Howard Hughes Corp
Form 10-Q
August 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

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	**36-4673192**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

13355 Noel Road, 22nd Floor, 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 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. x Yes 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). x Yes 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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (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, $0.01 par value, outstanding as of August 5, 2012 was 37,973,640.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	June 30, 2012	December 31, 2011
	(In thousands, except share amounts)	
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,597,244	$ 1,602,437
Land	253,024	236,363
Buildings and equipment	627,554	556,786
Less: accumulated depreciation	(101,169)	(92,494)
Developments in progress	204,450	195,034
Net property and equipment	2,581,103	2,498,126
Investment in Real Estate Affiliates	32,597	62,595
Net investment in real estate	2,613,700	2,560,721
Cash and cash equivalents	254,288	227,566
Accounts receivable, net	15,315	15,644
Municipal Utility District receivables, net	94,710	86,599
Notes receivable, net	30,182	35,354
Tax indemnity receivable, including interest	326,972	331,771
Deferred expenses, net	12,549	10,338
Prepaid expenses and other assets, net	119,987	127,156
Total assets	$ 3,467,703	$ 3,395,149
Liabilities:		
Mortgages, notes and loans payable	$ 659,397	$ 606,477
Deferred tax liabilities	76,876	75,966
Warrant liabilities	226,185	127,764
Uncertain tax position liability	133,404	129,939
Accounts payable and accrued expenses	119,435	125,404
Total liabilities	1,215,297	1,065,550
Commitments and Contingencies (see Note 13)		
Equity:		
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued		
Common stock: $.01 par value; 150,000,000 shares authorized, 37,973,640 shares issued and outstanding as of June 30, 2012 and 37,945,707 shares issued and outstanding as of December 31, 2011	379	379
Additional paid-in capital	2,713,178	2,711,109
Accumulated deficit	(459,275)	(381,325)
Accumulated other comprehensive loss	(8,308)	(5,578)
Total stockholders equity	2,245,974	2,324,585
Noncontrolling interests	6,432	5,014
Total equity	2,252,406	2,329,599

Total liabilities and equity	$	3,467,703	$	3,395,149

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	$ 43,928	$ 18,148	$ 80,017	$ 41,540
Builder price participation	1,528	597	2,341	1,118
Minimum rents	20,577	16,976	39,474	33,695
Tenant recoveries	6,003	4,615	11,867	9,139
Condominium unit sales	134	6,660	267	10,424
Resort and conference center revenues	11,970		21,626	
Other land revenues	3,531	2,257	7,048	3,556
Other rental and property revenues	6,268	1,568	11,062	4,451
Total revenues	93,939	50,821	173,702	103,923
Expenses:				
Master Planned Community cost of sales	22,978	9,438	41,657	24,874
Master Planned Community operations	9,979	4,941	21,026	11,027
Rental property real estate taxes	3,171	2,630	7,009	5,783
Rental property maintenance costs	2,086	1,563	4,041	3,123
Condominium unit cost of sales	36	5,273	96	8,252
Resort and conference center operations	7,371		14,785	
Other property operating costs	15,044	10,135	29,373	20,004
Provision for doubtful accounts	164	304	45	315
General and administrative	8,160	7,662	16,557	12,483
Depreciation and amortization	5,893	3,186	10,951	6,383
Total expenses	74,882	45,132	145,540	92,244
Operating income	19,057	5,689	28,162	11,679
Interest income	2,342	2,243	4,673	4,754
Interest expense	(200)		(201)	
Warrant liability gain (loss)	23,430	56,910	(98,421)	(69,135)
Loss on remeasurement of tax indemnity receivable	(8,782)		(8,782)	
Equity in earnings from Real Estate Affiliates	446	2,110	3,122	7,623
Income (loss) before taxes	36,293	66,952	(71,447)	(45,079)
Provision for income taxes	1,301	959	5,085	3,415
Net income (loss)	34,992	65,993	(76,532)	(48,494)
Net income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Net income (loss) attributable to common stockholders	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)
Basic Income (Loss) Per Share:	$ 0.91	$ 1.74	$ (2.06)	$ (1.28)

Diluted Income (Loss) Per Share:	$	0.27	$	0.22	$	(2.06)	$	(1.28)

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except per share amounts)			
Comprehensive Income (Loss), Net of Tax:				
Net income (loss)	$ 34,992	$ 65,993	$ (76,532)	$ (48,494)
Other comprehensive income (loss):				
Interest rate swap	(2,263)	(748)	(2,161)	(748)
Capitalized swap interest	(159)		(569)	
Pension plan adjustment		(63)		(128)
Other comprehensive loss	(2,422)	(811)	(2,730)	(876)
Comprehensive income (loss)	32,570	65,182	(79,262)	(49,370)
Comprehensive income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Comprehensive income (loss) attributable to common stockholders	$ 31,888	$ 65,162	$ (80,680)	$ (49,418)

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

(UNAUDITED)

(In thousands, except shares)	Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests in Consolidated Ventures	Total Equity
Balance January 1, 2011	37,904,506	$ 379	$ 2,708,036	$ (528,505)	$ (1,627)	$ 824	$ 2,179,107
Net income (loss)				(48,542)		48	(48,494)
Distributions to noncontrolling interests						(63)	(63)
Other comprehensive loss					(876)		(876)
Stock plan activity	37,601		1,245				1,245
Balance, June 30, 2011	37,942,107	$ 379	$ 2,709,281	$ (577,047)	$ (2,503)	$ 809	$ 2,130,919
Balance January 1, 2012	37,945,707	$ 379	$ 2,711,109	$ (381,325)	$ (5,578)	$ 5,014	$ 2,329,599
Net income (loss)				(77,950)		1,418	(76,532)
Interest rate swaps, net of tax ($150)					(2,161)		(2,161)
Capitalized swap interest, net of tax $330					(569)		(569)
Stock plan activity	27,933		2,069				2,069
Balance, June 30, 2012	37,973,640	$ 379	$ 2,713,178	$ (459,275)	$ (8,308)	$ 6,432	$ 2,252,406

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

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands)	
Cash Flows from Operating Activities:		
Net loss	$ (76,532)	$ (48,494)
Adjustments to reconcile net loss to cash provided by operating activities:		
Loss on remeasurement of tax indemnity receivable	8,782	
Equity in earnings (loss) from Real Estate Affiliates, net of distributions	72	(3,547)
Provision for doubtful accounts	45	315
Depreciation	8,853	5,435
Amortization	2,098	948
Amortization of deferred financing costs and debt market rate adjustments, net	(155)	277
Amortization of intangibles other than in-place leases	(89)	45
Straight-line rent amortization	(482)	(758)
Deferred income taxes	4,612	3,302
Restricted stock and stock option amortization	2,069	876
Warrant liability loss	98,421	69,135
Master Planned Community and condominium development expenditures	(47,235)	(33,206)
Master Planned Community and condominium cost of sales	39,467	29,938
Net changes:		
Accounts and notes receivable	9,682	2,512
Prepaid expenses and other assets	2,191	(3,803)
Deferred expenses	(1,730)	(492)
Accounts payable and accrued expenses	(20,508)	(234)
Other, net	(10)	(5,256)
Cash provided by operating activities	29,551	16,993
Cash Flows from Investing Activities:		
Real estate and property expenditures	(20,036)	(18,565)
Consideration paid to acquire Millennium Waterway Apartments, net of cash acquired	(2,721)	
Distribution from Millennium Waterway Apartments	6,876	
Proceeds from sales of investment in Real Estate Affiliates	8,579	
Investments in Real Estate Affiliates	(1,450)	(42)
Decrease in restricted cash	7,703	
Cash used in investing activities	(1,049)	(18,607)
Cash Flows from Financing Activities:		
Proceeds from issuance of mortgages, notes and loans payable	35,827	29,000
Principal payments on mortgages, notes and loans payable	(36,308)	(38,049)
Deferred financing costs	(1,299)	
Proceeds from issuance of management warrants		2,000
Distributions to noncontrolling interests		(63)
Cash used in financing activities	(1,780)	(7,112)

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	Six Months Ended June 30, 2012	2011
	(In thousands)	
Net change in cash and cash equivalents	26,722	(8,726)
Cash and cash equivalents at beginning of period	227,566	284,682
Cash and cash equivalents at end of period	$ 254,288	$ 275,956
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 10,284	$ 7,410
Interest capitalized	13,253	8,707
Income taxes paid	824	
Non-Cash Transactions:		
Consolidation of partner s interest:		
Land	(15,917)	
Building and equipment	(56,002)	
Other Assets	(2,669)	
Mortgages, notes and loans payable	55,584	
Other liabilities	754	
Reduction in investments in Real Estate Affiliates due to the Millennium Waterway Apartments acquisition	22,405	
Special Improvement District bond transfers associated with land sales	(2,189)	(3,188)
Real estate and property expenditures	4,345	
Prepetition liabilities funded by GGP		2,714

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

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the SEC. Such condensed consolidated financial statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (Quarterly Report) should refer to The Howard Hughes Corporation s (HHC or the Company) audited Consolidated Financial Statements for the year ended December 31, 2011 which are included in the Company s Annual Report on Form 10-K (the Annual Report) for the fiscal year ended December 31, 2011. 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. We have made certain reclassifications in 2011 to conform to the 2012 presentation. In 2011, we reclassified $3.3 million of deferred income taxes from accounts payable and accrued expenses on the Condensed Consolidated Statements of Cash Flows to conform to the 2012 presentation. During the second quarter of 2012, we reclassified certain salaries and overhead costs relating to land development activities for The Woodlands from general and administrative expenses to Master Planned Community operations. Reclassification of $1.4 million for the six months ended June 30, 2012 was related to the three months ended March 31, 2012, and reclassifications of $1.3 million and $2.5 million were related to the three and six months ended June 30, 2011, respectively. In addition, we reclassified operating costs related to the Columbia office properties from general and administrative expenses to other property costs. The amounts reclassified were $0.1 million and $0.3 million for the three months and six months ended June 30, 2011. The results for the interim period ended June 30, 2012 and 2011 are not necessarily indicative of the results to be expected for the full fiscal year.

As more fully described in Note 4, on July 1, 2011, we acquired our partner s 47.5% economic interest in The Woodlands not previously owned by us. As a result of the acquisition, beginning on July 1, 2011, we consolidated the financial results of The Woodlands which were previously accounted for under the equity method. Our financial statements as of and for the six months ended June 30, 2012 are not comparable to the same period in 2011 due to the consolidation of The Woodlands.

Management has evaluated all material events occurring subsequent to the date of the condensed consolidated financial statements up to the date and time this Quarterly Report is filed on Form 10-Q.

NOTE 2 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010 (the Effective Date), we issued warrants to purchase 8.0 million shares of our common stock to certain of the sponsors (the Sponsors Warrants) with an estimated initial value of approximately $69.5 million. The initial exercise price for the warrants of $50.00 per share is subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. Approximately 6.1 million warrants are immediately exercisable and approximately 1.9 million warrants are exercisable upon 90 days prior notice for the first 6.5 years after issuance and are subsequently exercisable without notice any time thereafter. The Sponsors Warrants expire on November 9, 2017.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The estimated $178.4 million fair value for the Sponsors Warrants and estimated $47.8 million fair value for the Management Warrants as of June 30, 2012, have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data. The estimated fair values for the Sponsor Warrants and Management Warrants were $102.6 million and $25.2 million, respectively, as of December 31, 2011. Changes in the fair value of the Sponsors Warrants and the Management Warrants are recognized in earnings, and accordingly, a warrant liability gain of $23.4 million and a warrant liability loss of $98.4 million were recognized for the three and six months ended June 30, 2012, respectively, compared to a warrant liability gain of $56.9 million and a warrant liability loss of $69.1 million for the three and six months ended June 30, 2011, respectively.

NOTE 3 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 any potentially dilutive common shares. The dilutive effect of options and non-vested stock issued under stock-based compensation plans is computed using the treasury stock method. The dilutive effect of the Sponsors Warrants and Management Warrants is computed using the if-converted method. Gains, if any, associated with the Sponsors Warrants and Management Warrants are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti-dilutive.

Information related to our EPS calculations is summarized as follows:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except per share amounts)			
Basic EPS:				
Numerator:				
Net income (loss)	$ 34,992	$ 65,993	$ (76,532)	$ (48,494)
Net income attributable to noncontrolling interests	(682)	(20)	(1,418)	(48)
Net income (loss) attributable to common stockholders	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)
Denominator:				
Weighted average basic common shares outstanding	37,907	37,897	37,905	37,897
Diluted EPS:				
Numerator:				
	$ 34,310	$ 65,973	$ (77,950)	$ (48,542)

Net income (loss) attributable to common stockholders								
Less: Warrant liability gain		(23,430)		(56,910)				
Adjusted net income (loss) available to common stockholders	$	10,880	$	9,063	$	(77,950)	$	(48,542)
Denominator:								
Weighted average basic common shares outstanding		37,907		37,897		37,905		37,897
Restricted stock and stock options		5		3				
Warrants		2,339		2,970				
Weighted average diluted common shares outstanding		40,251		40,870		37,905		37,897
Basic Earnings (Loss) Per Share:	$	0.91	$	1.74	$	(2.06)	$	(1.28)
Diluted Earnings (Loss) Per Share:	$	0.27	$	0.22	$	(2.06)	$	(1.28)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The diluted EPS computation for the three months ended June 30, 2012 excludes 847,937 stock options and 14,900 shares of restricted stock because their inclusion would have been anti-dilutive. The diluted EPS computation for the six months ended June 30, 2012 excludes 847,937 stock options, 57,933 shares of restricted stock and 10,862,687 Sponsors and Management warrants because their inclusion would have been anti-dilutive.

NOTE 4 ACQUISITIONS AND DISPOSITIONS

On May 31, 2012, we acquired our partner s interest in the 393-unit Millennium Waterway Apartments for $6.9 million, following the funding of a $55.6 million ten-year non-recourse mortgage bearing a 3.75% interest rate. Total assets of $78.6 million and liabilities of $56.4 million, including the recently funded loan, were consolidated into our financial statements at fair value as of the acquisition date. Prior to the acquisition, we accounted for our investment in Millennium Waterway Apartments under the equity method. We now own 100% of this stabilized Class A multi-family property located in The Woodlands Town Center. This transaction did not represent a significant acquisition of assets under the SEC rules. Included in the consolidated statements of income (loss) since the acquisition date are revenues of $0.6 million and net income of $0.3 million for the three months ended June 30, 2012. In conjunction with this acquisition, we entered into a new joint venture with the partner to construct a 314-unit Class A multi-family property. Please refer to Note 7 Real Estate Affiliates for a description of the new joint venture.

As previously disclosed in our annual report, we are actively pursuing the sale of our 22-acre site in Pocatello, Idaho (Alameda Plaza). On July 6, 2012, we sold 11.5 acres consisting of 104,705 square feet of mostly vacant retail space for $4.6 million. We are continuing to explore the sale of the remaining 10.5 acres consisting of 85,636 square feet of mostly vacant retail space.

On July 1, 2011, we acquired our partner s 47.5% economic interest (represented by a 57.5% legal interest) in TWCPC Holdings, L.P., The Woodlands Operating Company, L.P. and TWLDC Holdings, L.P. (collectively referred to as The Woodlands) for $117.5 million. The Woodlands is located near Houston, Texas. We made the acquisition so that we can control attractive residential and commercial future development opportunities and assets as well as to internalize The Woodlands platform to benefit our Master Planned Community (MPC) business. As a result of the acquisition, we now consolidate The Woodlands operations and our condensed consolidated financial statements are therefore not comparable to prior periods. Please refer to Note 15 Segments for a presentation of the results as if we consolidated The Woodlands for all periods presented. Prior to such acquisition, we accounted for The Woodlands using the equity method.

Pro Forma Information

The following pro forma information for the three and six months ended June 30, 2011 was prepared as if The Woodlands acquisition had occurred as of the beginning of such period:

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
	(In thousands)	
Total revenues	$ 95,586	$ 185,847
Net income (loss) attributable to common shareholders	72,702	(37,888)

Pro forma adjustments were made for: (1) purchase accounting, including (a) depreciation for the step-up in basis for property, plant and equipment, (b) amortization of in-place and above/below market leases, (c) land cost of sales increase for step-up in land basis for finished lots acquired and sold and (d) amortization of deferred financing costs,

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

prepaid commissions and deferred profits which were eliminated and (2) adjustments for interest expense which is capitalizable in accordance with the Company s interest capitalization policy.

The pro forma information is not necessarily indicative of the results that would have occurred had the acquisition occurred as of the beginning of the period presented, nor is it necessarily indicative of future results.

NOTE 5 IMPAIRMENT

We review our real estate assets, including operating assets, land held for development and sale and developments in progress, for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Generally accepted accounting principles require that if impairment indicators exist and the undiscounted cash flows expected to be generated by an asset are less than its carrying amount, an impairment provision should be recorded to write down the carrying amount of such asset to its 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.

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

There were no impairment charges recorded during the three or six months ended June 30, 2012 and 2011.

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	June 30, 2012	December 31, 2011

	Fair Value Measurements Using				Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)				(In thousands)			
Liabilities								
Warrants	$ 226,185	$	$	$ 226,185	$ 127,764	$	$	$ 127,764
Interest rate swaps	6,697		6,697		4,367		4,367	

The valuation of warrants is based on an option pricing valuation model. The inputs to the model include the fair value of the stock related to the warrants, exercise price of the warrants, term, expected volatility, risk-free interest rate and dividend yield.

The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts and includes consideration

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of counterparty credit risk. The variable cash receipts are based on an expectation of future interest rates derived from observable market interest rate curves.

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

	2012	2011
	(In thousands)	
Balance as of December 31,	$ 127,764	$ 227,348
Warrant liability loss	98,421	69,135
Purchases		2,000
Balance as of June 30,	$ 226,185	$ 298,483

The significant unobservable input used in the fair value measurement of our warrants designated as Level 3 is as follows:

	Fair Value (In thousands)	Valuation Technique	Unobservable Input	Range/ Average
Warrants	$ 226,185	Option Pricing Valuation Model	Expected Volatility (a)	27%-33% (29.6%)

(a) Based on the asset volatility of comparable companies.

The expected volatility in the table above is a significant unobservable input used to estimate the fair value of our warrant liabilities. An increase in expected volatility would increase the fair value of the liability, while a decrease in expected volatility would decrease the fair value of the liability.

The following table summarizes our assets and liabilities that were measured at fair value on a non-recurring basis as a result of the acquisition of our partner s interest in the Millennium Waterway Apartments.

	Quoted Prices in	Significant		Total Loss (Gain)

	Total Fair Value Measurement	Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2) (In thousands)	Significant Unobservable Inputs (Level 3)	Three and Six Months Ended June 30, 2012
Investment in Real Estate Affiliates	$ 22,405	$ 22,405(a)	$	$	$

(a) We measured our equity interest in Millennium Waterway Apartments based on our purchase of our partners 23.5% economic interest in Millennium Waterway Apartments. We used Level 1 inputs for the cash payment.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	June 30, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Fixed-rate debt	$ 142,624	$ 144,098	$ 83,164	$ 85,047
Variable-rate debt (a)	465,046	465,046	468,100	468,100
SID bonds (b)	51,727	51,727	55,213	55,213
Total	$ 659,397	$ 660,871	$ 606,477	$ 608,360

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

(b) Due to the uncertain repayment terms of the Special Improvement District (SID) bonds, the carrying value approximates fair value.

The fair value of debt in the table above was estimated based on level 2 inputs which includes 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 reflect our judgment as to what the approximate current lending rates for loans or groups of loans with similar maturities and credit quality would be if credit markets were operating efficiently and assuming that the debt is outstanding through maturity.

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

Notes receivable are carried at net realizable value which approximates fair value. Factors considered by us in determining the net realizable value include current interest rates, maturity date, credit worthiness of the borrower and any collateral pledged as security.

NOTE 7 REAL ESTATE AFFILIATES

In the ordinary course of business, we enter into partnerships or joint ventures primarily for the development and operations of real estate assets. These partnerships or joint ventures are typically characterized by a non-controlling ownership interest with decision making and distribution of expected gains and losses being proportionate to the ownership interest. We account for these partnerships and joint ventures in accordance with

ASC 810, as amended (ASC 810).

In accordance with ASC 810, we assess our partnerships or joint ventures at inception to determine if any meet the qualifications of a variable interest entity (VIE). We consider a partnership or joint venture to be a VIE if: (a) the total equity investment is not sufficient to permit the entity to finance its activities without additional subordinated financial support; (b) characteristics of a controlling financial interest are missing (either the ability to make decisions through voting or other rights, the obligation to absorb the expected losses of the entity or the right to receive the expected residual returns of the entity); or (c) the voting rights of the equity holders are not proportional to their obligations to absorb the expected losses of the entity and/or their rights to receive the expected residual returns of the entity, and substantially all of the entity s activities either involve or are conducted on behalf of an investor that has disproportionately few voting rights. Upon the occurrence of certain events outlined in ASC 810,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

we reassess our initial determination of whether the partnership or joint venture is a VIE. We also perform a qualitative assessment of each VIE to determine if we are the primary beneficiary, as required by ASC 810.

We account for investments in joint ventures deemed to be variable interest entities for which we are not considered to be the primary beneficiary 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. 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.

On May 14, 2012, we entered into a joint venture, Millennium Woodlands Phase II, LLC (Millennium Phase II), with the same partner from Millennium Waterway Apartments as discussed in Note 4 on the construction of a 314-unit Class A multi-family unit in The Woodlands Town Center. Our partner is the managing member of Millennium Phase II. As the managing member, our partner controls, directs, manages and administers the affairs of Millennium Phase II. Millennium Phase II is a variable interest entity, and although we have the majority ownership interest in the joint venture, we determined that we are not the primary beneficiary because our partner has the power to direct activities that most significantly impact the economic performance of the joint venture. On July 5, 2012, Millennium Phase II was capitalized by our contribution of 4.8 acres of land valued at $15.5 million to the joint venture, our partner s contribution of $3.0 million in cash, and by a construction loan in the amount of $37.7 million which is guaranteed by our partner. Currently, there is no outstanding balance on this loan. The development of Millennium Phase II further expands our portfolio in the vibrant Woodlands Town Center.

The Bridges at Mint Hill, LLC, Parcel D Development, LLC, and the HHMK Development, LLC joint venture entities included in the table below are VIEs. The aggregate carrying value of the unconsolidated VIEs was $4.6 million and $3.2 million as of June 30, 2012 and December 31, 2011, respectively, and was classified as Investments in Real Estate Affiliates in the Condensed Consolidated Balance Sheet. Because these joint ventures are in the pre-development stage, there were no earnings for the three and six months ended June 30, 2012. We did not hold an interest in any VIEs as of or during the three and six months ended June 30, 2011. Our maximum exposure to loss as a result of these investments is limited to the aggregate carrying value of the investment as we have not provided any guarantees on behalf of these VIEs. Our initial ownership in the Bridges at Mint Hill, LLC is 79.0%, and our ownership percentage could increase to 90.5% if we are required to make a $4.5 million cash contribution to the venture related to a mortgage secured by land to be contributed by our partner.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Below is a summary of our Investments in Real Estate Affiliates:

	Economic Ownership		Carrying Value		Share of Earnings/Dividends			
					Three Months Ended June 30,		Six Months Ended June 30,	
	June 30, 2012	December 31, 2011	June 30, 2012	December 31, 2011	2012	2011	2012	2011
	(In percentages)		(In thousands)		(In thousands)			
The Woodlands (a)			$	$	$	$ 2,110	$	$ 3,729
Bridges at Mint Hill, LLC	79.00%	79.00%	503	180				
Circle T	50.00%	50.00%	9,004	9,004				
Forest View (b) (c)		50.00%		5,358	1		2	
HHMK Development, LLC	50.00%	50.00%	418					
Millennium Waterway Apartments (d)	100.00%	83.55%		21,998	185		406	
Millennium Woodlands Phase II, LLC (e)	81.43%							
Parcel D Development, LLC	50.00%	50.00%	3,673	2,990				
Stewart Title (b)	50.00%	50.00%	3,684	3,643	257		316	
Timbermill Apartments (b) (c)		50.00%		3,988	1		2	
Woodlands Sarofim#1 (b)	20.00%	20.00%	2,476	2,456	2		20	
			19,758	49,617	446	2,110	746	3,729
Cost basis investments (f)			12,839	12,978			2,376	3,894
Total			$ 32,597	$ 62,595	$ 446	$ 2,110	$ 3,122	$ 7,623

(a) As of July 1, 2011, The Woodlands is consolidated and no longer a Real Estate Affiliate (Refer to Note 4). For the three and six months ended June 30, 2011, we owned 52.5% economic interest in The Woodlands.

(b) Equity investment consolidated into our financial statements as part of the acquisition of our partner s economic interest in The Woodlands on July 1, 2011.

(c) On April 19, 2012, the joint ventures owning the Forest View and Timbermill Apartments completed their sale to a third party. Our share of the distributable cash, after repayment of debt and transaction expenses, was $8.6 million. Also in April, we received approximately $0.8 million in distributions from earnings from these joint

(d) On May 31, 2012, we acquired our partner s interest for $6.9 million. We now consolidate this property.

(e) Represents our ownership percentage as of July 5, 2012, the date that the partners contributed capital to the venture.

(f) Includes dividends received from Summerlin Hospital Medical Center.

As of June 30, 2012, approximately $6.9 million of indebtedness was secured by the properties owned by our Real Estate Affiliates in which our share was approximately $1.4 million (Woodlands Sarofim #1) based upon our economic ownership. All of this debt is non-recourse to us.

NOTE 8 MORTGAGES, NOTES AND LOANS PAYABLE

Mortgages, notes and loans payable are summarized as follows:

	June 30, 2012	December 31, 2011
	(In thousands)	
Fixed-rate debt:		
Collateralized mortgages, notes and loans payable	$ 142,624	$ 83,164
Special Improvement District bonds	51,727	55,213
Variable-rate debt:		
Collateralized mortgages, notes and loans payable	465,046	468,100
Total mortgages, notes and loans payable	$ 659,397	$ 606,477

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Property	Final Maturity (a)	Interest Rate	Maximum Facility Amount	Carrying Value June 30, 2012	Carrying Value December 31, 2011
				(In thousands)	
110 N. Wacker (b)	October 2019	5.21%		$ 29,000	$ 29,000
Bridgeland					
Note #1 - #4	various dates December 2017 - May 2033	6.50%			20,604
Land Loan (c)	June 2022	5.50%		18,066	
Development Loan (d)	June 2015	5.00%	$ 30,000	3,026	
Bridgeland Total				21,092	20,604
Special Improvement District					
Summerlin South - S108	December 2016	5.95%		1,183	1,302
Summerlin South - S124	December 2019	5.95%		342	378
Summerlin South - S128	December 2020	7.30%		825	862
Summerlin South - S128C	December 2030	6.05%		5,847	5,956
Summerlin South - S132	December 2020	7.88%		5,079	5,378
Summerlin South - S151	June 2025	6.00%		11,378	12,293
Summerlin West - S808	April 2021	5.71%		71	682
Summerlin West - S809	April 2023	6.65%		104	1,000
Summerlin West - S810	April 2031	7.13%		22,483	22,770
The Shops at Summerlin Centre - S128	December 2030	6.05%		3,765	3,829
The Shops at Summerlin Centre - S108	December 2016	5.95%		650	713
SID Payable to Nevada Cancer Institute	December 2019	5.95%			50
Special Improvement District bonds Total				51,727	55,213
The Woodlands					
Master Credit Facility (e)	March 2015	5.00%	$ 270,000	176,703	183,000
Resort and Conference Center (f)	October 2013	6.00%		36,100	36,100
2201 Lake Woodlands Drive	November 2016	5.25%			4,803
Weiner Tract	January 2013	6.25%			1,479
Land in Montgomery Co.	December 2012	6.00%			649
Land in Harris Co.	January 2013	6.00%			381
Capital lease obligation		2.72%		95	147
CVS	upon sale	3.25%			101
4 Waterway Square	December 2023	4.88%		40,575	41,000
9303 New Trails	December 2023	4.88%		13,855	14,000
3 Waterway Square (g)	January 2017	3.25%	$ 43,295	216	

20/25 Waterway	May 2022	4.79%		14,450	
Millennium Waterway Apartments (h)	June 2022	3.75%		55,584	
The Woodlands Total				337,578	281,660
Ward Centers					
Victoria Ward (i)	September 2016	3.43%	$ 250,000	220,000	220,000
Ward Centers Total				220,000	220,000
				$ 659,397	$ 606,477

(a) Maturity date includes any extension option periods which are within our control.

(b) Loan has a stated interest rate of one-month LIBOR + 2.25%. The $29.0 million outstanding principal balance is swapped to a 5.21% fixed rate through maturity.

(c) Loan is for ten year term. First five years interest is fixed at 5.50% and for second five years interest rate is floating based on three-month LIBOR +2.75%.

(d) Revolving development loan provides for a maximum of $30.0 million outstanding balance at any time with all draws not exceeding $140.0 million. The loan bears interest at three-month LIBOR + 3.25% and has a 5% minimum rate.

(e) Loan bears interest at one-month LIBOR + 4.00% and has a 1.00% LIBOR floor.

(f) Loan currently bears interest at one-month LIBOR + 5.00% and has a 1.00% LIBOR floor. The rate increases by 0.5% every six months after March 23, 2012 until maturity.

(g) Loan bears interest at one-month LIBOR + 2.65%.

(h) Loan payments are interest only until June 2017, then monthly principal and interest payment of $257,418 with unpaid balance due at maturity.

(i) Loan has a stated interest rate of one-month LIBOR + 2.50%. $143.0 million of the outstanding principal balance is swapped to a 3.80% fixed rate through maturity.

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The weighted average interest rate on our mortgages, notes and loans payable was 4.57% and 4.68% as of June 30, 2012 and December 31, 2011, respectively.

Collateralized Mortgages, Notes and Loans Payable

As of June 30, 2012, we had $659.4 million of collateralized mortgages, notes and loans payable. Approximately $337.6 million of the debt included in the table above is related to The Woodlands, which was consolidated on July 1, 2011. All of the debt is non-recourse and is secured by the individual properties as listed in the table above, except for The Woodlands Master Credit Facility and Resort and Conference Center loans which are recourse to the partnerships that directly own The Woodlands operations, and a $7.0 million corporate recourse guarantee associated with the 110 N. Wacker mortgage, which is more fully discussed below.

The Woodlands Master Credit Facility is a $270.0 million facility consisting of a $170.0 million term loan and a $100.0 million revolving credit line (together, the TWL Facility). As of June 30, 2012, the TWL Facility had an outstanding balance of $176.7 million. The TWL Facility bears interest at one-month LIBOR plus 4.0% with a 1.0% LIBOR floor, has a March 29, 2014 initial maturity date and a one-year extension at borrower s option. The TWL Facility also contains certain restrictions or covenants that, among other things, require the maintenance of specified financial ratios, restrict the incurrence of additional indebtedness at The Woodlands, and limit distributions from The Woodlands to us. Until The Woodlands leverage, as defined by the credit agreement, is less than a 40.0% loan to value ratio, we must amortize the debt on a dollar for dollar basis for any distributions that we make from The Woodlands. We have not distributed and do not currently intend to distribute cash from The Woodlands; therefore, this distribution provision has had no impact on us. As of June 30, 2012, leverage was approximately 38.4%. There was $19.1 million of undrawn and available borrowing capacity under the TWL Facility based on the collateral underlying the facility and covenants as of June 30, 2012. The TWL Facility also requires mandatory principal amortization payments during its initial term and during the extension period, if exercised. Repayments of $25.0 million and $30.0 million are required on March 29, 2013 and, if extended, 2014, respectively. Furthermore, $10.0 million is due on each of June 29, September 29 and December 29, 2014 during the extension period.

The Woodlands Resort and Conference Center loan has a $36.1 million outstanding balance as of June 30, 2012 that matures on October 30, 2012 and may be extended for one year at our option. The loan bears interest at one-month LIBOR plus 5.0% as of June 30, 2012 and has a 1.0% LIBOR floor. The rate increases by 0.5% every six months after March 23, 2012 until maturity. The loan is secured by a 440-room and 40-acre conference center and resort located within The Woodlands, and requires the maintenance of specified financial ratios.

During the second quarter of 2012, we refinanced $18.1 million of existing debt related to our Bridgeland master planned community with a ten-year term loan facility at a fixed interest rate of 5.50% for the first five years and three-month LIBOR plus 2.75% for the remaining term and maturing on June 29, 2022. Beginning on June 29, 2014, annual principal payments are required in the amount of 5% of the then outstanding principal balance. In addition, we simultaneously entered into a three-year revolving credit facility with aggregate borrowing capacity of $140.0 million and which has a $30.0 million maximum outstanding loan amount. The revolving loan bears interest at the greater of 5.00% or LIBOR plus 3.25% and matures on June 29, 2015. This loan is intended to provide working capital at Bridgeland to accelerate development efforts to meet the demand of homebuilders for finished lots in the community. The Bridgeland loans are cross collateralized and cross-defaulted and the Bridgeland master planned community serves as collateral for the loans. The loans also require that Bridgeland maintain a minimum $3.0 million cash balance and a minimum net worth of $250.0 million. We also may not make cash distributions from Bridgeland unless the revolver has no outstanding balance and one year of real estate taxes and debt service on the term loan are escrowed with the lender.

On May 31, 2012, as part of our acquisition of the partner s interest in Millennium Waterway Apartments, we consolidated a $55.6 million non-recourse first mortgage loan. The proceeds from the mortgage were used to refinance the joint venture s existing debt as well as to fund our acquisition of the partner s interest in the property. The loan matures on June 1, 2022 and has a fixed interest rate of 3.75%. Payments are interest only until June 2017, then monthly principal and interest payments of $257,418 with unpaid principal balance due at maturity.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On April 26, 2012, we closed on a 10-year, fixed rate loan with interest at 4.79% secured by 20/25 Waterway Avenue. The proceeds from the loan were $13.6 million.

On February 2, 2012, we secured non-recourse financing totaling $43.3 million for 3 Waterway Square. Proceeds will be used to construct an eleven-story, 232,021-square foot office building in The Woodlands. The loan matures on January 31, 2015 and has two, one-year extension options. The loan bears interest at LIBOR plus 2.65%.

On December 5, 2011, we secured a $41.0 million loan for 4 Waterway Square and a $14.0 million loan for 9303 New Trails. The non-recourse mortgages mature on December 11, 2023 and have fixed interest rates of 4.88%.

On September 30, 2011, we closed on a $250.0 million first mortgage financing secured by the Ward Centers in Honolulu, Hawaii, that bears interest at LIBOR plus 2.50%. The loan matures on September 29, 2016, and $143.0 million of the principal balance was swapped to a 3.80% fixed rate for the term of the loan. The loan had a weighted-average interest rate of 3.43% as of June 30, 2012. The loan may be drawn to a maximum $250.0 million to fund capital expenditures at the property, provided that the outstanding principal balance cannot exceed 65.0% of the property s appraised value and the borrowers are required to have a minimum 10.0% debt yield in order to draw additional loan proceeds under the facility. The loan also permits partial repayment during its term in connection with property releases for development.

On May 10, 2011, we closed a $29.0 million first mortgage financing secured by our office building located at 110 N. Wacker Drive in Chicago, Illinois and bears interest at LIBOR plus 2.25%. At closing, the interest rate on the loan was swapped to a 5.21% fixed rate for the term of the loan. The loan matures on October 31, 2019 and its term is coterminous with the expiration of the first term of the existing tenant s lease. The loan has an interest-only period through April 2015 and, thereafter, amortizes ratably to $12.0 million through maturity. We provided a $7.0 million repayment guarantee for the loan, which is reduced on a dollar for dollar basis during the amortization period.

As of June 30, 2012, $1.1 billion of land, buildings and equipment and developments in progress (before accumulated depreciation) have been pledged as collateral for our mortgages, notes and loans payable.

Special Improvement District Bonds

The Summerlin master planned community uses Special Improvement District bonds to finance certain common infrastructure improvements. These bonds are issued by the municipalities and, although unrated, are secured by the assessments on the land. The majority of proceeds from each bond issued is held in a construction escrow and disbursed to us as infrastructure projects are completed, inspected by the municipalities and approved for reimbursement. Accordingly, the Special Improvement District bonds have been classified as debt. The Summerlin master planned community pays the debt service on the bonds semi-annually. However, our residential land sales contracts provide for the reimbursement of the principal amounts included in these debt service payments. In addition, as Summerlin sells land, the purchasers assume a proportionate share of the bond obligation.

As of June 30, 2012, we were in compliance with all of the financial covenants related to our debt agreements.

NOTE 9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income (AOCI) and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The outstanding derivatives at June 30, 2012 were used to hedge the variable cash flows associated with existing variable-rate debt. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and six months ended June 30, 2012, the amount of ineffectiveness recorded in earnings was insignificant.

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. Over the next 12 months, we estimate that an additional $2.2 million will be reclassified as an increase to interest expense.

As of June 30, 2012, we had gross notional amounts of $172.0 million for interest rate swaps and a $100.0 million interest rate cap that were designated as cash flow hedges of interest risk. The fair value of the interest rate cap derivative was insignificant.

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

	June 30, 2012	December 31, 2011
	(In thousands)	
Interest Rate Swaps	$ 6,697	$ 4,367
Total derivatives designated as hedging instruments	$ 6,697	$ 4,367

The table below presents the effect of our derivative financial instruments on the Condensed Consolidated Income Statement:

	Three months ended June 30,			Three months ended June 30,	
	2012	2011		2012	2011
Cash Flow Hedges	Amount of (Loss) Recognized in OCI	Amount of Gain (Loss) Recognized in OCI	Location of Gain (Loss) Reclassified from Accumulated OCI into Earnings	Amount of (Loss) Reclassified from Accumulated OCI into Earnings	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Earnings
	(In thousands)			(In thousands)	
Interest Rate Swaps	$ (2,770)	$	Interest Expense	$ (507)	$
	$ (2,770)	$		$ (507)	$

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six months ended June 30,			Six months ended June 30,	
	2012	2011		2012	2011
Cash Flow Hedges	**Amount of (Loss) Recognized in OCI**	**Amount of Gain (Loss) Recognized in OCI**	**Location of Gain (Loss) Reclassified from Accumulated OCI into Earnings**	**Amount of (Loss) Reclassified from Accumulated OCI into Earnings**	**Amount of Gain or (Loss) Reclassified from Accumulated OCI into Earnings**
	(In thousands)			**(In thousands)**	
Interest Rate Swaps	$ (3,161)	$	Interest Expense	$ (1,000)	$
	$ (3,161)	$		$ (1,000)	$

NOTE 10 INCOME TAXES

We file a consolidated corporate tax return which includes all of our subsidiaries with the exception of Victoria Ward, Limited (Ward , substantially all of which is owned by us). Ward elected to be taxed as a REIT under sections 856-860 of the Internal Revenue Code of 1986, as amended (the Code), commencing with the taxable year beginning January 1, 2002. To qualify as a REIT, Ward must meet a number of organizational and operational requirements, including requirements to distribute at least 90% of its ordinary taxable income and to distribute to stockholders or pay tax on 100% of capital gains and to meet certain asset and income tests. Ward has satisfied such REIT distribution requirements for 2011, and presently we intend to continue to operate Ward as a REIT. As a REIT, Ward is ordinarily not subject to income taxes; however, Ward is required to make annual distributions to its stockholders, and the stockholders are taxed on these distributions.

Pursuant to the Tax Matters Agreement, GGP has indemnified us from and against 93.75% of any and all losses, claims, damages, liabilities and reasonable expenses to which we become subject (the Tax Indemnity), in each case solely to the extent directly attributable to certain taxes related to sales of certain assets in our Master Planned Communities segment prior to March 31, 2010 (MPC Taxes), in an amount up to $303.8 million, plus interest and penalties related to these amounts (the Indemnity Cap) so long as GGP controls the action in the Tax Court related to the dispute with the IRS as described below. We recorded The Tax Indemnity receivable at the Indemnity Cap amount as of the spinoff date. The unrecognized tax benefits and related accrued interest recorded through June 30, 2012 are primarily related to the taxes that are the subject of the Tax Indemnity. We have recorded interest income receivable on the tax indemnity receivable in the amounts of $32.0 million and $28.0 million as of June 30, 2012 and December 31, 2011, respectively.

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

During the three and six months ended June 30, 2012, we recorded a non-cash loss on remeasurement of the Tax Indemnity receivable of $8.8 million which occurred in 2011 and to a lesser extent in 2010, related to our utilization of tax assets pursuant to the Tax Matters Agreement as well as changes to our deferred tax liability for the MPC Taxes.

On May 6, 2011, GGP filed Tax Court petitions on behalf of the two former taxable REIT subsidiaries of GGP seeking a redetermination of federal income tax for the years 2007 and 2008. The petitions seek to overturn determinations by the IRS that the taxpayers were liable for combined deficiencies totaling $144.1 million. On October 20, 2011, GGP filed a motion in the United States Tax Court to consolidate the cases of the two former taxable REIT subsidiaries of GGP subject to litigation with the Internal Revenue Service due to the common nature

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the cases facts and circumstances and the issues being litigated. The United States Tax Court granted the motion to consolidate. The litigation is currently scheduled for a November 2012 trial date.

Unrecognized tax benefits recorded pursuant to uncertain tax positions were $101.0 million as of June 30, 2012 and $101.4 as of December 31, 2011, excluding interest, of which this entire amount would not impact our effective tax rate. Accrued interest related to these unrecognized tax benefits amounted to $32.4 million as of June 30, 2012 and $28.5 million as of December 31, 2011. We recognized an increase in interest expense related to the unrecognized tax benefits of $1.9 million and $3.9 million for the three and six months ended June 30, 2012, respectively. A significant amount of the unrecognized tax benefits recorded in the financial statements are related to the tax court litigation and are expected to be resolved within the next twelve months.

NOTE 11 STOCK-BASED PLANS

Our stock based plans are described, and informational disclosures provided, in the notes to the Consolidated Financial Statements included in the Form 10-K for the year ended December 31, 2011. The following table summarizes our stock option plan activity for the six months ended June 30, 2012:

	Weighted