PREFERRED APARTMENT COMMUNITIES INC
Form 10-Q
May 12, 2014

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

FORM 10-Q

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from to

Commission File No. 001-34995

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

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

3625 Cumberland Boulevard, Suite 1150, Atlanta, GA 30339
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (770) 818-4100

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec. 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

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

The number of shares outstanding of the registrant's Common Stock, as of May 7, 2014 was 16,379,794.

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PART I - FINANCIAL INFORMATION

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

	March 31, 2014	December 31, 2013
Assets		
Real estate		
Land	$32,070,576	$30,320,000
Building and improvements	120,626,673	116,716,766
Furniture, fixtures, and equipment	18,313,449	18,183,822
Construction in progress	101,263	53,663
Gross real estate	171,111,961	165,274,251
Less: accumulated depreciation	(13,304,013)	(11,410,035)
Net real estate	157,807,948	153,864,216
Property held for sale (net of accumulated depreciation of $2,723,386 and $2,723,386)	36,491,529	36,451,523
Real estate loans, net ($14,842,018 and $14,332,658 carried at fair value)	107,181,677	103,433,147
Real estate loans to related parties, net	8,081,532	7,164,768
Total real estate and real estate loans, net	309,562,686	300,913,654
Cash and cash equivalents	9,109,413	9,180,431
Restricted cash	2,442,610	2,064,819
Notes receivable	11,252,035	10,248,178
Note receivable from related party	1,500,000	1,500,000
Revolving line of credit to related party	7,794,718	5,358,227
Accrued interest receivable on real estate loans	4,258,841	3,286,660
Acquired intangible assets, net of amortization of $12,975,953 and $12,569,581	441,932	907,883
Deferred loan costs, net of amortization of $872,261 and $963,043	1,993,777	1,719,194
Deferred offering costs	6,077,441	5,255,636
Tenant receivables and other assets	901,469	1,202,013
Total assets	$355,334,922	$341,636,695
Liabilities and equity		
Liabilities		
Mortgage notes payable	$140,873,000	$140,516,000
Revolving credit facility	32,007,780	29,390,000
Accounts payable and accrued expenses	2,126,167	1,638,401
Accrued interest payable	348,016	443,099
Dividends and partnership distributions payable	2,988,176	2,900,478
Security deposits and other liabilities	847,044	695,998
Total liabilities	179,190,183	175,583,976
Commitments and contingencies (Note 11)		

Equity		
Stockholders' equity		
Series A Redeemable Preferred Stock, $0.01 par value per share; 989,408 shares authorized; 101,581 and 89,408 shares issued; 101,486 and 89,313 shares outstanding at March 31, 2014 and December 31, 2013, respectively	1,015	893
Common Stock, $0.01 par value per share; 400,066,666 shares authorized; 15,390,839 and 15,294,578 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	153,908	152,945
Additional paid in capital	185,511,627	177,824,720
Accumulated deficit	(10,634,358)	(13,391,341)
Total stockholders' equity	175,032,192	164,587,217
Non-controlling interest	1,112,547	1,465,502
Total equity	176,144,739	166,052,719
Total liabilities and equity	$355,334,922	$341,636,695

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

	Three months ended March 31, 2014	2013
Revenues:		
Rental revenues	$4,889,463	$3,689,832
Other property revenues	567,194	333,820
Interest income on loans and notes receivable	4,293,442	1,295,080
Interest income from related party	432,307	16,850
Total revenues	10,182,406	5,335,582
Operating expenses:		
Property operating and maintenance	785,503	528,822
Property salary and benefits reimbursement to related party	532,163	408,529
Property management fees to related party	218,020	160,666
Real estate taxes	541,128	390,255
General and administrative	173,867	108,036
Equity compensation to directors and executives	444,222	308,921
Depreciation and amortization	2,308,526	3,913,508
Acquisition and pursuit costs	188,031	198,611
Acquisition fees to related party	57,268	908,400
Management fees to related party	688,749	383,868
Insurance, professional fees and other expenses	365,321	288,095
Total operating expenses	6,302,798	7,597,711
Operating income (loss)	3,879,608	(2,262,129)
Interest expense	1,401,188	1,019,867
Net income (loss) from continuing operations	2,478,420	(3,281,996)
Income from discontinued operations	317,425	96,167
Net income (loss)	2,795,845	(3,185,829)
Consolidated net (income) loss attributable to non-controlling interests	(38,862)	61,486
Net income (loss) attributable to the Company	2,756,983	(3,124,343)
Dividends declared to preferred stockholders	(1,420,536)	(1,050,515)
Earnings attributable to unvested restricted stock	(4,678)	(4,792)
Net income (loss) attributable to common stockholders	$1,331,769	$(4,179,650)
Net income (loss) per share of Common Stock, basic:		
From continuing operations	$0.07	$(0.81)
From discontinued operations	0.02	0.02
Available to Common Stockholders	$0.09	$(0.79)
Net income (loss) per share of Common Stock, diluted:		
From continuing operations	$0.07	$(0.81)

From discontinued operations	0.02	0.02
Available to Common Stockholders	$ 0.09	$ (0.79)
Dividends per share declared on Common Stock	$ 0.16	$ 0.145
Weighted average number of shares of Common Stock outstanding:		
Basic	15,316,816	5,289,690
Diluted	15,562,608	5,289,690

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

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Preferred Apartment Communities, Inc.
Consolidated Statements of Stockholders' Equity
For the three months ended March 31, 2014 and 2013
(Unaudited)

	Series A Redeemable Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated (Deficit)	Total Stockholders' Equity	Non-Controlling Interest	Total Equity
Balance at January 1, 2013	$198	$52,885	$59,412,744	$(9,408,253)	$50,057,574	$1	$50,057,575
Issuance of Units	217	—	20,840,428	—	20,840,645	—	20,840,645
Syndication and offering costs	—	—	(1,408,665)	—	(1,408,665)	—	(1,408,665)
Equity compensation to executives and directors	—	21	308,900	—	308,921	—	308,921
Vesting of Class B Units and conversion to Class A Units	—	—	(479,841)	—	(479,841)	479,841	—
Net loss	—	—	—	(3,124,343)	(3,124,343)	(61,486)	(3,185,829)
Distributions to non-controlling interests	—	—	—	—	—	(15,513)	(15,513)
Dividends to series A preferred stockholders ($5.00 per share per month)	—	—	(360,039)	—	(360,039)	—	(360,039)
Dividends to series B preferred stockholders ($17.26 per share)	—	—	(690,476)	—	(690,476)	—	(690,476)
Dividends to common stockholders ($0.145 per share)	—	—	(771,923)	—	(771,923)	—	(771,923)
Balance at March 31, 2013	$415	$52,906	$76,851,128	$(12,532,596)	$64,371,853	$402,843	$64,774,696
Balance at January 1, 2014	$893	$152,945	$177,824,720	$(13,391,341)	$164,587,217	$1,465,502	$166,052,719
Issuance of Units	122	—	12,157,658	—	12,157,780	—	12,157,780
Syndication and offering costs	—	—	(1,394,971)	—	(1,394,971)	—	(1,394,971)
	—	22	82,265	—	82,287	—	82,287

Equity compensation to executives and directors							
Conversion of Class A Units to Common Stock	—	941	504,540	—	505,481	(505,481)	—
Current period amortization of Class B OP Units	—	—	—	—	—	361,936	361,936
Net income	—	—	—	2,756,983	2,756,983	38,862	2,795,845
Reallocation adjustment to non-controlling interests	—	—	211,720	—	211,720	(211,720)	—
Distributions to non-controlling interests	—	—	—	—	—	(36,552)	(36,552)
Dividends to series A preferred stockholders ($5.00 per share per month)	—	—	(1,420,536)	—	(1,420,536)	—	(1,420,536)
Dividends to common stockholders ($0.16 per share)	—	—	(2,453,769)	—	(2,453,769)	—	(2,453,769)
Balance at March 31, 2014	$1,015	$153,908	$185,511,627	$(10,634,358)	$175,032,192	$1,112,547	$176,144,739

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

	Three months ended March 31,	
	2014	2013
Operating activities:		
Net income (loss)	$2,795,845	$(3,185,829)
Reconciliation of net income (loss) to net cash provided by operating activities:		
Depreciation expense	1,894,411	1,728,867
Amortization expense	414,115	2,383,436
Amortization of below market leases	(5,723)	(115,498)
Deferred fee income amortization	(308,608)	(37,031)
Deferred loan cost amortization	140,658	137,761
Change in accrued interest income on real estate loans	(972,181)	(443,362)
Equity compensation to executives and directors	444,222	308,921
Deferred cable income amortization	(2,734)	(2,733)
Changes in operating assets and liabilities:		
Decrease (increase) in tenant receivables and other assets	307,425	(10,176)
Increase in accounts payable and accrued expenses	356,039	39,630
(Decrease) in accrued interest payable	(95,083)	(51,796)
(Decrease) increase in prepaid rents	(44,790)	184
Increase in security deposits and other liabilities	185,170	4,016
Net cash provided by operating activities	5,108,766	756,390
Investing activities:		
Investments in real estate loans	(4,880,179)	(4,776,376)
Repayments of real estate loans	520,009	—
Notes receivable issued	(1,175,905)	(2,155,529)
Notes receivable repaid	164,743	456,665
Draws on line of credit by related party	(3,311,611)	(1,410,778)
Repayments of line of credit by related party	771,449	1,421,384
Acquisition fees received on real estate loans	21,576	308,348
Acquisition fees paid on real estate loans	(10,788)	(154,174)
Acquisition of properties	(5,701,393)	(21,647,242)
Additions to real estate assets - improvements	(299,765)	(103,482)
(Increase) decrease in restricted cash	(150,961)	77,006
Net cash used in investing activities	(14,052,825)	(27,984,178)
Financing activities:		
Proceeds from mortgage notes payable	13,357,000	59,045,000
Payments for mortgage extinguishment	(13,000,000)	(69,428,389)
Payments for mortgage loan costs	(415,241)	(907,477)
Proceeds from lines of credit	3,700,001	12,943,000
Payments on lines of credit	(1,082,220)	(27,744,197)
Proceeds from sales of Series B Preferred Stock, net of offering costs	—	37,238,896
Proceeds from sales of Units, net of offering costs	10,954,492	19,983,826
Common Stock dividends paid	(2,451,697)	(771,616)
Series A preferred stock dividends paid	(1,354,344)	(307,304)

Distributions to non-controlling interests	(17,118)	—
Payments for deferred offering costs	(817,832)	(349,962)
Net cash provided by financing activities	8,873,041	29,701,777
Net (decrease) increase in cash and cash equivalents	(71,018)	2,473,989
Cash and cash equivalents, beginning of period	9,180,431	2,973,509
Cash and cash equivalents, end of period	$9,109,413	$5,447,498

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

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

	Three months ended March 31,	
	2014	2013
Supplemental cash flow information:		
Cash paid for interest	$1,165,447	$1,142,715
Supplemental disclosure of non-cash activities:		
Accrued capital expenditures	$113,377	$131,463
Dividends payable - common	$2,453,769	$771,923
Dividends payable - preferred	$497,855	$823,079
Partnership distributions payable to non-controlling interest	$36,552	$15,513
Accrued and payable deferred offering costs	$478,671	$479,599
Reclass of offering costs from deferred asset to equity	$154,211	$85,220
Mortgage loans assumed on acquisitions	$—	$69,428,389

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

Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements
March 31, 2014
(Unaudited)

1. Organization

Preferred Apartment Communities, Inc. was formed as a Maryland corporation on September 18, 2009, and elected to be taxed as a real estate investment trust, or REIT, under the Internal Revenue Code of 1986, as amended, or the Code, effective with its tax year ended December 31, 2011. Unless the context otherwise requires, references to the "Company", "we", "us", or "our" refer to Preferred Apartment Communities, Inc., together with its consolidated subsidiaries, including Preferred Apartment Communities Operating Partnership, L.P., or the Operating Partnership. The Company was formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As part of its business strategy, the Company may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the construction of multifamily communities and other properties. As a secondary strategy, the Company also may acquire or originate senior mortgage loans, subordinate loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets and invest not more than 10% of its total assets in other real estate related investments, as determined by its Manager (as defined below) as appropriate for the Company. The Company is externally managed and advised by Preferred Apartment Advisors, LLC, or its Manager, a Delaware limited liability company and related party (see Note 6).

The Company completed its initial public offering, or IPO, on April 5, 2011. As of March 31, 2014, the Company had 15,390,839 shares of common stock, par value $0.01 per share, or Common Stock, issued and outstanding and owned units in the Operating Partnership which represented a weighted-average ownership percentage of 98.61% for the three-month period ended March 31, 2014. The number of partnership units not owned by the Company totaled 144,432 at March 31, 2014 and represented Class A OP Units of the Operating Partnership, or Class A OP Units. The Class A OP Units are convertible at any time at the option of the holder into the Company's choice of either cash or Common Stock. In the case of cash, the value is determined based upon the trailing 20-day volume weighted average price of the Company's Common Stock.

The consolidated financial statements include the accounts of the Company and the Operating Partnership. The Company controls the Operating Partnership through its sole general partner interest and plans to conduct substantially all of its business through the Operating Partnership.

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited consolidated financial statements include all of the accounts of the Company and the Operating Partnership presented in accordance with accounting principles generally accepted in the United States of America, or GAAP. All significant intercompany transactions have been eliminated in consolidation. Certain adjustments have been made consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair presentation of the Company's financial condition and results of operations. These financial statements should be read in conjunction with our audited financial statements and notes thereto included in our 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on March 17, 2014.

Use of Estimates

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

Acquisitions and Impairments of Real Estate Assets

The Company generally records its initial investments in income-producing real estate at fair value at the acquisition date in accordance with ASC 805-10, Business Combinations. The aggregate purchase price of acquired properties is apportioned to the tangible and identifiable intangible assets and liabilities acquired at their estimated fair values. The value of acquired land, buildings and improvements is estimated by formal appraisals, observed comparable sales transactions, and information gathered during pre-acquisition due diligence activities and the valuation approach considers the value of the property as if it were vacant. The values of furniture, fixtures, and equipment are estimated by calculating their replacement cost and reducing that value by factors based upon estimates of their remaining useful lives. Intangible assets and liabilities for multifamily communities include the values of in-place leases, customer relationships, and above-market or below-market leases. In-place lease values are estimated by calculating the estimated time to fill a hypothetically empty apartment complex to its stabilization level (estimated to be 92% occupancy) based on historical observed move-in rates for each property. Carrying costs during these hypothetical expected lease-up periods are estimated, considering current market conditions and include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates. The intangible assets are calculated by estimating the net cash flows of the in-place leases to be realized, as compared to the net cash flows that would have occurred had the property been vacant at the time of acquisition and subject to lease-up. The acquired in-place lease values are amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. The values of customer relationships are estimated by calculating the product of the avoided hypothetical lost revenue and the average renewal probability and are amortized to operating expense over the average remaining historical period of residency, plus an estimate of the average expected renewal period. The amounts of above-market or below-market lease values are developed by comparing the Company's estimate of the average market rent to the average contract rent of the leases in place at the property acquisition date any amount. This ratio is applied on a lease by lease basis to derive a total asset or liability amount for the property. The above-market or below-market lease values are recorded as a reduction or increase, respectively, to rental income over the remaining average non-cancelable term of the respective leases, plus any below market renewal options. Acquired intangible assets have no residual value.

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

Loans and Notes Held for Investment

The Company carries its investments in real estate loans at amortized cost with assessments made for impairment in the event recoverability of the principal amount becomes doubtful. If, upon testing for impairment, the fair value result is lower than the carrying amount of the loan, a valuation allowance is recorded to lower the carrying amount to fair value, with a loss recorded in earnings. Recoveries of valuation allowances are only recognized in the event of maturity or a sale or disposition in an amount above carrying value. The balances of real estate loans presented on the consolidated balance sheets consist of drawn amounts on the loans, net of deferred loan fee revenue. See the "Revenue Recognition" section of this Note for other loan-related policy disclosures required by ASC 310-10-50-6. Certain loans contain contingent exit fees, which are deemed to be embedded derivatives. The Company elects the fair value option for these loans and recognizes in earnings any material changes in fair value.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Restricted cash includes cash restricted by state law or contractual requirement and relates primarily to tax and insurance escrows and resident security deposits.

Fair Value Measurements

Certain assets and liabilities are required to be carried at fair value, or if they are deemed impaired, to be adjusted to reflect this condition. The Company follows the guidance provided by ASC 820, Fair Value Measurements and Disclosures, in accounting and reporting for real estate assets where appropriate, as well as debt instruments both held for investment and as liabilities. The standard requires disclosure of fair values calculated under each level of inputs within the following hierarchy:

•Level 1 – Quoted prices in active markets for identical assets or liabilities at the measurement date.
•Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
•Level 3 – Unobservable inputs for the asset or liability.

Deferred Loan Costs

Deferred loan costs are amortized using the straight-line method, which approximates the effective interest method, over the terms of the related indebtedness.

Deferred Offering Costs

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

Non-controlling Interest

Non-controlling interest represents the equity interest of the Operating Partnership that is not owned by the Company. Non-controlling interest is adjusted for contributions, distributions and earnings or loss attributable to the non-controlling interest in the consolidated entity in accordance with the Agreement of Limited Partnership of the Operating Partnership, as amended.

Redeemable Preferred Stock

Shares of the Series A Preferred Stock issued pursuant to the Primary Series A Offering (further described in note 5) are redeemable at the option of the holder, subject to a declining redemption fee schedule. Redemptions are therefore outside the control of the Company. However, the Company retains the right to fund any redemptions of Series A Preferred Stock in either Common Stock or cash at its option. Therefore, the Company records the Series A Preferred Stock as a component of permanent stockholders' equity.

Revenue Recognition

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

Rental revenue from tenants' operating leases in the Company's retail shopping center is recognized on a straight-line basis over the term of the lease regardless of when payments are due. The Company estimates the collectability of the accounts receivable related to base rents, straight-line rents, expense reimbursements, and other revenue taking into consideration the Company's historical write-off experience, tenant credit-worthiness, current economic trends, and remaining lease terms. Substantially all of the lease agreements with anchor tenants contain "percentage rent" provisions that provide for additional rents that become due upon achievement of specified sales revenue targets as defined in their lease agreements. Substantially all lease agreements contain provisions for reimbursement of the tenants' share of real estate taxes, insurance and common area maintenance costs, or CAM, costs. Recovery of real estate taxes, insurance, and CAM costs are recognized as the respective costs are incurred in accordance with the lease agreements.

Interest income on real estate loans and notes receivable is recognized on an accrual basis over the lives of the loans using the effective interest method. In the event that a loan or note is refinanced with the proceeds of another loan issued by the Company,

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Preferred Apartment Communities, Inc.
Notes to Consolidated Financial Statements – (continued)
March 31, 2014
(Unaudited)

any unamortized loan fee revenue from the first loan will be recognized as interest revenue over the term of the new loan. Direct loan origination fees and origination or acquisition costs applicable to real estate loans are amortized over the lives of the loans as adjustments to interest income. The accrual of interest on all these instruments is stopped when there is concern as to the ultimate collection of principal or interest, which is generally a delinquency of 30 days in required payments of interest or principal. Any payments received on such non-accrual loans are recorded as interest income when the payments are received. Real estate loan assets are reclassified as accrual-basis once interest and principal payments become current. Certain real estate loan assets include limited purchase options and exit fees or additional interest payments that are due the Company at maturity or in the event of a sale of the property or refinancing of the loan by the borrower to a third party. If the Company purchases the subject property, any accrued exit fee will be treated as additional consideration for the acquired project.

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

The PAC Rewards program, implemented in the first quarter of 2012, allows residents to accumulate reward points on a monthly basis for actions such as resident referrals and making rent payments online. A resident must rent an apartment from the Company for at least 14 months before reward points may be redeemed for services or upgrades to a resident's unit. The Company accrues a liability for the estimated cost of these future point redemptions, net of a 35% breakage fee, which is the Company's current estimate of rewards points that will not be redeemed. In accordance with Staff Accounting Bulletin 13.A.3c, the Company deems its obligations under PAC Rewards as inconsequential to the delivery of services according to the lease terms. Therefore, the expense related to the PAC Rewards Program is included in property operating and maintenance expense on the consolidated statements of operations.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with guidance provided by ASC 505, Equity-Based Payments to Non-Employees and ASC 718, Stock Compensation. We calculate the fair value of equity compensation instruments at the date of grant based upon estimates of their expected term, the expected volatility of and dividend yield on our Common Stock over this expected term period and the market risk-free rate of return. We will also estimate forfeitures of these instruments and accrue the compensation expense, net of estimated forfeitures, over the vesting period(s). We record the fair value of restricted stock awards based upon the closing stock price on the trading day immediately preceding the date of grant.

Acquisition Costs

The Company expenses property acquisition costs as incurred, which include costs such as due diligence, legal, certain accounting, environmental and consulting, when the acquisition constitutes a business combination. The Company capitalizes these costs for transactions deemed to be asset acquisitions.

Capitalization and Depreciation

The Company capitalizes replacements of furniture, fixtures and equipment, as well as carpet, appliances, air conditioning units, certain common area items, and other assets. Significant repair and renovation costs that improve the usefulness or extend the useful life of the properties are also capitalized. These assets are then depreciated on a straight-line basis over their estimated useful lives, as follows:

•Buildings	30 - 40 years
•Furniture, fixtures & equipment	5 - 10 years
•Improvements to buildings and land	5 - 10 years

Operating expenses related to unit turnover costs, such as carpet cleaning, mini-blind replacements, and minor repairs are expensed as incurred.

Discontinued Operations

The Company evaluates all disposal groups for held-for-sale classification and for those disposal groups for which it will have no continuing involvement, nor receipt of cash flows post-disposal, for presentation in the consolidated financial statements according to criteria provided by ASC 360-10-45-9. If the disposal group meets the criteria necessary for held for sale classification, the assets and liabilities to be transferred upon sale or disposal are summarized into single line items entitled property held for sale on the consolidated balance sheets, and the results of operations are reclassified into a single line entitled gain/loss from discontinued operations on the consolidated statements of operations. Previous periods are similarly reclassified for comparability.

Income Taxes

The Company has elected to be taxed as a REIT under the Code. To continue to qualify as a REIT, the Company must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of the Company's annual REIT taxable income to its stockholders (which is computed without regard to the dividends paid deduction or net capital gain which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Company generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income tax on its taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which qualification is lost unless the Internal Revenue Service grants the Company relief under certain statutory provisions. Such an event could materially adversely affect the Company's net income and net cash available for distribution to stockholders. The Company intends to operate in such a manner as to maintain its election for treatment as a REIT.

The Company recognizes a liability for uncertain tax positions. An uncertain tax position is defined as a position taken or expected to be taken in a tax return that is not based on clear and unambiguous tax law and which is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company measures the tax benefits recognized based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income or loss available to common stockholders by the weighted average number of shares of Common Stock outstanding for the period. Net income or loss attributable to common stockholders is calculated by deducting dividends due to preferred stockholders, as well as non-forfeitable dividends due to holders of unvested restricted stock, which are participating securities under the two-class method of calculating earnings per share. Diluted earnings (loss) per share is computed by dividing earnings or net loss available to common stockholders by the weighted average number of shares of Common Stock outstanding adjusted for the effect of dilutive securities such as share grants or warrants. No adjustment is made for potential Common Stock equivalents that are anti-dilutive during the period.

New Accounting Pronouncements

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

3. Real Estate Assets

The Company's real estate assets consisted of six multifamily communities with 1,929 total units at March 31, 2014 and six multifamily communities with 1,693 total units at March 31, 2013. The acquired second phases of our Trail Creek and Summit Crossing communities (described below) are managed in combination with the initial phases of these communities, both of which were acquired in April 2011 and are therefore considered single properties. At March 31, 2014, the combined phases of our Trail Creek communities, which is comprised of 300 units, was classified as held for sale.

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(Unaudited)

On February 12, 2014, the Company completed the acquisition of a 66,122 square foot retail shopping center in Woodstock, Georgia, or Woodstock Crossing, for $5,701,393, which approximated the fair value of the acquired assets.

The Company allocated the purchase price of Woodstock Crossing to the acquired assets and liabilities based upon their fair values, as follows:

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

The in-place leases, above market leases, legal fees and commissions, and below-market leases will be amortized over the remaining lease terms, which range from six months to ten years as of March 31, 2014. Woodstock Crossing contributed approximately $89,000 of revenue and $37,000 of net income to the Company's consolidated results for the three-month period ended March 31, 2014. See note 6 for details regarding the acquisition fee paid related to this transaction.

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

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

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

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

Amortization of acquired intangible assets for the three-month period ended March 31, 2013 related to the Ashford Park, McNeil Ranch and Lake Cameron communities commenced on January 23, 2013, the date of acquisition. The intangible assets were amortized over a period ranging from the average remaining lease term, which was approximately six to twelve months, to the average remaining lease term plus the average estimated renewal period.

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On December 4, 2013, pursuant to the approval of the investment committee of the board of directors, the Company entered into an exclusive marketing agreement with an outside firm to market for sale the combined phases of its Trail Creek multifamily community (Trail I and Trail II). The operating results of the community are classified as held for sale and are included in the line entitled income from discontinued operations on the consolidated statements of operations and are reported within the Company's multifamily communities segment. Effective on December 4, 2013, the Company ceased recording depreciation on the communities. The following is a summary of income from discontinued operations:

	Three months ended March 31,	
	2014	2013
Property revenues	$ 1,057,677	$ 655,377
Property expenses	425,789	238,348
Interest expense	314,463	122,067
Depreciation and amortization	—	198,796
Income from discontinued operations	$ 317,425	$ 96,166

The Company recorded depreciation and amortization of tangible and intangible assets, excluding such charges for the combined Trail Creek multifamily community, as follows:

	Three months ended March 31,	
	2014	2013
Depreciation:		
Buildings and improvements	$ 942,746	$ 736,600
Furniture, fixtures, and equipment	951,665	793,472
	1,894,411	1,530,072
Amortization:		
Acquired intangible assets	412,924	2,382,285
Website development costs	1,191	1,151
Total depreciation and amortization	$ 2,308,526	$ 3,913,508

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Notes to Consolidated Financial Statements – (continued)
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4. Real Estate Loans, Notes Receivable, and Line of Credit

At March 31, 2014, our portfolio of real estate loans consisted of:

Project/Property (1)	Location	Date of loan	Maturity date	Optional extension date	Total loan commitments	Approved senior loan held by unrelated third party	Current / deferred interest % per annum
City Park	Charlotte, NC	9/6/2012	9/5/2017	N/A	$10,000,000	$18,600,000	8 / 6
City Vista	Pittsburgh, PA	8/31/2012	6/1/2016	7/1/2017	12,153,000	$28,400,000	8 / 6
Madison - Rome	Rome, GA (2)	11/13/2012	10/15/2015	N/A	5,360,042	$11,500,000	8 / 6
Lely	Naples, FL	3/28/2013	2/28/2016	2/28/2018	12,713,242	$25,000,000	8 / 6
Crosstown Walk	Suburban Tampa, FL (3)	4/30/2013	11/1/2016	5/1/2018	10,962,000	$25,900,000	8 / 6
Overton	Atlanta, GA	5/8/2013	11/1/2016	5/1/2018	16,600,000	$31,700,000	8 / 6
Haven West	Carrollton, GA (4) (6)	7/15/2013	6/2/2016	6/2/2018	6,940,795	$16,195,189	8 / 6
Starkville	Starkville, MS (5) (6)	8/21/2013	5/31/2014	N/A	1,730,000	N/A	8 / 0
Founders' Village	Williamsburg, VA	8/29/2013	8/29/2018	N/A	10,346,000	$26,936,000	8 / 6
Encore	Atlanta, GA (7)	11/18/2013	8/18/2014	N/A	16,026,525	N/A	8 / 2
Manassas	Northern VA (8)	12/23/2013	5/31/2014	N/A	10,932,000	N/A	8 / 5
Irvine	Irvine, CA (9)	12/18/2013	5/31/2014	N/A	16,250,000	N/A	8.5 / 4.3
					$130,013,604		

(1) All loans are mezzanine loans pertaining to developments of multifamily communities, except as otherwise indicated. The borrowers for each of these projects are as follows: "City Park" - Oxford City Park Development LLC; "City Vista" - Oxford City Vista Development LLC; "Madison - Rome" - Madison Retail - Rome LLC; "Lely" - Lely Apartments LLC; "Crosstown Walk" - Iris Crosstown Partners LLC; "Overton" - Newport Overton Holdings, LLC; "Haven West" - Haven Campus Communities Member, LLC; "Starkville" - Haven Campus Communities - Starkville, LLC; "Founders' Village" - Oxford NTW Apartments LLC; "Encore" - GP - RV Land I, LLC; "Manassas" - Oxford Palisades Apartments LLC; and "Irvine" - 360 - Irvine, LLC.

(2) Madison-Rome is a mezzanine loan for an 88,351 square foot retail development project. On October 16, 2013, the anchor tenant obtained a certificate of occupancy and took possession of approximately 54,340 square feet of space.

(3) Crosstown Walk was a land acquisition bridge loan that was converted to a mezzanine loan in April 2013.

(4) Planned 568 bed student housing community adjacent to the University of West Georgia campus.

(5) A land acquisition loan which pays 8% current interest only, in support of a planned 168-unit, 536-bed student housing community adjacent to the Mississippi State University campus.

(6) See note 6 - Related Party Transactions.

(7)

Bridge loan of up to approximately $16.0 million to partially finance the acquisition of land and predevelopment costs for a 340-unit multifamily community in Atlanta, Georgia.

(8) Bridge loan of up to approximately $10.9 million to partially finance the acquisition of land and predevelopment costs for a 304-unit multifamily community in Northern Virginia.

(9) Bridge loan of up to approximately $16.3 million to partially finance the acquisition of land and predevelopment costs for a 280-unit multifamily community in Irvine, California.

The Company's real estate loans are collateralized by 100% of the membership interests of the underlying project entity, and, where necessary, by unconditional joint and several repayment guaranties and performance guaranties by the principal(s) of the borrower. These guaranties generally remain in effect until the receipt of a final certificate of occupancy. All of the guaranties are subject to the rights held by the senior lender pursuant to a standard intercreditor agreement. The Starkville, Encore, Manassas and Irvine loans are also collateralized by the acquired land. The Haven West loan is additionally collateralized by an assignment by the developer of security interests in an unrelated project. Prepayment of the mezzanine loans are permitted in whole, but not in part, without the Company's consent.

Management monitors the level of credit quality for each of the Company's mezzanine real estate loans by tracking the timeliness of scheduled interest and principal payments relative to the due dates as specified in the loan documents, as well as draw requests on the

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loans relative to the project budgets. In addition, management monitors the actual progress of development and construction relative to the construction plan, as well as local, regional and national economic conditions as may bear on our current and target markets. The credit quality of the Company's borrowers is primarily based on their payment history on an individual loan basis, and as such, the Company does not assign quantitative credit value measures or categories to its real estate loans and notes receivable in credit quality categories.

	As of March 31, 2014				Carrying amount as of	
Project/Property	Amount drawn	Loan Fee received from borrower - 2%	Acquisition fee paid to Manager - 1%	Unamortized deferred loan fee revenue	March 31, 2014	December 31, 2013
City Park	$10,000,000	$200,000	$100,000	$(65,810)	$9,934,190	$9,928,017
City Vista	12,153,000	243,040	121,520	(81,941)	12,071,059	12,063,939
Madison - Rome	5,360,042	107,201	53,600	(31,317)	5,328,725	5,322,770
Lely	11,721,229	254,265	127,133	(75,839)	11,645,390	11,402,372
Crosstown Walk	10,247,119	219,240	109,620	(42,398)	10,204,721	9,997,245
Overton	14,911,166	332,079	166,040	(111,216)	14,799,950	14,487,178
Haven West	6,543,076	138,816	69,408	(49,009)	6,494,067	5,582,018
Starkville	1,590,600	34,600	17,300	(3,134)	1,587,466	1,582,750
Founders' Village	9,033,839	197,320	98,660	(79,317)	8,954,522	7,572,698
Encore	8,772,524	320,531	160,265	(78,423)	8,694,101	7,716,421
Manassas	10,707,000	214,140	107,070	—	10,707,000	10,609,849
Irvine	14,897,033	298,634	149,317	(55,015)	14,842,018	14,332,658
	$115,936,628	$2,559,866	$1,279,933	$(673,419)	$115,263,209	$110,597,915

The Company holds options, but not obligations, to purchase certain of the properties which are partially financed by its mezzanine loans, as shown in the table below. The option purchase prices are negotiated at the time of the loan closing.

	Purchase option window			
Project/Property	Begin	End	Purchase option price	Total units upon completion
City Park	11/1/2015	3/31/2016	$30,945,845	284
City Vista	2/1/2016	5/31/2016	$43,560,271	272
Madison - Rome	N/A	N/A	N/A	N/A
Lely	4/1/2016	8/30/2016	$43,500,000	308
Crosstown Walk	7/1/2016	12/31/2016	$39,654,273	342
Overton	7/8/2016	12/8/2016	$51,500,000	294
Haven West	8/1/2016	1/31/2017	$26,138,466	160
Starkville	N/A	N/A	N/A	168
Founders' Village	2/1/2016	9/15/2016	$44,266,000	247
Encore	N/A	N/A	N/A	340
Manassas	N/A	N/A	N/A	304
Irvine	N/A	N/A	N/A	280
				2,999

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At March 31, 2014, our portfolio of notes and line of credit receivable consisted of:

Borrower	Type of instrument	Date of loan	Maturity date	Total loan commitments	Amount drawn	Interest rate
360 Residential, LLC	Bridge loan	3/20/2013	12/31/2014	$ 2,000,000	$ 1,077,035	8 % [1]
TPKG 13th Street Development, LLC	Land acquisition loan	5/3/2013	8/1/2014	7,200,000	7,200,000	8 % [2]
Preferred Capital Marketing Services, LLC	Promissory note	1/24/2013	1/23/2015	1,500,000	1,500,000	10 %
Riverview Associates, Ltd.	Promissory note	12/17/2012	12/16/2014	1,300,000	1,300,000	8 % [3]
Pecunia Management, LLC	Subordinated loan	11/16/2013	11/15/2014	200,000	200,000	10 %
Oxford Contracting LLC	Promissory note	8/27/2013	4/30/2017	1,500,000	1,475,000	8 % [4]
Preferred Apartment Advisors, LLC	Revolving credit line	8/21/2012	12/31/2015	9,500,000	7,794,718	8 % [5]
				$ 23,200,000	$ 20,546,753	

(1) Amendment of the bridge loan which was originated on March 20, 2013. The amounts payable under the terms of the loan, which include an additional 6% deferred interest, are collateralized by guaranties of payment and performance by the principals of the borrower.
(2) Note pays current interest at 8% per annum, plus an additional interest amount necessary to provide the Company with a 14% cumulative simple rate of return through August 31, 2013, scaling upward to 20% per annum on January 1, 2014 and thereafter. The loan was amended on March 17, 2014 to extend the maturity date to August 1, 2014. The borrower paid deferred interest of $351,491 and repaid principal of $164,743 at the date of amendment. The note is collateralized by a pledge of 100% of the membership interests of the project as well as by a first mortgage on the property.
(3) The amounts payable under the terms of the loan are collateralized by an assignment of project documents and guaranties of payment and performance by the principal of the borrower.
(4)