Howard Hughes Corp
Form 10-Q
May 10, 2011
Table of Contents

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 March 31, 2011

or

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

For the Transition Period from to

Commission file number 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**36-4673192** (I.R.S. Employer Identification Number)

13355 Noel Road, Suite 950, Dallas, Texas 75240
(Address of principal executive offices, including Zip Code)

(214) 741-7744

(Registrant s telephone number, including area code)

N / A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) 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. xYes o No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

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

The number of shares of Common Stock, $.01 par value, outstanding on May 6, 2011 was 37,933,154.

Table of Contents

THE HOWARD HUGHES CORPORATION, INC.

INDEX

Table of Contents

THE HOWARD HUGHES CORPORATION

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

[redacted]				
Assets:				
[redacted]				
Master Planned Community assets	$	1,348,531	$	1,350,648
[redacted]				
Buildings and equipment		342,797		343,006
[redacted]				
Developments in progress		293,954		293,403
[redacted]				
Investment in and loans to/from Real Estate Affiliates		151,093		149,543
[redacted]				
Cash and cash equivalents		280,481		284,682
[redacted]				
Notes receivable		38,883		38,954
[redacted]				
Deferred expenses, net		6,076		6,619
[redacted]				
Total assets	$	3,026,547	$	3,022,707
[redacted]				
Liabilities:				
[redacted]				
Deferred tax liabilities		79,639		78,680
[redacted]				
Uncertain tax position liability		142,329		140,076
[redacted]				
Total liabilities		961,925		843,600
[redacted]				
Commitments and Contingencies				
[redacted]				
Equity:				
[redacted]				
Additional paid-in capital		2,708,165		2,708,036
[redacted]				
Accumulated other comprehensive loss		(1,692)		(1,627)
[redacted]				
Noncontrolling interests in consolidated ventures		790		824
[redacted]				
Total liabilities and equity	$	3,026,547	$	3,022,707

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

3

Table of Contents

THE HOWARD HUGHES CORPORATION

CONSOLIDATED AND COMBINED STATEMENTS OF OPERATIONS AND COMPREHENSIVE

INCOME (LOSS)

(UNAUDITED)

	Three Months Ended March 31, 2011 (Consolidated)	2010 (Combined)
	(In thousands)	
Revenues:		
Master Planned Community land sales	$ 23,392	$ 3,215
Builder price participation	521	744
Minimum rents	16,719	17,031
Tenant recoveries	4,524	4,819
Condominium unit sales	3,764	
Other land sale revenues	1,248	1,111
Other rental and property revenues	2,933	1,870
Total revenues	53,101	28,790
Expenses:		
Master Planned Community cost of sales	15,436	1,326
Master Planned Community land sales operations	5,628	8,491
Rental property real estate taxes	3,474	2,978
Rental property maintenance costs	1,559	1,844
Condominium unit cost of sales	2,980	
Other property operating costs	9,592	8,472
Provision for doubtful accounts	11	101
General and administrative	5,232	4,135
Provisions for impairment		278
Depreciation and amortization	3,199	4,450
Total operating expenses	47,111	32,075
Operating income (loss)	5,990	(3,285)
Interest income	2,512	105
Interest expense		(712)
Warrant liability expense	(126,045)	
Loss before income taxes, income from Real Estate Affiliates, reorganization items and noncontrolling interests	(117,543)	(3,892)
Provision for income taxes	(2,457)	(1,486)
Income from Real Estate Affiliates	5,513	1,492
Reorganization items		(16,595)
Loss from continuing operations	(114,487)	(20,481)
Allocation to noncontrolling interests	(28)	(48)
Net loss attributable to common stockholders	$ (114,515)	$ (20,529)
Basic and Diluted Loss Per Share:		
Continuing operations	$ (3.02)	$ (0.54)
Total basic and diluted loss per share	$ (3.02)	$ (0.54)

Comprehensive Income (Loss), Net:				
Net loss	$	(114,487)	$	(20,481)
Other comprehensive income (loss)		(65)		410
Comprehensive loss		(114,552)		(20,071)
Comprehensive loss allocated to noncontrolling interests		(28)		(48)
Comprehensive loss attributable to common stockholders	$	(114,580)	$	(20,119)

The accompanying notes are an integral part of these condensed consolidated and combined financial statements

Table of Contents

THE HOWARD HUGHES CORPORATION

CONSOLIDATED AND COMBINED STATEMENTS OF EQUITY

(UNAUDITED)

	Common Stock	Additional Paid-In Capital	Accumulated Deficit	GGP Equity (In thousands)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests in Consolidated Ventures	Total Equity
Balance, January 1, 2010	$	$	$	$ 1,504,364	$ (1,744)	$ 900	$ 1,503,520
Net (loss) income				(20,529)		48	(20,481)
Distributions to noncontrolling interests						(41)	(41)
Other comprehensive income					410		410
Contributions from GGP, net				33,398			33,398
Balance, March 31, 2010	$	$	$	$ 1,517,233	$ (1,334)	$ 907	$ 1,516,806
Balance, January 1, 2011	$ 379	$ 2,708,036	$ (528,505)	$	$ (1,627)	$ 824	$ 2,179,107
Net (loss) income			(114,515)			28	(114,487)
Distributions to noncontrolling interests						(62)	(62)
Other comprehensive loss					(65)		(65)
Restricted stock amortization		129					129
Balance, March 31, 2011	$ 379	$ 2,708,165	$ (643,020)	$	$ (1,692)	$ 790	$ 2,064,622

The accompanying notes are an integral part of these condensed consolidated and combined financial statements

Table of Contents

THE HOWARD HUGHES CORPORATION

CONSOLIDATED AND COMBINED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31, 2011 (Consolidated)	2010 (Combined)
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	$ (114,487)	$ (20,481)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Income from Real Estate Affiliates	(5,513)	(1,492)
Distributions received from Real Estate Affiliates	3,894	
Provision for doubtful accounts	11	101
Depreciation	2,748	3,884
Amortization	451	566
Amortization (accretion) of deferred financing costs and debt market rate adjustments	(1,709)	713
Amortization of intangibles other than in-place leases	33	51
Straight-line rent amortization	(835)	(494)
Non-cash expense on warrant liabilities	126,045	
Provisions for impairment		278
Land/residential development and acquisitions expenditures	(18,687)	(11,870)
Cost of sales	18,416	1,326
Non-cash reorganization items		(248)
Net changes:		
Accounts and notes receivable	(75)	436
Prepaid expenses and other assets	(387)	8,088
Deferred expenses	(62)	(451)
Accounts payable and accrued expenses and deferred tax liabilities	(5,115)	(116)
Other, net	(58)	3
Net cash provided by (used in) operating activities	4,670	(19,706)
Cash Flows from Investing Activities:		
Development of real estate and property additions/improvements, primarily previously accrued	(9,140)	(9,342)
Increase in investments in Real Estate Affiliates	(10)	(27)
Distributions received from Real Estate Affiliates in excess of income	79	19
Net cash used in investing activities	(9,071)	(9,350)
Cash Flows from Financing Activities:		
Change in GGP investment, net		30,109
Principal payments on mortgages, notes and loans payable	(1,738)	(1,466)
Proceeds from issuance of Management Warrant	2,000	
Distributions to noncontrolling interests	(62)	(41)
Net cash provided by financing activities	200	28,602
Net change in cash and cash equivalents	(4,201)	(454)
Cash and cash equivalents at beginning of period	284,682	3,204
Cash and cash equivalents at end of period	$ 280,481	$ 2,750

Supplemental Disclosure of Cash Flow Information:				
Interest paid	$	3,597	$	3,793
Interest capitalized		4,224		5,104
Reorganization items paid				720
Non-Cash Transactions:				
Change in accrued capital expenditures included in accounts payable and accrued expenses	$	(5,687)	$	(7,622)
Other non-cash GGP equity transactions				3,289

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

Table of Contents

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

NOTE 1 ORGANIZATION

The accompanying condensed consolidated and combined 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 SEC. Therefore, such condensed consolidated and combined 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 should refer to the Company s (as defined below) audited Consolidated and Combined Financial Statements for the year ended December 31, 2010 which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2010 (Commission File No. 001-34856). Capitalized terms used, but not defined in this Quarterly Report have the same meanings as in our Annual Report.

General

The Howard Hughes Corporation (HHC or the Company) is a Delaware corporation that was formed on July 1, 2010 to hold, after receipt via a tax-free distribution, certain assets of General Growth Properties, Inc. (GGP) and certain of its subsidiaries (collectively, the Predecessors) pursuant to their plans of reorganization (the Plan) under Chapter 11 of the United States Code (Chapter 11). We are a real estate company that specializes in the development and operation of master planned communities, operating rental properties and other strategic real estate opportunities across the United States. Pursuant to the Plan, certain of the assets and liabilities of the Predecessors (the HHC Businesses) were transferred to us and our common stock was distributed to the holders of GGP s common stock and common units (the Separation) on a pro-rata basis (approximately 32.5 million shares of our common stock) on GGP s date of emergence from bankruptcy, November 9, 2010 (the Effective Date). Also as part of the Plan, approximately 5.25 million shares of our common stock and 8.0 million warrants were purchased by certain of the investors sponsoring the Plan for $250 million. Unless the context otherwise requires, references to we, us and our refer to HHC and its subsidiaries, and, for periods in 2010, after giving effect to the Separation.

The accompanying consolidated balance sheets at March 31, 2011 and December 31, 2010 reflect the consolidation of HHC and its subsidiaries, as of such date, with all intercompany balances and transactions eliminated. The accompanying combined financial statements for the periods prior to the Separation have been prepared in accordance with GAAP on a carve-out basis from the consolidated financial statements of GGP using the historical results of operations and bases of the assets and liabilities of the transferred businesses and including allocations from GGP. This presentation incorporates the same principles used when preparing consolidated financial statements, including elimination of intercompany transactions. The presentation also includes the accounts of the HHC Businesses in which we have a controlling interest. The noncontrolling equity holders share of the assets, liabilities and operations are reflected in noncontrolling interests within permanent equity of the Company. All intercompany balances and transactions between the HHC Businesses have been eliminated. Accordingly, the results presented for the three months ended March 31, 2010 reflect the aggregate of operations and changes in cash flows and equity on a carved-out basis for the period from January 1, 2010 through March 31, 2010 and on a consolidated basis for the period from January 1, 2011 through March 31, 2011.

As discussed above, we were formed for the purpose of receiving, via a tax-free distribution, certain assets and assuming certain liabilities of the Predecessors pursuant to the Plan. We conducted no business and had no separate material assets or liabilities until the Separation was consummated. No previous historical financial statements for the HHC Businesses have been prepared and, accordingly, our combined financial statements for the three months ended March 31, 2010 are derived from the books and records of GGP and were carved-out from GGP at a carrying value reflective of such historical cost in such GGP records. Our historical financial results reflect allocations for certain corporate expenses which include, but are not limited to, costs related to property management, human resources, security, payroll and benefits, legal, corporate communications, information services and restructuring and reorganizations. Costs of the services (approximately $2.8 million for the three months ended March 31, 2010) that were allocated or charged to us were based on either actual costs incurred or a proportion of costs estimated to be applicable to us based on a number of factors, most significantly the Company s percentage of GGP s adjusted revenue and assets and the number of properties. We believe these allocations are reasonable; however, these results do not reflect what our expenses would have

Table of Contents

been had the Company been operating as a separate, stand-alone public company for such period. In addition, the HHC Businesses were operated as subsidiaries of GGP, which operated as a real estate investment trust during such period. We operate as a taxable corporation. The historical combined balance sheet, statement of operations and comprehensive income (loss), statement of equity and statement of cash flows presented for the three months ended March 31, 2010 therefore are not indicative of the results of operations, financial position or cash flows that would have been obtained if we had been an independent, stand-alone entity during such period or of our future performance as an independent, stand-alone entity.

As of March 31, 2011, our assets consisted of the following:

- four master planned communities;
- thirteen operating assets; and
- seventeen strategic developments.

Our ownership interests in properties in which we own a majority or controlling interest are combined for the period from January 1, 2010 through March 31, 2010 and consolidated for the period from January 1, 2011 through March 31, 2011 under GAAP, with the non-controlling interests in such consolidated or combined ventures reflected as components of equity. Our interests in TWCPC Holdings, L.P., (The Woodlands Commercial), the Woodlands Operating Company, L.P. (The Woodlands Operating) and the Woodlands Land Development Company, L.P. (The Woodlands MPC), all located in Houston, Texas and, collectively, the Woodlands Partnerships , and our interests in Westlake Retail Associates, Ltd (Circle T Ranch) and 170 Retail Associates Ltd (Circle T Power Center) and, together with Circle T Ranch, Circle T , located in Dallas/Fort Worth, Texas, are held through joint venture entities in which we own non-controlling interests and are unconsolidated and accounted for on the equity method. The Woodlands Partnerships, Circle T and certain cost method investments (for example, our interest in the Summerlin Hospital Medical Center) are collectively referred to in this report as our Real Estate Affiliates.

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 interim periods ended March 31, 2011 and 2010 are not necessarily indicative of the results to be obtained for the full fiscal year.

Warrants

As described above, on the Effective Date, we issued warrants to purchase up to approximately 8.0 million shares of our common stock to certain of the sponsors of the Plan (the Sponsors Warrants) with an estimated initial value of approximately $69.5 million. The warrants have an initial exercise price of $50.00 per share and will be subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. Approximately 6.08 million warrants are immediately exercisable and approximately 1.92 million warrants are exercisable upon 90 days prior notice for the first 6.5 years after issuance and exercisable without notice any time thereafter. Sponsors Warrants expire on November 9, 2017.

In addition, in 2010 and 2011, the Company entered into certain warrant agreements with David R. Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our Chief Financial Officer, (the Management Warrants), in each case prior to his appointment to such position. Warrants for an aggregate of 2,862,687 shares were issued pursuant to such agreements in exchange for approximately $19 million from such executives at the commencement of their respective employment, which was deemed to be the fair value of such warrants. The Management Warrants have exercise prices of $42.23 per share and $54.50 per share. Generally, the Management Warrants become exercisable in November 2016 and expire by February 2018.

Table of Contents

The aggregate estimated $355.4 million and $227.3 million fair value of the Sponsors and Management Warrants as of March 31, 2011 and December 31, 2010, respectively, has been recorded as a liability because the holders of the warrants could require HHC to settle such warrants in cash due to a subsequent change of control. Such fair values were estimated using an option pricing model and level 3 inputs due to the unavailability of comparable market data. Changes in fair value of the Sponsors Warrants and the Management Warrants have been and will continue to be recognized in earnings and, accordingly, warrant liability expense of approximately $126.0 million was recognized for the three months ended March 31, 2011.

Reorganization and Other 2010 Bankruptcy-Related Items

As certain of the HHC Businesses had filed for bankruptcy protection in April 2009 (the HHC Debtors), these entities are required by GAAP to separately present as Reorganization items elements of expense or income that were incurred or realized as a result of the bankruptcy filings. These items include professional fees and similar types of expenses and gains and interest earned on cash accumulated by certain of our subsidiaries, all as a result of the bankruptcy. Reorganization items specific to the HHC Debtors have been allocated to us and have been reflected in our combined statement of operations and comprehensive income (loss) for the three months ended March 31, 2010 and in the table presented below.

Reorganization items are as follows:

Reorganization Items		Three Months Ended March 31, 2010 (In thousands)
Gains on liabilities subject to compromise - vendors (a)	$	(246)
U.S. Trustee fees		139
Restructuring costs (b)		16,702
Total reorganization items	$	16,595

(a) This amount includes gains from repudiation, rejection or termination of contracts or guarantee of obligations. Such gains reflect agreements reached with certain critical vendors, which were authorized by the Bankruptcy Court and for which payments on an installment basis began in July 2009.
(b) Restructuring costs primarily include professional fees incurred related to the bankruptcy filings, our allocated share of the KEIP payment, finance costs incurred by debtors upon emergence from bankruptcy and any associated write-off of unamortized deferred finance costs related to emerged debtors.

Gains on liabilities subject to compromise represent the income effects of the settlement of certain liabilities of the HHC Debtors that were incurred prior to their bankruptcy filings in 2009. All liabilities incurred by the HHC Debtors prior to such bankruptcy filings were subject to compromise in 2010 as the amounts to be paid were subject to settlement, adjustment, or reinstatement as provided by Chapter 11. The amounts of the various categories of liabilities that were subject to compromise are set forth below and represented the then estimates of known or potential liabilities likely to be resolved in connection with the then planned 2010 emergence from bankruptcy of the HHC Debtors. As the plans of reorganization for the HHC Debtors ultimately approved subsequent to March 31, 2010 provided for, in general, full payment of allowed claims, substantially all recorded liabilities of the HHC Debtors that were subject to compromise at March 31, 2010 were settled, reinstated or retained by the Effective Date. In addition, GGP has agreed that it will reimburse HHC up to $5.0 million for liability claims related to periods prior to the HHC Debtors bankruptcy filings, the majority of which is unpaid as of March 31, 2011.

The amounts subject to compromise at March 31, 2010 consisted of the following items:

		March 31, 2010 (In thousands)
Mortgages and secured notes	$	133,631
Accounts payable and accrued liabilities		136,619
Total liabilities subject to compromise	$	270,250

Table of Contents

Properties

Real estate assets are stated at cost less any provisions for impairments. Construction and improvement costs incurred in connection with the development of new properties or the redevelopment of existing properties are capitalized. Real estate taxes and interest costs incurred during construction periods are also capitalized. Capitalized interest costs are based on qualified expenditures and interest rates in place during the construction period. For these costs, amounts related to the Master Planned Communities are reflected in Master Planned Community assets and in Buildings and equipment for the operating retail properties and Developments in progress for our Strategic Developments assets.

Pre-development costs associated with specifically identified development properties, which generally include legal and professional fees and other directly-related third-party costs, are capitalized as part of the property being developed. In the event that management no longer has the ability or intent to complete a development, the costs previously capitalized are expensed (see also our impairment policies below). Such costs are reflected in Master Planned Community assets for the Master Planned Communities and in Developments in progress for the Strategic Developments properties.

With respect to the operating retail properties, tenant improvements, either paid directly or in the form of construction allowances paid to tenants, are capitalized and depreciated over the applicable lease term. Maintenance and repairs are charged to expense when incurred. Expenditures for significant improvements are capitalized.

Depreciation or amortization expense is computed using the straight-line method based upon the following estimated useful lives:

Asset Type	Years
Buildings and improvements	40-45
Equipment, tenant improvements and fixtures	5-10

Certain of the HHC Businesses, particularly certain properties in our Master Planned Communities segment, were purchased by the Predecessors rather than developed. Accordingly, the acquisitions of such properties were accounted for utilizing the acquisition method. Estimates of future cash flows and other valuation techniques were used to allocate the purchase price of acquired property between land, buildings and improvements, equipment, debt liabilities assumed and identifiable intangible assets and liabilities such as amounts related to in-place at-market tenant leases, acquired above and below-market tenant and ground leases and tenant relationships.

Impairment

The generally accepted accounting principles related to accounting for the impairment or disposal of long-lived assets require that if impairment indicators exist and the undiscounted cash flows expected to be generated by an asset are less than its carrying amount, the fair value of such assets should be estimated and an impairment provision should be recorded to write down the carrying amount of such asset to its estimated fair value. 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. We review our real estate assets (including those held by our Real Estate Affiliates), including operating assets, land held for development and sale, developments in progress and investments in Real Estate Affiliates, for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

If an indicator of potential impairment exists, the asset is tested for recoverability by comparing its carrying amount to the estimated future undiscounted cash flow during our expected holding period. The cash flow estimates used both for determining recoverability and estimating fair value are inherently judgmental and reflect current and projected trends in rental, occupancy, pricing, development costs, sales pace and capitalization rates, and estimated holding periods for the applicable assets. Although the estimated fair value of certain assets may be exceeded by the carrying amount, a real estate asset is only considered to be impaired when its carrying amount is not expected to be recovered through estimated future undiscounted cash flows. To the extent an impairment provision is necessary, the excess of the carrying amount of the asset over its estimated fair value is expensed to operations. In addition, the impairment provision is allocated proportionately to adjust the carrying amount of the asset. The adjusted carrying amount, which represents the new cost basis of the asset, is depreciated over the remaining useful life of the asset or, for Master Planned Communities, is

Table of Contents

expensed as a cost of sales when land is sold. Assets that have been impaired will in the future have lower depreciation and cost of sale expenses, but the impairment will have no impact on cash flow.

Based on our policies and procedures, no impairment provisions were recorded in the three months ended March 31, 2011 and approximately $0.3 million of impairment provisions, on predevelopment costs at certain of our Strategic Developments properties, were recorded in the three months ended March 31, 2010. As of March 31, 2011, certain of our properties had fair values less than their carrying amounts; however, based on the Company s plans with respect to those properties, we believe that the carrying amounts are recoverable and therefore, under applicable GAAP guidance, no additional impairments were taken. Despite this conclusion, additional impairment charges in the future could result if our plans regarding our assets change and/or economic conditions deteriorate. We can provide no assurance that material impairment charges with respect to Master Planned Community assets, Operating Assets, Strategic Developments, Real Estate Affiliates or Developments in progress will not occur in future periods. Accordingly, we will continue to monitor circumstances and events in future periods to determine whether additional impairments are warranted.

Investments in Real Estate Affiliates

We account for investments in joint ventures where we own a non-controlling participating interest using the equity method and, investments in joint ventures where we have virtually no influence on the joint venture s operating and financial policies, on the cost method. Under the equity method, the cost of our investment is adjusted for our share of the equity in earnings (losses) of such Real Estate Affiliates from the date of acquisition and reduced by distributions received. 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. We generally also share in the profit and losses, cash flows and other matters relating to our Real Estate Affiliates in accordance with our respective ownership percentages. Differences between the carrying amount of our investment in the Real Estate Affiliates and our share of the underlying equity of such Real Estate Affiliates are amortized over the related asset lives ranging from five to 45 years. For cost method investments, we recognize earnings to the extent of distributions received from such investments, and along with equity method earnings, is included in Income from Real Estate Affiliates in our consolidated and combined statements of operations and comprehensive income (loss).

Contingent Stock Agreement

In conjunction with GGP s acquisition of The Rouse Company (TRC) in November 2004, GGP assumed TRC s obligations under the Contingent Stock Agreement, (the CSA). TRC entered into the CSA in 1996 when it acquired The Hughes Corporation (Hughes). This acquisition included various assets, including Summerlin (the CSA Assets), a development in our Master Planned Communities segment. The CSA provided that the Beneficiaries receive a share of the cash flow and income from the development or sale of the CSA assets and a final payment representing their share of the valuation of the CSA Assets as of December 31, 2009. The Plan provided that the final payment and settlement of all other claims under the CSA was $230 million (down from the $245 million estimate at December 31, 2009), and such amount was distributed by GGP after the Effective Date. Accordingly, during September 2010, we reduced our carrying value of the CSA assets, and the related GGP equity, by $15 million for this revised estimate.

Fair Value Measurements

The Company is required to estimate the fair value of its long-lived assets, such as its real estate investments, that it determines are impaired. Accordingly, those assets which were impaired in 2009 and 2010 were recorded at their estimated fair value in the year in which impairment occurred. As of March 31, 2011, we do not have any derivative financial instruments and our investments in marketable securities are immaterial.

Table of Contents

The accounting principles for fair value measurements establish a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 - defined as observable inputs such as quoted prices for identical assets or liabilities in active markets;
- Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and
- Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The asset or liability fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. Any fair values utilized or disclosed in our financial statements were developed for the purpose of complying with the accounting principles established for fair value measurements.

For the three months ended March 31, 2011, as discussed above, no real estate assets were considered impaired and therefore no real estate assets were measured at fair value in such period. The only liabilities presented at fair value and measured on a recurring basis at March 31, 2011 are the Sponsor and Management Warrants for which, as discussed above, we recognized approximately $126.0 million of expense in the three months ended March 31, 2011 for the increase in the recorded valuation of such warrants. For the three months ended March 31, 2010, also as discussed above, non-recurring fair value measurements included approximately $0.3 million of impairment provisions, representing the full write-off of various pre-development costs that were determined to be non-recoverable due to the related projects being terminated. In addition, no debt was measured at fair value during the three months ended March 31, 2010 as no HHC Debtors emerged from bankruptcy during this time period.

Fair Value of Financial Instruments

The fair values of our financial instruments approximate their carrying amount in our financial statements except for debt. Management s required estimates of fair value are presented below for our debt at March 31, 2011 and December 31, 2010. This fair value was estimated solely for financial statement reporting purposes and should not be used for any other purposes, including estimating the value of any of the Company s securities. We estimated the fair value of this debt based on quoted market prices for publicly-traded debt, recent financing transactions (which may not be comparable), estimates of the fair value of the property that serves as collateral for such debt, historical risk premiums for loans of comparable quality, the current London Interbank Offered Rate (LIBOR), a widely quoted market interest rate which is frequently the index used to determine the rate at which we borrow funds, U.S. treasury obligation interest rates and on the discounted estimated future cash payments to be made on such debt. The discount rates estimated 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 assume that the debt is outstanding through maturity. We have utilized available market information or present value techniques to estimate the amounts required to be disclosed. Since such amounts are estimates that are based on limited available market information for similar transactions and do not acknowledge transfer or other repayment restrictions that may exist in specific loans, it is unlikely that the estimated fair value of any of such debt could be realized by immediate settlement of the obligation.

Table of Contents

	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Fixed-rate debt	$ 190,421	$ 202,756	$ 191,037	$ 202,897
Variable-rate debt	65,210	65,549	65,518	65,629
SID bonds (*)	59,293	59,293	62,105	62,105
Total	$ 314,924	$ 327,598	$ 318,660	$ 330,631

(*) Due to the uncertain repayment terms of special improvement district (SID) bonds, the carrying value has been used as an approximation of fair value.

Revenue Recognition and Related Matters

Revenues from land sales are recognized using the full accrual method if various criteria provided by GAAP relating to the terms of the transactions and our subsequent involvement with the land sold are met. Revenues relating to transactions that do not meet the established criteria are deferred and recognized when the criteria are met or using the installment or cost recovery methods, as appropriate in the circumstances. In addition, we recognize revenue related to our right to participate in the ultimate home sale proceeds of the builders we sell our lots to as such amounts are collected.

Cost of land sales is determined as a specified percentage of land sales revenues recognized for each community development project. These cost ratios used are based on actual costs incurred and estimates of future development costs and sales revenues to completion of each project. The ratios are reviewed regularly and revised for changes in sales and cost estimates or development plans. Significant changes in these estimates or development plans, whether due to changes in market conditions or other factors, could result in changes to the cost ratio used for a specific project. The specific identification method is used to determine cost of sales for certain parcels of land, including acquired parcels we do not intend to develop or for which development was complete at the date of acquisition.

Nouvelle at Natick is a 215 unit residential condominium project, located in Natick, Massachusetts. Pursuant to the Plan, only the unsold units at Nouvelle at Natick on the Effective Date were distributed to us and no deferred revenue or sales proceeds from unit closings prior to the Effective Date was allocated to us. As of March 31, 2011, 34 units were unsold at Nouvelle at Natick. Income related to unit sales subsequent to the Effective Date is accounted for on a unit-by-unit full accrual method.

Minimum rent revenues are recognized on a straight-line basis over the terms of the related leases. Minimum rent revenues also include amounts collected from tenants to allow the termination of their leases prior to their scheduled termination dates and accretion related to above and below-market tenant leases on acquired properties. Certain of our leases include both a base rent component and a component which requires tenants to pay amounts related to all, or substantially all, of their share of real estate taxes and certain property operating expenses, including common area maintenance and insurance. The portion of the tenant rent from these leases attributable to real estate tax and operating expense recoveries are recorded as tenant recoveries.

Straight-line rent receivables, which represent the current net cumulative rents recognized prior to when billed and collectible as provided by the terms of the leases, of $2.8 million as of March 31, 2011 and $2.0 million as of December 31, 2010, are included in Accounts receivable, net in our consolidated balance sheets.

Percentage rent in lieu of fixed minimum rent received from tenants was $0.9 million for the three months ended March 31, 2011 and $0.7 million for the three months ended March 31, 2010, and is included in Minimum rents in our consolidated and combined statements of operations and comprehensive income (loss).

Table of Contents

Income Taxes

Deferred income taxes are accounted for using the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred income taxes also reflect the impact of operating loss and tax credit carryforwards. A valuation allowance is provided if we believe it is more likely than not that all or some portion of the deferred tax asset will not be realized. There are events or circumstances that could occur in the future that could limit the benefit of deferred tax assets. An increase or decrease in the valuation allowance that results from a change in circumstances, and which causes a change in our judgment about the realizability of the related deferred tax asset, is included in the current year deferred tax provision. In addition, we recognize and report interest and penalties, if necessary, related to uncertain tax positions within our provision for income tax expense.

In many of our Master Planned Communities, gains with respect to sales of land for commercial use are reported for tax purposes on the percentage of completion method. Under the percentage of completion method, gain is recognized for tax purposes as costs are incurred in satisfaction of contractual obligations. The method used for determining the percentage complete for income tax purposes is different than that used for financial statement purposes. In addition, gains with respect to sales of land for single family residences are reported for tax purposes under the completed contract method. Under the completed contract method, gain is recognized for tax purposes when 95% of the costs of our contractual obligations are incurred or the contractual obligation is transferred.

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income available 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 warrants (including fixed awards and nonvested stock issued under stock-based compensation plans) is computed using the treasury stock method.

As defined and described in Note 6, certain HHC Replacement Options outstanding are required to be settled by GGP and therefore do not represent dilutive securities at any date presented. Of the HHC Replacement Options outstanding that are required to be settled by HHC, diluted EPS excludes options where the exercise price was higher than the average market price of our common stock and options for which vesting requirements were not satisfied. Such options totaled 2,497 shares as of March 31, 2011. Finally, the effect of an additional 25 HHC Replacement Options, 651,340 options for our common stock issued in 2011 (Note 6) and 10.9 million shares represented by our outstanding warrants were excluded from diluted EPS as the effect of such items were anti-dilutive due to net losses recognized for all periods presented.

As discussed above, in connection with the Separation on November 9, 2010, GGP distributed to its stockholders 32.5 million shares of our common stock and approximately 5.25 million shares were purchased by certain investors sponsoring the Plan. This share amount is being used in the calculation of basic and diluted EPS for the three months ended March 31, 2010 as our common stock was not traded prior to November 9, 2010 and there were no dilutive securities in the prior periods.

Table of Contents

Information related to our EPS calculations is summarized as follows:

	Three Months Ended March 31,			
	2011		2010	
	Basic	Diluted	Basic	Diluted
	(In thousands)			
Numerators:				
Net loss	$ (114,487)	$ (114,487)	$ (20,481)	$ (20,481)
Allocation to noncontrolling interests	(28)	(28)	(48)	(48)
Net loss attributable to common stockholders	$ (114,515)	$ (114,515)	$ (20,529)	$ (20,529)
Denominators:				
Weighted average number of common shares outstanding - basic	37,905	37,905	37,716	37,716
Effect of dilutive securities				
Weighted average number of common shares outstanding - diluted	37,905	37,905	37,716	37,716

Municipal Utility Districts

In Houston, Texas, certain development costs are reimbursable through the creation of Municipal Utility Districts (MUDS) and Water Control and Improvement Districts, which are separate political subdivisions authorized by Article 16, Section 59 of the Texas Constitution and governed by the Texas Commission on Environmental Quality (TCEQ). MUDs are formed to provide municipal water, waste water, drainage services, recreational facilities and roads to those areas where they are currently unavailable through the regular city services. Typically, the developer advances funds for the creation of the facilities, which must be designed, bid and constructed in accordance with the City of Houston s and TCEQ requirements. The developer initiates the MUD process by filing the applications for the formation of the MUD, and once the applications have been approved, a board of directors is elected for the MUD and given the authority to issue ad valorem tax bonds and the authority to tax residents. The MUD Board authorizes and approves all MUD development contracts and pay estimates. The Company estimates the costs it believes will be eligible for reimbursement for MUD receivables and MUD bond sale proceeds are used to reimburse the developer for its construction costs, including interest. MUD taxes are used to pay the debt service on the bonds and the operating expenses of the MUD. The Company estimates the costs it believes will be eligible for reimbursement as MUD receivables and has not incurred any debt relating to the MUDs.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. For example, estimates and assumptions have been made with respect to useful lives of assets, capitalization of development and leasing costs, provision for income taxes, recoverable amounts of receivables and deferred taxes, initial valuations and related amortization periods of deferred costs and intangibles, particularly with respect to acquisitions, impairment of long-lived assets and goodwill, fair value of warrants and debt and cost ratios and completion percentages used for land sales. Actual results could differ from these and other estimates.

Table of Contents

NOTE 2 INTANGIBLE ASSETS AND LIABILITIES

The following table summarizes our intangible assets and liabilities:

	Gross Asset (Liability)	Accumulated (Amortization) / Accretion (In thousands)	Net Carrying Amount
As of March 31, 2011			
Tenant leases:			
In-place value	$ 11,738	$ (10,262)	$ 1,476
Above-market	1,820	(1,768)	52
Below-market			
Ground leases:			
Above-market	(3,545)	756	(2,789)
Below-market	23,096	(2,162)	20,934
As of December 31, 2010			
Tenant leases:			
In-place value	$ 11,824	$ (10,221)	$ 1,603
Above-market	1,820	(1,701)	119
Below-market	(77)	77	
Ground leases:			
Above-market	(3,545)	638	(2,907)
Below-market	23,096	(2,078)	21,018

The gross asset balances of the in-place value of tenant leases are included in Buildings and equipment in our consolidated balance sheets. The above-market and below-market tenant and ground leases are included in Prepaid expenses and other assets and Accounts payable and accrued expenses in our consolidated balance sheets.

Amortization/accretion of these intangible assets and liabilities decreased our income (excluding the impact of noncontrolling interests and the provision for income taxes) by $0.2 million for the three months ended March 31, 2011 and 2010.

Future amortization of these intangible assets and liabilities is estimated to decrease net income (excluding the impact of noncontrolling interests and the provision for income taxes) by approximately $0.3 million in 2011, $0.3 million in 2012, $0.2 million in 2013, $0.1 million in 2014 and zero in 2015.

NOTE 3 REAL ESTATE AFFILIATES

We own noncontrolling investments in The Woodlands Partnerships and Circle T whereby, generally, we share in the profits and losses, cash flows and other matters relating to our investments in Real Estate Affiliates in accordance with our respective ownership percentages. As we have joint interest and joint control of these ventures with our venture partners, we account for these joint ventures using the equity method. For cost method investments (Note 1), we recognize earnings to the extent of distributions received from such investments, which are included, along with equity method earnings, in Income from Real Estate Affiliates in our consolidated and combined statements of operations and comprehensive income (loss).

As of March 31, 2011, approximately $331.6 million of indebtedness was secured by the properties owned by our Real Estate Affiliates, our share of which was approximately $141.0 million.

Table of Contents

Condensed Combined Financial Information of Certain Real Estate Affiliates

As The Woodlands Partnerships and Circle T are accounted for on the equity method, the following summarized financial information as of March 31, 2011 and December 31, 2010 and for the three months ended March 31, 2011 and 2010, is presented below:

	March 31, 2011	December 31, 2010
	(In thousands)	
Condensed Combined Balance Sheets - Certain Real Estate Affiliates		
Assets:		
Land	$ 31,077	$ 31,077
Building and equipment	241,426	241,436
Less accumulated depreciation	(83,164)	(81,218)
Developments in progress	26,222	25,431
Net property and equipment	215,561	216,726
Land held for development and sale	232,105	237,117
Net investment in real estate	447,666	453,843
Cash and cash equivalents	57,344	99,769
Accounts and notes receivable, net	39,003	45,863
Deferred expenses, net	5,532	895
Prepaid expenses and other assets	41,535	41,663
Total assets	$ 591,080	$ 642,033
Liabilities and Owners Equity:		
Mortgages, notes and loans payable	$ 331,650	$ 372,222
Accounts payable, accrued expenses and other liabilities	114,868	122,877
Owners equity	144,562	146,934
Total liabilities and owners equity	$ 591,080	$ 642,033
Investment in Real Estate Affiliates, Net		
Owners equity	$ 144,562	$ 146,934
Less joint venture partners equity	(69,117)	(70,243)
Basis differences, loans and cost basis investments	75,648	72,852
Investment in Real Estate Affiliates	$ 151,093	$ 149,543

Table of Contents

	Three Months Ended March 31, 2011	2010
	(In thousands)	
Condensed Combined Statements of Income - Certain Real Estate Affiliates		
Revenue:		
Land sales	$ 21,973	$ 23,386
Tenant rents	1,841	921
Other	12,770	11,336
Total revenues	36,584	35,643
Expenses:		
Cost of sales - land	11,490	12,149
Land sales operations	5,319	6,156
Real estate taxes	499	490
Property maintenance costs	469	(85)
Other property operating costs	11,159	10,458
Provision for impairment		(1)
Depreciation and amortization	1,930	1,965
Total operating expenses	30,866	31,132
Operating income	5,718	4,511
Interest income	445	769
Interest expense	(4,009)	(2,902)
Provision for income taxes	(497)	(310)
Net income attributable to joint venture partners	$ 1,657	$ 2,068
Income from Real Estate Affiliates:		
Net income attributable to joint venture partners	$ 1,657	$ 2,068
Joint venture partners share of income	(787)	(983)