.1 million for Hughes Landing retail, and \$16.1 million in purchase deposits for a land parcel near the South Street Seaport.

The decrease in the Corporate segment's asset balance as of September 30, 2014 of \$150.5 million compared to December 31, 2013 is primarily due to cash used to fund development activities.

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THE HOWARD HUGHES CORPORATION

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

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

Forward-looking information

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

Forward-looking statements include:

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

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

- capital required for our operations and development opportunities for the properties in our Operating Assets and Strategic Developments segments;
- expected performances of our Master Planned Communities segment and other current income producing properties; and
- future liquidity, development opportunities, development spending and management plans.

Forward-looking statements discuss matters that are not historical facts. Because they discuss future events or conditions, forward-looking statements often include words such as anticipate, believe, can, could, estimate, expect, forecast, intend, may, likely, plan,

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should, target, would, and other words of similar expressions. Forward-looking statements should not be unduly relied upon. They give our expectations about the future and are not guarantees.

There are several factors, many beyond our control, which could cause results to differ materially from our expectations. These risk factors are described in our Annual Report on Form 10-K for the year ended December 31, 2013 (the Annual Report) and are incorporated herein by reference. Any factor could, by itself, or together with one or more other factors, adversely affect our business, results of operations or financial condition. There may also be other factors that we have not described in this Quarterly Report or in our Annual Report that could cause results to differ from our expectations. These forward-looking statements present our estimates and assumptions only as of the date of this Quarterly Report. Except as may be required by law, we undertake no obligation to modify or revise any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report.

Real Estate Property Earnings Before Taxes

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

REP EBT, as it relates to our business, is defined as net income (loss) excluding general and administrative expenses, corporate interest income, corporate interest and depreciation expense, provision for income taxes,

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warrant liability gain (loss), other income and the changes in tax indemnity receivable. We present REP EBT because we use this measure, among others, internally to assess the core operating performance of our assets. We also present this measure because we believe certain investors use it as a measure of a company's historical operating performance and its ability to service existing and obtain additional debt. We believe that the inclusion of certain adjustments to net income (loss) to calculate REP EBT is appropriate to provide additional information to investors. A reconciliation of REP EBT to consolidated net income (loss) as computed in accordance with GAAP has been presented in Note 16 *Segments*.

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

- cash expenditures, or future requirements for capital expenditures or contractual commitments;
- corporate general and administrative expenses;
- interest expense on our corporate debt;
- income taxes that we may be required to pay;
- any cash requirements for replacement of depreciated or amortized assets; and
- limitations on, or costs related to, transferring earnings from our Real Estate Affiliates to us.

Operating Assets Net Operating Income

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

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

Results of Operations

Consolidated revenues for the three months ended September 30, 2014 increased \$19.6 million compared to the same period in 2013, primarily due to \$9.7 million of higher revenues in our MPC segment as a result of increased land sales and builder price participation, \$6.8 million of higher revenues in our Operating Assets segment as a result of increased minimum rents and tenant recoveries and \$3.2 million of higher revenues in our Strategic Developments segment related primarily to our ONE Ala Moana condominium project.

Consolidated revenues for the nine months ended September 30, 2014 increased \$92.0 million compared to the same period in 2013, primarily due to \$100.2 million of higher revenues in our MPC segment as a result of increased MPC land sales and builder price participation and \$11.2 million of higher revenues in our Operating Assets segment as a result of increased minimum rents and tenant recoveries. These increases are partially offset by \$19.4 million of lower revenues in our Strategic Developments segment. The decrease is primarily due to lower revenue recognized on the gain on sale of our condominium rights which is recognized using the percentage of completion method compared to the same period in 2013. The 2013 ONE Ala Moana revenues and cost of sales related primarily to our initial sale of the air rights to the joint venture in which we have a 50% interest and the portion of the deferred sale relating to our ongoing interest in the condominium rights recognized on the percentage of completion basis.

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Net income attributable to common stockholders was \$45.6 million, or \$0.48 per diluted share for the three months ended September 30, 2014 compared to a net income attributable to common stockholders of \$7.3 million, or \$0.17 per diluted share for the three months ended September 30, 2013. The \$38.3 million increase in net income for the three months ended September 30, 2014 compared to the same period in 2013 was primarily due to the change in warrant liability of \$29.2 million, an increase of \$7.7 million in other income from insurance proceeds received as a result of the damage South Street Seaport suffered from Superstorm Sandy and \$2.2 million of other variances.

Net loss attributable to common stockholders was \$(55.5) million, or \$(1.41) loss per diluted share for the nine months ended September 30, 2014 compared to a net loss attributable to common stockholders of \$(92.3) million, or \$(2.34) million loss per diluted share for the nine months ended September 30, 2013. The \$36.9 million decrease in net loss for the nine months ended September 30, 2014 compared to the same period in 2013 was primarily due to higher earnings from our MPC segment of \$85.4 million resulting from increased commercial land sales at The Woodlands, an increase of \$17.0 million in corporate other income, and lower warrant liability loss of \$9.6 million. These increases are partially offset by a higher provision for income taxes of \$28.9 million, higher general and administrative expenses of \$14.8 million, higher corporate interest expense of \$27.3 million resulting from the Senior Notes and \$4.2 million of other variances.

Please refer to the individual segment operations sections and the general and administrative section for explanations of these variances.

Segment Operations

Please refer to Note 16 - *Segments* for additional information including reconciliations of our segment basis results to generally accepted accounting principles (GAAP) basis results.

Master Planned Communities Segment

MPC revenues vary between periods based on economic conditions and several factors such as, but not limited to, location, availability of land for sale, development density and residential or commercial use. Although our business does not involve the sale or resale of homes, we believe that net new home sales are an important indicator of future demand for our superpad sites and finished lots; therefore, we use this statistic in the discussion of our MPCs below. Net new home sales reflect home sales made by home builders, less cancellations. Cancellations occur when a home buyer signs a contract to purchase a home, but later fails to qualify for a home mortgage or is unable to provide an adequate down payment to complete the home sale. Reported results may differ significantly from actual cash flows generated principally because cost of sales for GAAP purposes is derived from margins calculated using carrying values, projected future improvements and other capitalized project costs in relation to projected future land sale revenues. Carrying values, generally, represent acquisition and development costs, less adjustments for previous impairment charges. Development expenditures are capitalized and generally not reflected in the Condensed Consolidated Statements of Operations in the current year.

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MPC sales for the three months ended September 30, 2014 and 2013 is summarized as follows:

(\$ in thousands)	Land Sales		Acres Sold		MPC Sales Summary Number of Lots/Units		Price per Acre		Price per Lot/Units	
	2014	2013	2014	2013	Three Months Ended September 30,		2014	2013	2014	2013
					2014	2013				
Bridgeland										
Residential										
Single family - detached	\$ 8,734	\$ 1,761	18.8	6.0	109	29	\$ 465	\$ 294	\$ 80	\$ 61
Commercial										
Multi-family		2,636		16.6				159		
	8,734	4,397	18.8	22.6						