UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

Commission File Number 001-15663

American Realty Investors, Inc.

(Exact name of registrant as specified in its charter)

Nevada	**75-2847135**
(State or other jurisdiction of	**(IRS Employer**

Incorporation or organization)	**Identification Number)**
1800 Valley View Lane, Suite 300	
Dallas, Texas	**75234**
(Address of principal executive offices)	**(Zip Code)**

(469) 522-4200

Registrant s Telephone Number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	*Name of each exchange on which registered*
Common Stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ¨ No x

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The aggregate market value of the shares of voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the closing price at which the common equity was last sold which was the sales price of the Common Stock on the New York Stock Exchange as of June 30, 2007 (the last business day of the Registrant s most recently completed second fiscal quarter) was $14,220,379 based upon a total of 1,736,310 shares held as of June 30, 2007 by persons believed to be non-affiliates of the Registrant. The basis of the calculation does not constitute a determination by the Registrant as defined in Rule 405 of the Securities Act of 1933, as amended, such calculation, if made as of a date within sixty days of this filing, would yield a different value.

As of March 20, 2008, there were 11,217,914 shares of common stock outstanding, which includes 746,972 shares issued to and owned by Transcontinental Realty Investors, Inc.

Documents Incorporated By Reference:

Consolidated Financial Statements of Income Opportunity Realty Investors, Inc.; Commission File No. 001-14784

Table of Contents

INDEX TO

ANNUAL REPORT ON FORM 10-K

		Page
	PART I	
Item 1.	Business.	3
Item 1A.	Risk Factors.	12
Item 1B.	Unresolved Staff Comments	17
Item 2.	Properties.	18
Item 3.	Legal Proceedings.	23
Item 4.	Submission of Matters to a Vote of Security Holders.	24
	PART II	
Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.	25
Item 6.	Selected Financial Data.	28
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operation.	29
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk.	41
Item 8.	Financial Statements and Supplementary Data.	42
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.	97
Item 9A(T).	Controls and Procedures.	97
Item 9B.	Other Information.	98
	PART III	
Item 10.	Directors, Executive Officers and Corporate Governance.	99
Item 11.	Executive Compensation.	107
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	108
Item 13.	Certain Relationships and Related Transactions, and Director Independence.	109
Item 14.	Principal Accountant Fees and Services.	111
	PART IV	
Item 15.	Exhibits and Financial Statement Schedules.	114
Signature Page		116

Table of Contents

FORWARD-LOOKING STATEMENTS

Certain Statements in this Form 10-K are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. The words estimate, plan, intend, expect, anticipate, believe, and similar expressions are intended to identify forward-looking statements. The forward-looking statements are found at various places throughout this Report and in the documents incorporated herein by reference. The Company disclaims any intention or obligations to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Although we believe that our expectations are based upon reasonable assumptions, we can give no assurance that our goals will be achieved. Important factors that could cause our actual results to differ from estimates or projections contained in any forward-looking statements are described in Item 1A. Risk Factors .

PART I

ITEM 1. ***BUSINESS***

General

As used herein, the terms ARI, the Company, we, our or us refer to American Realty Investors, Inc., a Nevada corporation, individually or together with its subsidiaries. The Company s common stock trades on the New York Stock Exchange under the symbol ARL . ARI is a C corporation for U.S. federal income tax purposes. ARI was organized in 1999. In August 2000 the Company acquired American Realty Trust, Inc., a Georgia corporation (ART) and National Realty LP, a Delaware limited partnership (NRLP). ART was the successor to a District of Columbia business trust organized in 1961. The business trust was merged into ART in 1988. NRLP was organized in 1987 and subsequently acquired all of the assets and assumed all of the liabilities of several public and private limited partnerships. NRLP also owned a portfolio of real estate and mortgage loan investments.

ARI subsidiaries own approximately 80.2 percent of the outstanding shares of common stock of Transcontinental Realty Investors, Inc., a Nevada corporation (TCI) whose common stock is traded on the New York Stock Exchange under the symbol TCI . TCI owns approximately 24.88% of the outstanding common shares of Income Opportunity Realty Investors, Inc., (IORI) whose common stock is traded on the American Stock Exchange under the symbol IOT . ARI s ownership of the TCI shares was achieved through a series of transactions, including a cash tender offer completed in 2003, an exchange by certain ARI subsidiaries of securities with Basic Capital Management, Inc. (BCM) and a sale of a participating interest in certain loans made by One Realco Corporation (One Realco) to BCM, as well as certain open market purchases of TCI shares in 2003. BCM and One Realco are companies affiliated with ARI. ARI has consolidated TCI s accounts and operations since March 2003.

ARI s contractual Advisor is Prime Income Asset Management, LLC (Prime), the sole member of which is Prime Income Asset Management, Inc., a Nevada corporation (PIAMI). PIAMI is owned by Realty Advisors, Inc. (RAI)(80%) and Syntek West, Inc. (SWI)(20%), SWI is owned by Gene E. Phillips, Realty Advisors, Inc. is owned by a Trust for the benefit of the children of Gene E. Phillips (the Trust). Gene E. Phillips is an officer and director of SWI and serves as a representative of the Trust. While Mr. Phillips is not an officer or director of ARI, he does periodically consult with the executive officers and directors of ARI rendering advice and input with respect to investment decisions affecting ARI. PIAMI also owns approximately 14.9% of the common stock of ARI and approximately 7.4% of the Series A 10% cumulative convertible preferred Stock of ARI.

ARI s Board of Directors represents the Company s shareholders and is responsible for directing the overall affairs of ARI and for setting the strategic policies that guide the Company. The Board of Directors has delegated the day-to-day management of the Company to Prime Income Asset Management, LLC (Prime) under a written advisory agreement that is reviewed annually by ARI s Board of Directors.

Prime is a limited liability company whose sole member is a Nevada corporation indirectly owned 80 percent by the Trust and 20 percent by another Nevada corporation wholly-owned by Mr. Phillips. Prime owns approximately 13 percent of the outstanding common stock of ARI. Prime s duties include but are not limited to locating, evaluating and recommending real estate and real estate-related investment opportunities. Prime also arranges, for ARI s benefit, debt and equity financing with third party lenders and investors. Prime is compensated by ARI under an advisory agreement that is more fully described in Part III, Item 10, Directors, Executive Officers and Corporate Governance .

Prime also serves as advisor to TCI. The officers of ARI are also officers of IORI, TCI, and Prime. The directors of ARI also serve as directors of TCI. The Chairman of the Board of Directors of ARI also serves as the Chairman of the Board of Directors of TCI. One director of ARI also serves as a director of TCI and IORI. Affiliates of Prime have provided property management services to ARI. Currently, Triad Realty Services, LP. (Triad), an affiliate, and Carmel Realty, Inc. (Carmel) provide such property management services. Triad and Carmel subcontract with other entities for property-level management services. The general partner of Triad is Prime Income Asset Management, Inc. (PIAMI). The limited partner of Triad is Highland Realty Services, Inc. (HRS Holdings LLC (HRSHLLC). Triad subcontracts the property-level management and leasing our commercial properties (shopping centers, office buildings, and industrial warehouses) to Regis Realty I, LLC (Regis I) which is owned by HRSHLLC. Regis I receives property and construction management fees and leasing commissions in accordance with the terms of its property-level management agreement with Triad. Regis Hotel I, LLC, manages our hotels. The sole member of Regis I and Regis Hotel I, LLC is HRSHLLC. Carmel is owned by Regis I.

Regis I is also entitled to receive real estate brokerage commissions in accordance with the terms of the Advisory Agreement as discussed in ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

ARI s primary business is the acquisition, development and ownership of income-producing residential, hotel and commercial real estate properties. In addition, ARI opportunistically acquires land for future development in in-fill or high-growth suburban markets. From time to time and when we believe it appropriate to do so, we will also sell land and income-producing properties. We generate revenues by leasing apartment units to residents; leasing office, industrial and retail space to various for-profit businesses as well as certain local, state and federal agencies; leasing trade show and exhibit space to temporary as well as long-term tenants; and renting hotel rooms to guests. We also generate revenues from gains on sales of income-producing properties and land. At December 31, 2007, our income-producing properties consisted of:

- 5.9 million rentable square feet of commercial properties, including 18 office buildings, 7 industrial properties, 5 retail properties and a four-story, 344,975 square-foot trade show and exhibit hall located in Denver, Colorado
- 69 residential apartment communities comprising almost 12,788 units
- Nine hotels comprising 1,125 rooms

Subsequent to the year ended, we purchased and sold various properties. See NOTE 22 Subsequent Events.

The following table sets forth the location of our real estate held for investment (income-producing properties only) by asset type as of December 31, 2007:

	Apartments		Commercial		Hotels	
Location	**No.**	**Units**	**No.**	**SF**	**No.**	**Rooms**
Greater Dallas-Ft. Worth, TX	18	3,825	13	2,769,587		
Greater Houston, TX	9	2,202				
Midland-Odessa, TX	15	2,457				
San Antonio, TX	4	1,112	1	101,500		
Other Texas	6	1,193				
Mississippi	7	450				
Arkansas	3	428				
Florida	3	322				
New Orleans, LA			6	1,369,388		
Denver, CO			2	419,791	1	161
Fresno, CA					4	647
Chicago, IL					3	152
Other	4	799	9	1,241,305	1	165
Totals	**69**	**12,788**	**31**	**5,901,571**	**9**	**1,125**

We finance our acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. We finance our development projects principally with short-term, variable-rate construction loans that are refinanced with the proceeds of long-term, fixed-rate amortizing mortgages when the development has been completed and occupancy has been stabilized. When we sell properties, we may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable, secured by the property being sold. We may also from time to time enter into partnerships or joint ventures with various investors to acquire land or income-producing properties or to sell interests in certain of our properties.

We partner with various third-party development companies to construct residential apartment communities. The third-party developer typically holds a general partner as well as a limited partner interest in a limited partnership formed for the purpose of building a single property while we generally take a limited partner interest in the limited partnership. We may contribute land to the partnership as part of our equity contribution or we may contribute the necessary funds to the partnership to acquire the land. We are required to fund all required equity contributions while the third-party developer is responsible for obtaining construction financing, hiring and a general contractor and for the overall management, successful completion and delivery of the project. We generally bear all the economic risks and rewards of ownership in these partnerships and therefore include these partnerships in our consolidated financial statements. The third-party developer is paid a developer fee typically equal to a percentage of the construction costs. When the project reaches stabilized occupancy, we acquire the third-party developer s partnership interests in exchange for any remaining unpaid developer fees.

Table of Contents

At December 31, 2007, our projects in development included:

Property	Location	No. of Units	Costs to Date	Total Projected Costs
Bolivar Homes	Cleveland, MS	65	$ 5,273	$ 8,613
Broadway Estates	Greenville, MS	104	4,385	8,362
Dorado Ranch	Odessa, TX	224	2,690	19,137
Huntington Ridge Desoto	Desoto, TX	198	13,691	17,873
Lakeview @ Pecan Creek/Preserve	Denton, TX	192	5,296	18,008
Lincoln Estate I	Leake County, MS	55	1,536	7,708
Longfellow Arms	Longview, TX	216	12,684	16,672
Mansions of Mansfield	Mansfield, TX	208	5,618	18,687
Mason Park	Houston, TX	312	14,436	23,018
Northside of Travis	Sherman, TX	200	2,078	16,999
Parc at Rogers	Rogers, AR	250	22,205	24,192
Parc at Clarksville	Clarksville, TN	168	14,291	14,291
Parkway Place	Greenwood, MS	65	1,369	16,999
Pecan Pointe	Temple, TX	232	17,643	19,526
Portafino Lago Vista	Farmer s Branch, TX	212	20,078	26,450
Sunflower Estates	Indianola, MS	65	4,266	8,435
Yazoo Estates	Yazoo City, MS	96	4,101	8,351
Castleglen	Garland, TX	150	760	11,380
Pioneer Crossing	Austin, TX	240	814	22,000
		3,252	$ 153,214	$ 306,701

Our Subsidiary, TCI, has formed a number of joint ventures with Icon Partners, LLC (Icon) to develop various residential, commercial and mixed-use projects. The subsidiary typically owns 75 percent of these joint ventures, arranges for and guarantees all debt financing and provides all required equity capital. The terms of the joint ventures also allow our subsidiary to receive its cumulative investment plus a preferred return before Icon receives any equity distribution. Icon provides various development and project management services to the joint ventures and is paid monthly developer fees for those services. We include these joint ventures in the Company s consolidated financial statements and record a minority interest for Icon s equity in the venture.

We have made substantial investments in a number of large tracts of undeveloped and partially developed land and intend to a) continue to improve these tracts of land for our own development purposes or b) make the improvements necessary to ready the land for sale to other developers.

At December 31, 2007, our investments in undeveloped and partially developed land consisted of the following:

Property	Location	Date(s) Acquired	Acres	Cost	Primary Intended Use
Mercer Crossing	Dallas, TX	1996-2007	772	108,230	Mixed use
Windmill Farms	Dallas, TX	2006	3,035	55,881	Single-family residential
Pioneer Crossing	Austin, TX	1997-2005	760	33,935	Multi-family residential
Circle C Ranch	Austin, TX	2006	1,092	32,669	Single-family residential
McKinney Ranch	Dallas, TX	1997-2005	306	26,385	Mixed use
Las Colinas Multi-Tracts	Dallas, TX	1995-2006	277	23,238	Commercial
Dallas North Tollway	Dallas, TX	2006	17	15,905	Commercial
Mandhal Bay	St. Thomas, USVI	2005	91	14,710	Single-family residential
Kaufman County	Dallas, TX	2000-2005	2,633	13,001	Single-family residential

Waco Multi-Tracts	Waco, TX	2005-2006	545	5,469	Single-family residential
Meloy Portage	Kent, OH	2004	53	5,119	Multi-family residential
Jackson Convention Center	Jackson, MS	2007	2	3,848	Mixed use
Beltine-Geller Road	Dallas, TX	2007	379	2,888	Commercial
Subtotal			9,962	341,278	
Other land holdings	Various	1990-2007	912	48,714	Various
Total land holdings			10,874	389,992	

Table of Contents

In addition, we own 1) a non-controlling 20 percent interest in Milano Restaurants International, which operates and franchises several quick service restaurant concepts in California and 2) various other interests in real estate and real-estate related entities. We generally use the equity method to account for these investments.

Transactions during 2007

Land and income producing properties acquired during 2007 consisted of:

Property	Acres/ SF/ Units	Location	Property Type/ Intended Use	Date Acquired	Purchase Price	Debt Incurred	Annual Interest Rate	Fixed/ Variable	Maturity Date
Income-Producing Properties:									
Parkwest I	383,000SF	Dallas, TX	Office	Jan-07	40,604	35,000	6.06%	Fixed	Jan-08
Parkwest II	708,000SF	Dallas, TX	Office	Jan-07	69,694	62,000	9.32%		Jan-08
Thornwood[1]	109Units	Midland, TX	Multi-family residential		1,895	1,638			
Subtotal					112,193	98,638			
Land:									
Keller Springs	6Acres	Dallas, TX	Multi-family residential	Jan-07	2,646	2,021	8.25%	Prime + 100 bps	8-Feb
Audubon Terrace[2]	29Acres	Natchez, MS	Multi-family residential	Mar-07					
Waco 151	151Acres	Waco, TX	Single-family residential	Apr-07	2,106	1,300	8.25%	Prime + 100 bps	10-Apr
Senlac Road	4Acres	Dallas, TX	Commercial	Apr-07	1,005		NA	NA	NA
Hines Meridian	40Acres	Dallas, TX	Commercial	May-07	8,490	5,000	9.25%	Fixed	10-Jun
William Sprowles	1Acres	Dallas, TX	Commercial	Jun-07	288		NA	NA	NA
Jackson Convention Center	2Acres	Jackson, MS	Mixed use	Jul-07	3,848		NA	NA	NA
Dorado Ranch	11Acres	Odessa, TX	Multi-family residential	Jul-07	733	467			
Austin Landing	11Acres	Sherman, TX	Multi-family residential	Oct-07	1,301	950	5.35%		9-Feb
Denham Springs	16Acres	Denham Springs, LA	Multi-family residential	Oct-07	1,350	892			
Beltline-Geller Road	379Acres	Dallas, TX	Commercial	Nov-07	2,782	1,909			
Subtotal					24,549	12,539			
Total					$ 136,742	$ 111,177			

(1) Acquired from an affiliated company.
(2) Currently undergoing development.

Significant Real Estate Acquisitions / Dispositions and Financings

The highlights of the twelve months ended December 31, 2007 included the following:

On January 1, 2007, we obtained a $7.0 million loan secured by 109 acres of land in Farmers Branch, Texas known as the Manhattan land. We received $6.6 million in cash after paying closing costs.

On January 17, 2007, we refinanced the existing $3.6 million mortgage on City Suites Hotel in Chicago, Illinois for a new note of $7.3 million. We received $3.3 million in cash after paying down the existing debt and closing costs.

On January 19, 2007, we acquired a 383,114 and a 707,599 square foot office building in Farmers Branch, Texas known as Park West I and Park West II, respectively and a 4.7-acre tract of undeveloped land at an aggregate purchase price of $110.2 million. The acquisition was financed with $10.1 million in cash and $97.0 million in new debt. Two separate notes were obtained on this acquisition; a $35.0 million note which accrues interest at 6.06% maturing January 2009 and a $62.0 million note which accrues interest at a variable rate (currently 9.32%) maturing January 2013.

On February 16, 2007, we sold the Bluffs at Vista Ridge a 272-unit apartment complex in Lewisville, Texas for $24.6 million. The proceeds were used to pay down the existing mortgage of $15.5 million receiving $9.1 million in cash. A gain of $3.6 million was recorded on this sale.

On February 23, 2007, we obtained a $5.0 million loan secured by 97 acres of Pioneer Crossing land located in Austin, Texas. The note accrues interest at prime plus 1% and matures February 23, 2008.

On March 5, 2007, we refinanced the existing $3.1 million and $3.4 million mortgage on the Majestic Hotel and Willows Hotels with a new note for $6.0 million and $5.2 million, respectively with a single lender. We received cash in aggregate of $4.4 million after pay off of existing notes and closing costs. The Hotels are located in Chicago, IL, the Majestic is a 55-room hotel and the Willows is a 52 room Hotel. The notes accrue interest at 7.76% and matures March in 2010.

On March 16, 2007, we refinanced with a single lender three existing mortgage totaling $11.6 million on three hotels located in Fresno, California; the Piccadilly Chateau, Piccadilly Shaw, and Piccadilly Airport totaling 457 rooms for new debt totaling $28.7 million. We received $14.7 million in cash, after paying off the existing debt and $ 2.4 million in closing costs and early payment penalties. The new note accrues interest at 8% and matures on February 2012.

On April 30, 2007, we refinanced the existing debt of $7.1 million on the Whispering Pines Apartments, a 320-unit complex in Topeka, Kansas for a new note of $8.3 million, receiving $1.0 million in cash. The new note accrues interest at 7.0% and matures in April 2008.

On May 3, 2007, we obtained a loan for $12.0 million receiving $11.2 million in cash. The loan is secured by 257 acres of land in Austin, Texas known as Pioneer Crossing. The loan accrues interest at 10.25% and matures in May 2008.

On May 8, 2007, we acquired 40.1 acres of land in Las Colinas, Texas known as Hines Meridian for $8.4 million. The purchase was financed with $2.9 million in cash and a note payable of $5.0 million. The note accrues interest at 9.25% and matures in June 2010.

On May 31, 2007, we refinanced the existing debt of $12.2 million on the Hickory IV building, a 221,000 square foot commercial building in Farmers Branch, Texas for a new note of $26.0 million. The note accrues interest at 8.67% and matures in May 2009.

Table of Contents

On June 6, 2007, we refinanced $12.4 million in existing mortgages with a single commercial lender. The mortgages relate to eight different apartment complexes; Arbor Pointe, Courtyard, Coventry Point, Fountains at Waterford, Southgate, Sunchase, Thornwood, and Westwood Square Apartments totaling 1,287 units, located throughout Midland and Odessa, Texas. The new loans total $33.2 million. We received $16.0 million in cash after paying down property debt and defeasance costs totaling $4.1 million. The notes accrue interest at 7.03% and mature in July 2037. All eight of these apartments were sold, subsequent to year end.

On June 26, 2007, we sold the Durham office building, a 207,171 square foot commercial building located in Durham North Carolina for $19.2 million, recording a gain of $1.7 million. We received $3.4 million in cash after paying off the existing debt and closing costs.

On June 28, 2007, we refinanced the existing $2.9 million mortgage on Sunset Apartments, a 240-unit complex located in Odessa, Texas with a new note of $5.5 million. We received $1.3 million in cash after paying off the existing debt and closing costs. The new note accrues interest at prime plus 25 basis points and matures on September 2008.

On July 6, 2007, we refinanced the existing $2.9 million mortgage on seven tracts of land located in and around Dallas, Texas with a new note for $8.4 million. We received 5.3 million in cash, after paying down the existing debt and $200,000 in closing costs. The note accrues interest at 8.6% and matures on August 10, 2009.

On July 27, 2007, we sold the Forum Office Building in Richmond, Virginia, a 79,791 square foot commercial building, for $9.4 million, recording a $3.4 million gain on sale. We received $3.1 million in cash after paying off the $5.9 million mortgage and $400,000 in closing costs.

On August 30, 2007, we refinanced the existing $13.3 million mortgage on the Amoco building, a 378,895 square foot commercial building located in New Orleans, LA, with a new note for $19.5 million receiving $4.6 million in cash after paying closing costs, accrued interest and fees. The new note accrues interest at LIBOR plus 400 points, currently 8.1%. The note is payable in monthly payments of interest only through September 1, 2008 at which time all accrued and unpaid interest and outstanding principal or due. The note contains a provision to extend the maturity date to September 1, 2010 with an increase in the interest rate of LIBOR plus 425 points for the first extension and LIBOR plus 450 basis points for the second extension.

On September 27, 2007, we sold 2.2 acres of land in Dallas Texas, known as the West End Land, for $6.5 million, recording a gain of $3.8 million. We received $2.3 million in cash after paying of the existing debt of $3.8 million.

On September 28, 2007, we refinanced three existing mortgages totaling $32.7 million on three apartment complexes; Limestone Ranch, Limestone Canyon, and Tivoli, located through Texas with a single lender for a new note of $38.7 million. We received $3.5 million in cash after paying down the existing debt and $2.5 million in closing costs.

On November 4, 2007, we sold the El Chaparral Apartments, a 190-unit community complex, in San Antonio, Texas for $5.5 million, recording a gain of $3.9 million on the sale. We received $1.0 million in cash after paying off the $3.9 million mortgage and $600,000 in closing costs and commissions.

On November 29, 2007, we sold the Atlantic Sands Hotel, a 110-room hotel located in Virginia Beach, Virginia, for $12.0 million. We provided $2.0 million in seller financing, and recorded a gain on sale of $5.4 million. We received cash proceeds of $7.4 million, after paying down the existing $3.1 million mortgage, closing costs, and commissions.

On November 27, 2007, we sold the Arlington Place Apartments, a 230-unit apartment complex, located in Houston, Texas for $5.8 million, recording a gain on sale of $4.8 million. We received $1.6 million in cash after pay off of the existing $3.9 million mortgage and $300,000 in closing costs and commissions.

On November 28, 2007, we sold the Woodlake Apartments, a 256-unit apartment complex, located in Carrollton, Texas for $10.8 million, recording a gain on sale of $8.4 million. We received $2.5 million in cash after paying off the $7.8 million mortgage and $500,000 in closing costs and commissions.

On December 12, 2007, we refinanced the existing $7.8 million note on 80.6 acres of land in McKinney, Texas known as McKinney Ranch Land with a new note for $8.0 million with a commercial lender. We received approximately $2,600 in cash after paying off the existing debt and closing costs. The new note is payable in monthly installments of interest only. The note accrues interest at prime plus 2.5%, which was 10% at December 31, 2007. The principal and all unpaid and accrued interest are due and payable on maturity, December 1, 2010.

On December 19, 2007, we sold the Harpers Ferry apartments, a 122-unit complex, in Lafayette, Louisiana for $5.5 million, recording a gain on sale of $3.6 million. We received $1.6 million in cash after pay off of the existing $3.0 million mortgage, $500,000 in early payment penalties and $400,000 in closing costs.

Business Plan and Investment Policy

Our business objective is to maximize long-term value for our stockholders by investing in commercial real estate through the acquisition, development and ownership of apartments, commercial properties, hotels, and land. We intend to achieve this objective through acquiring and developing properties in multiple markets and operating as an industry-leading landlord. We believe this objective will provide the benefits of enhanced investment opportunities, economies of scale and risk diversification, both in terms of geographic market and real estate product type. We believe our objective will also result in continuing access to favorably priced debt and equity capital. In pursuing our business objective, we seek to achieve a combination of internal and external growth while maintaining a strong balance sheet and employing a strategy of financial flexibility. We maximize the value of our apartments and commercial properties by maintaining high occupancy levels while charging competitive rental rates, controlling costs and focusing on tenant retention. We also pursue attractive development opportunities either directly or in partnership with other investors.

For our portfolio of commercial properties, we generate increased operating cash flow through annual contractual increases in rental rates under existing leases. We also seek to identify best practices within our industry and across our business units in order to enhance cost savings and gain operating efficiencies. We employ capital improvement and preventive maintenance programs specifically designed to reduce operating costs and increase the long-term value of our real estate investments.

We seek to acquire properties consistent with our business objectives and strategies. We execute our acquisition strategy by purchasing properties which management believes will create stockholder value over the long-term. We will also sell properties when management believes value has been maximized or when a property is no longer considered an investment to be held long-term.

We are continuously in various stages of discussions and negotiations with respect to development, acquisition, and disposition projects. The consummation of any current or future development, acquisition, or disposition, if any, and the pace at which any may be completed cannot be assured or predicted.

Substantially all of our properties are owned by subsidiary companies, many of which are single-asset entities. This ownership structure permits greater access to financing for individual properties and permits flexibility in negotiating a sale of either the asset or the equity interests in the entity owning the asset. From time-to-time, our subsidiaries have invested in joint ventures with other investors, creating the possibility of risks that do not exist with properties solely owned by an ARI subsidiary. In those instances where other investors are involved, those other investors may have business, economic, or other objectives that are inconsistent with our objectives, which may in turn require us to make investment decisions different from those if we were the sole owner.

Real estate generally cannot be sold quickly. We may not be able to promptly dispose of properties in response to economic or other conditions. To offset this challenge, selective dispositions have been a part of our strategy to

maintain an efficient investment portfolio and to provide additional sources of capital. We finance acquisitions through non-recourse mortgages, internally generated funds, and, to a lesser extent, property sales. Those sources provide the bulk of funds for future acquisitions. We may purchase properties by assuming existing loans secured by the acquired property. When properties are acquired in such a manner, we customarily seek to refinance the asset in order to properly leverage the asset in a manner consistent with our investment objectives.

Our businesses are not generally seasonal with regard to real estate investments. Our investment strategy seeks both current income and capital appreciation. Our plan of operation is to continue, to the extent our liquidity permits, to make equity investments in income-producing real estate such as hotels, apartments, and commercial properties. We may also invest in the debt or equity securities of real estate-related entities. We intend to pursue higher risk, higher reward investments, such as improved and unimproved land where we can obtain reasonably-priced financing for substantially all of a property s purchase price. We intend to continue the development of apartment properties in selected markets in Texas and in other locations where we believe adequate levels of demand exist. We intend to pursue sales opportunities for properties in stabilized real estate markets where we believe our properties value has been maximized. We also intend to be an opportunistic seller of properties in markets where demand exceeds current supply. Although we no longer actively seek to fund or purchase mortgage loans, we may, in selected instances, originate mortgage loans or we may provide purchase money financing in conjunction with a property sale.

Our Board of Directors has broad authority under our governing documents to make all types of investments, and we may devote available resources to particular investments or types of investments without restriction on the amount or percentage of assets that may be allocated to a single investment or to any particular type of investment, and without limit on the percentage of securities of any one issuer that may be acquired. Investment objectives and policies may be changed at any time by the Board without stockholder approval.

The specific composition from time-to-time of our real estate portfolio owned by ARI directly and through our subsidiaries depends largely on the judgment of management to changing investment opportunities and the level of risk associated with specific investments or types of investments. We intend to maintain a real estate portfolio that is diversified by both location and type of property.

Competition

The real estate business is highly competitive and ARI competes with numerous companies engaged in real estate activities (including certain entities described in ITEM 13. Certain Relationships and Related Transactions, and Director Independence.), some of which have greater financial resources than ARI. We believe that success against such competition is dependent upon the geographic location of a property, the performance of property-level managers in areas such as leasing and marketing, collection of rents and control of operating expenses, the amount of new construction in the area and the maintenance and appearance of the property. Additional competitive factors include ease of access to a property, the adequacy of related facilities such as parking and other amenities, and sensitivity to market conditions in determining rent levels. With respect to apartments, competition is also based upon the design and mix of the units and the ability to provide a community atmosphere for the residents. With respect to hotels, competition is also based upon the market served, i.e., transient, commercial, or group users. We believe that beyond general economic circumstances and trends, the degree to which properties are renovated or new properties are developed in the competing submarket are also competitive factors. See also ITEM 1A. RISK FACTORS.

To the extent that ARI seeks to sell any of its properties, the sales prices for the properties may be affected by competition from other real estate owners and financial institutions also attempting to sell properties in areas where ARI s properties are located, as well as aggressive buyers attempting to dominate or penetrate a particular market.

As described above and in ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE, the officers and directors of ARI serve as officers and directors of TCI,

Table of Contents

the officers of ARI serve as the officers of IORI and one director of ARI is also a director of IORI. Both TCI and IORI have business objectives similar to ARI s. ARI s officers and directors owe fiduciary duties to both IORI and TCI as well as to ARI under applicable law. In determining whether a particular investment opportunity will be allocated to ARI, IORI, or TCI, management considers the respective investment objectives of each Company and the appropriateness of a particular investment in light of each Company s existing real estate and mortgage notes receivable portfolio. To the extent that any particular investment opportunity is appropriate to more than one of the entities, the investment opportunity may be allocated to the entity which has had funds available for investment for the longest period of time, or, if appropriate, the investment may be shared among all three or two of the entities.

In addition, as described in ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE, ARI competes with affiliates of Prime having similar investment objectives related to the acquisition, development, disposition, leasing and financing of real estate and real estate-related investments. In resolving any potential conflicts of interest which may arise, Prime has informed ARI that it intends to exercise its best judgment as to what is fair and reasonable under the circumstances in accordance with applicable law.

We have historically engaged in and will continue to engage in certain business transactions with related parties, including but not limited to asset acquisitions and dispositions. Transactions revolving related parties cannot be presumed to be carried out on an arm s length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in the best interests of our company.

Available Information

ARI maintains an Internet site at http://www.amrealtytrust.com. Available through the website, free of charge, are Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, reports filed pursuant to Section 16, and amendments to those reports, as soon as reasonably practicable after they are electronically filed or furnished to the Securities and Exchange Commission. In addition, ARI has posted the charters for the Audit Committee, Compensation Committee, and Governance and Nominating Committee, as well as the Code of Business Conduct and Ethics, Corporate Governance Guidelines on Director Independence, and other information on the website. These charters and principles are not incorporated in this report by reference. ARI will also provide a copy of these documents free of charge to stockholders upon written request. ARI issues Annual Reports containing audited financial statements to its common stockholders.

ITEM 1A. *RISK FACTORS*

An investment in our securities involves various risks. All investors should carefully consider the following risk factors in conjunction with the other information in this Report before trading our securities.

Risk Factors Related to our Business

Adverse events concerning our existing tenants or negative market conditions affecting our existing tenants could have an adverse impact on our ability to attract new tenants, release space, collect rent or renew leases, and thus could adversely affect cash flow from operations and inhibit growth.

Cash flow from operations depends in part on the ability to lease space to tenants on economically favorable terms. We could be adversely affected by various facts and events over which the Company has limited or no control, such as:

- lack of demand for space in areas where the properties are located;
- inability to retain existing tenants and attract new tenants;

- oversupply of or reduced demand for space and changes in market rental rates;
- defaults by tenants or failure to pay rent on a timely basis;
- the need to periodically renovate and repair marketable space;
- physical damage to properties;
- economic or physical decline of the areas where properties are located;
- potential risk of functional obsolescence of properties over time.

At any time, any tenant may experience a downturn in its business that may weaken its financial condition. As a result, a tenant may delay lease commencement, fail to make rental payments when due, decline to extend a lease upon its expiration, become insolvent or declare bankruptcy. Any tenant bankruptcy or insolvency, leasing delay or failure to make rental payments when due could result in the termination of the tenant s lease and material losses to the Company.

If tenants do not renew their leases as they expire, we may not be able to rent the space. Furthermore, leases that are renewed, and some new leases for space that is re-let, may have terms that are less economically favorable than expiring lease terms, or may require us to incur significant costs, such as renovations, tenant improvements or lease transaction costs. Any of these events could adversely affect cash flow from operations and our ability to make distributions to shareholders and service indebtedness. A significant portion of the costs of owning property, such as real estate taxes, insurance, and debt service payments, are not necessarily reduced when circumstances cause a decrease in rental income from the properties.

We may not be able to compete successfully with other entities that operate in our industry.

We experience a great deal of competition in attracting tenants for the properties and in locating land to develop and properties to acquire.

In our effort to lease properties, we compete for tenants with a broad spectrum of other landlords in each of the markets. These competitors include, among others, publicly-held REITs, privately-held entities, individual property owners and tenants who wish to sublease their space. Some of these competitors may be able to offer prospective tenants more attractive financial terms than we are able to offer.

If the availability of land or high quality properties in our markets diminishes, operating results could be adversely affected.

We may experience increased operating costs which could adversely affect our financial results and the value of our properties.

Our properties are subject to increases in operating expenses such as insurance, cleaning, electricity, heating, ventilation and air conditioning, administrative costs and other costs associated with security, landscaping, repairs, and maintenance of the properties. While some current tenants are obligated by their leases to reimburse us for a portion of these costs, there is no assurance that these tenants will make such payments or agree to pay these costs upon renewal or new tenants will agree to pay these costs. If operating expenses increase in our markets, we may not be able to increase rents or reimbursements in all of these markets to offset the increased expenses, without at the same time decreasing occupancy rates. If this occurs, our ability to make distributions to shareholders and service indebtedness could be adversely affected.

Our ability to achieve growth in operating income depends in part on its ability to develop additional properties.

We intend to continue to develop properties where warranted by market conditions. We have a number of ongoing development and land projects being readied for commencement.

Table of Contents

Additionally, general construction and development activities include the following risks:

- construction and leasing of a property may not be completed on schedule, which could result in increased expenses and construction costs, and would result in reduced profitability for that property;
- construction costs may exceed original estimates due to increases in interest rates and increased cost of materials, labor or other costs, possibly making the property less profitable because of inability to increase rents to compensate for the increase in construction costs;
- some developments may fail to achieve expectations, possibly making them less profitable;
- we may be unable to obtain, or face delays in obtaining, required zoning, land-use, building, occupancy, and other governmental permits and authorizations, which could result in increased costs and could require us to abandon our activities entirely with respect to a project;
- we may abandon development opportunities after the initial exploration, which may result in failure to recover costs already incurred. If we determine to alter or discontinue its development efforts, future costs of the investment may be expensed as incurred rather than capitalized and we may determine the investment is impaired resulting in a loss;
- we may expend funds on and devote management s time to projects which will not be completed;
- occupancy rates and rents at newly-completed properties may fluctuate depending on various factors including market and economic conditions, and may result in lower than projected rental rates and reduced income from operations.

We face risks associated with property acquisitions.

We acquire individual properties and various portfolios of properties and intend to continue to do so. Acquisition activities are subject to the following risks:

- when we are able to locate a desired property, competition from other real estate investors may significantly increase the seller s offering price;
- acquired properties may fail to perform as expected;
- the actual costs of repositioning or redeveloping acquired properties may be higher than original estimates;
- acquired properties may be located in new markets where we face risks associated with an incomplete knowledge or understanding of the local market, a limited number of established business relationships in the area and a relative unfamiliarity with local governmental and permitting procedures;

we may be unable to quickly and efficiently integrate new acquisitions, particularly acquisitions of portfolios of properties, into existing operations, and results of operations and financial condition could be adversely affected.

We may acquire properties subject to liabilities and without any recourse, or with limited recourse, with respect to unknown liabilities. However, if an unknown liability was later asserted against the acquired properties, we might be required to pay substantial sums to settle it, which could adversely affect cash flow.

Many of our properties are concentrated in our primary markets and the Company may suffer economic harm as a result of adverse conditions in those markets.

Our properties are located principally in specific geographic areas in the Southwestern, Southeastern, and Midwestern United States. The Company s overall performance is largely dependent on economic conditions in those regions.

Table of Contents

We are leveraged and may not be able to meet our debt service obligations.

We had total indebtedness at December 31, 2007 of approximately $1.2 billion. Substantially all assets have been pledged to secure debt. These borrowings increase the risk of loss because they represent a prior claim on assets and most require fixed payments regardless of profitability. Our leveraged position makes us vulnerable to declines in the general economy and may limit the Company s ability to pursue other business opportunities in the future.

We may not be able to access financial markets to obtain capital on a timely basis, or on acceptable terms.

We rely on proceeds from property dispositions and third party capital sources for a portion of its capital needs, including capital for acquisitions and development. The public debt and equity markets are among the sources upon which the Company relies. There is no guarantee that we will be able to access these markets or any other source of capital. The ability to access the public debt and equity markets depends on a variety of factors, including:

- general economic conditions affecting these markets;
- our own financial structure and performance;
- the market s opinion of real estate companies in general;
- the market s opinion of real estate companies that own similar properties.

We may suffer adverse effects as a result of terms and covenants relating to the Company s indebtedness.

Required payments on our indebtedness generally are not reduced if the economic performance of the portfolio declines. If the economic performance declines, net income, cash flow from operations and cash available for distribution to stockholders may be reduced. If payments on debt cannot be made, we could sustain a loss or suffer judgments, or in the case of mortgages, suffer foreclosures by mortgagees. Further, some obligations contain cross-default and/or cross-acceleration provisions, which means that a default on one obligation may constitute a default on other obligations.

We anticipate only a small portion of the principal of its debt will be repaid prior to maturity. Therefore, we are likely to refinance a portion of its outstanding debt as it matures. There is a risk that we may not be able to refinance existing debt or the terms of any refinancing will not be as favorable as the terms of the maturing debt. If principal balances due at maturity cannot be refinanced, extended, or repaid with proceeds from other sources, such as the proceeds of sales of assets or new equity capital, cash flow may not be sufficient to repay all maturing debt in years when significant balloon payments come due.

Our credit facilities and unsecured debt contain customary restrictions, requirements and other limitations on the ability to incur indebtedness, including total debt to asset ratios, secured debt to total asset ratios, debt service coverage ratios, and minimum ratios of unencumbered assets to unsecured debt, which we must maintain. our continued ability to borrow is subject to compliance with financial and other covenants. In addition, failure to comply with such covenants could cause a default under credit facilities, and we may then be required to repay such debt with capital from other sources. Under those circumstances, other sources of capital may not be available, or be available only on unattractive terms.

Our degree of leverage could limit our ability to obtain additional financing or affect the market price of our common stock.

The degree of leverage could affect our ability to obtain additional financing for working capital, capital expenditures, acquisitions, development or other general corporate purposes. The degree of leverage could also make us more vulnerable to a downturn in business or the general economy.

Table of Contents

An increase in interest rates would increase interest costs on variable rate debt and could adversely impact the ability to refinance existing debt.

We currently have, and may incur more, indebtedness that bears interest at variable rates. Accordingly, if interest rates increase, so will the interest costs, which could adversely affect cash flow and the ability to pay principal and interest on our debt and the ability to make distributions to shareholders. Further, rising interest rates could limit our ability to refinance existing debt when it matures.

Unbudgeted capital expenditures or cost overruns could adversely affect business operations and cash flow.

If capital expenditures for ongoing or planned development projects or renovations exceed expectations, the additional cost of these expenditures could have an adverse effect on business operations and cash flow. In addition, we might not have access to funds on a timely basis to pay the unexpected expenditures.

Construction costs are funded in large part through construction financing, which the Company may guarantee and the Company s obligation to pay interest on this financing continues until the rental project is completed, leased up and permanent financing is obtained, or the for sale project is sold or the construction loan is otherwise paid. Unexpected delays in completion of one or more ongoing projects could also have a significant adverse impact on business operations and cash flow.

We may need to sell properties from time to time for cash flow purposes.

Because of the lack of liquidity of real estate investments generally, our ability to respond to changing circumstances may be limited. Real estate investments generally cannot be sold quickly. In the event that we must sell assets to generate cash flow, we cannot predict whether there will be a market for those assets in the time period desired, or whether we will be able to sell the assets at a price that will allow the Company to fully recoup its investment. we may not be able to realize the full potential value of the assets and may incur costs related to the early pay-off of the debt secured by such assets.

The Company intends to devote resources to the development of new projects.

We plan to continue developing new projects as opportunities arise in the future. Development and construction activities entail a number of risks, including but not limited to the following:

- we may abandon a project after spending time and money determining its feasibility;
- construction costs may materially exceed original estimates;
- the revenue from a new project may not be enough to make it profitable or generate a positive cash flow;
- we may not be able to obtain financing on favorable terms for development of a property, if at all;
- the Company may not complete construction and lease-ups on schedule, resulting in increased development or carrying costs;
- we may not be able to obtain, or may be delayed in obtaining, necessary governmental permits.

The overall business is subject to all of the risks associated with the real estate industry.

We are subject to all risks incident to investment in real estate, many of which relate to the general lack of liquidity of real estate investments, including, but not limited to:

our real estate assets are concentrated primarily in the Southwest and any deterioration in the general economic conditions of this region could have an adverse effect;

changes in interest rates may make the ability to satisfy debt service requirements more burdensome;

16

- lack of availability of financing may render the purchase, sale or refinancing of a property more difficult or unattractive;
- changes in real estate and zoning laws;
- increases in real estate taxes and insurance costs;
- federal or local economic or rent control;
- acts of terrorism, and
- hurricanes, tornadoes, floods, earthquakes and other similar natural disasters.

Real estate investments are illiquid, and the Company may not be able to sell properties if and when it is appropriate to do so.

Real estate generally cannot be sold quickly. We may not be able to dispose of properties promptly in response to economic or other conditions. In addition, provisions of the Internal Revenue Code may limit our ability to sell properties (without incurring significant tax costs) in some situations when it may be otherwise economically advantageous to do so, thereby adversely affecting returns to stockholders and adversely impacting our ability to meet our obligations.

ITEM 1B. ***UNRESOLVED STAFF COMMENTS***

None.

Table of Contents

ITEM 2. ***PROPERTIES***

On December 31, 2007, our portfolio consisted of 110 properties totaling 5.9 million rentable square feet. Our properties consisted of 69 apartments, 9 hotels, and 32 commercial properties consisting of; 18 office buildings, 7 Industrial warehouses, 5 shopping centers, a Merchandise Mart and a Town home. In addition, we own or control 11,000 acres of improved and unimproved land for future development or sale, 19 apartments under construction totaling approximately 3,252 rentable units upon completion. The table below shows information relating to those properties.

Property	Location	Units	Occupancy % 2007
Apartments			
Anderson Estates	Oxford, MS	48	98%
Blue Lake Villas	Waxahachie, TX	186	94%
Blue Lake Villas II	Waxahachie, TX	70	94%
Breakwater Bay	Beaumont, TX	176	96%
Bridges on Kinsey	Tyler, TX	232	98%
Bridgestone	Friendswood, TX	76	99%
Capitol Hill	Little Rock, AR	156	94%
Château	Bellevue, NE	115	94%
Château Bayou	Ocean Springs, MS	122	99%
Curtis Moore	Greenwood, MS	104	98%
Dakota Arms	Lubbock, TX	208	98%
David Johnson Phase II	Greenwood, MS	32	91%
David Johnson Phase III	Greenwood, MS	40	98%
DeSoto Ranch	DeSoto, TX	248	96%
Fairway View Estates	El Paso, TX	264	93%
Falcon Lakes	Arlington, TX	248	94%
Fountain Lake	Texas City, TX	166	90%
Foxwood	Memphis, TN	220	81%
Heather Creek	Mesquite, TX	200	94%
Kingsland Ranch	Houston, TX	398	92%
Laguna Vista	Dallas, TX	202	92%
Lake Forest	Houston, TX	240	93%
Legends of El Paso	El Paso, TX	240	87%
Limestone Canyon	Austin, TX	260	95%*
Limestone Ranch	Lewisville, TX	252	95%*
Mariposa Villas	Dallas, TX	216	91%
Mission Oaks	San Antonio, TX	228	93%
Monticello Estates	Monticello, AR	32	97%
Mountain Plaza	El Paso, TX	188	98%
Paramount Terrace	Amarillo, TX	181	92%
Parc at Maumelle	Little Rock, AR	240	92%
Parc at Metro	Nashville, TN	144	98%
Quail Oaks	Balch Springs, TX	131	92%
River Oaks	Wylie, TX	180	97%
Riverwalk I	Greenville, MS	32	91%
Riverwalk II	Greenville, MS	72	96%
Sendero Ridge	San Antonio, TX	384	92%*
Spy Glass	Mansfield, TX	256	93%
Stonebridge at City Park	Houston, TX	240	91%
Tivoli	Dallas, TX	190	94%*
Treehouse	Irving, TX	160	91%
Verandas at City View	Fort Worth, TX	314	95%
Villager	Ft. Walton, FL	33	94%
Vistas at Pinnacle Park	Dallas, TX	332	91%
Vistas at Vance Jackson	San Antonio, TX	240	90%
Westwood	Mary Ester, FL	120	93%

Whispering Pines	Topeka, KS	320	91%
Wildflower Villas	Temple, TX	220	91%
Willow Creek	El Paso, TX	112	90%
Windsong	Ft. Worth, TX	188	93%
	Total Units	9,256	

* These properties are subject to sale per the deposit method.

Table of Contents

Property	Location	Sq. Ft.	Occupancy % 2007
Office Buildings			
1010 Common	New Orleans, LA	512,593	76%
217 Rampart	New Orleans, LA	11,913	0%
225 Baronne	New Orleans, LA	422,037	0%
305 Baronne	New Orleans, LA	37,081	48%
600 Las Colinas	Las Colinas, TX	510,841	67%
Amoco	New Orleans, LA	378,895	90%
Cooley Building	Farmers Branch, TX	27,000	100%
Eton Square	Tulsa, OK	225,566	90%
Executive Court	Memphis, TN	41,340	0%
One Hickory Centre	Farmers Branch, TX	97,361	97%
Park West I (Browning Place)	Farmers Branch, TX	627,312	100%
Park West (Fenton Centre)	Farmers Branch, TX	696,638	89%
Parkway North	Dallas, TX	69,009	77%
University Square	Anchorage, AK	22,260	100%
Signature Building	Dallas, TX	58,910	0%
Two Hickory Centre	Farmers Branch, TX	97,117	72%
Westgrove Air Plaza	Addison, TX	79,713	80%
		3,915,586	
Industrial Warehouses			
5360 Tulane	Atlanta, GA	30,000	100%
Addison Hanger	Addison, TX	25,102	100%
Addison Hanger II	Addison, TX	24,000	100%
Clarke Garage	New Orleans, LA	6,869	0%
Encon	Fort Worth, TX	256,584	0%
Space Center	San Antonio, TX	101,500	61%
GNB	Farmers Branch, TX	200,000	93%
		644,055	
Shopping Centers			
Bridgeview Plaza	LaCrosse, WI	122,205	92%
Cross County Mall	Mattoon, IL	307,266	87%
Cullman	Cullman, AL	92,466	48%
Dunes Plaza	Michigan City, IN	220,461	52%
Willowbrook Village	Coldwater, MI	179,741	91%
		922,139	
Merchandise Mart			
Denver Mart	Denver, CO	344,975	83%
	Total Commeral SqFt	5,826,755	
Single Family Residence			
Tavel Circle	Dallas, TX	2,155	100%

Property	Location	Rooms	Occupancy % 2007
Hotels			
Akademia	Wroclaw, Poland	165	78%
Comfort Inn	Denver, CO	161	59%

Picadilly Airport	Fresno, CA	185	63%
Château Inn	Fresno, CA	78	57%
Picadilly Shaw	Fresno, CA	194	62%
Picadilly University	Fresno, CA	190	58%
	Total Rooms	973	

Table of Contents

Held For Sale

Property	Location	Rooms	Occupancy % 2007
Apartments			
4400	Midland, TX	92	98%
Arbor Point	Odessa, TX	194	96%
Ashton Way	Midland, TX	178	94%
Autumn Chase	Midland, TX	64	100%
Bay Walk	Galveston, TX	192	91%
Courtyard	Midland, TX	133	96%
Coventry	Midland, TX	120	93%
Fairways	Longview, TX	152	95%
Fountains of Waterford	Midland, TX	172	96%
Governor s Square	Tallahassee, FL	169	96%
Hunters Glen	Midland, TX	212	96%
Island Bay	Galveston, TX	458	89%
Marina Landing	Galveston, TX	256	89%
Southgate	Odessa, TX	180	98%
Sunchase	Odessa, TX	300	95%
Sunset	Odessa, TX	240	98%
Thornwood	Odessa, TX	109	95%
Westwood	Odessa, TX	79	94%
Woodview	Odessa, TX	232	96%
	Total Units	3,532	

Property	Location	Square feet	Occupancy % 2007
Office Building			
Lexington Center	Colorado Springs, CO	74,816	24%

Property	Location	Rooms	Occupancy % 2007
Hotels			
City Suites	Chicago, IL	45	66%
The Majestic	Chicago, IL	55	59%
Willows	Chicago, IL	52	58%
	Total Rooms	152	

Lease Expiration by Year

Year of lease Expiration	Rentable Square Feet Subject to Expiring Leases	Current Annualized[(1)] Contractual Rent Under Expiring Leases	Current Annualized[(1)] Contractual Rent Under Expiring Leases (p.s.f.)	Percentage of total Square Feet

2008	620,873	$ 7,098,743	$ 11.43	12.3%
2009	560,062	5,681,790	10.14	11.1%
2010	685,956	6,295,283	9.18	13.6%
2011	369,524	5,942,097	16.08	7.3%
2012	302,931	4,709,950	15.55	6.0%
2013	242,890	3,140,906	12.93	4.8%
2014	140,470	2,598,911	18.50	2.8%
2015	45,709	912,721	19.97	0.9%
2016	120,417	1,998,490	16.60	2.4%
2017	309,817	4,831,251	15.59	6.1%
Thereafter	193,251	3,243,001	16.78	3.8%

(1) Represents the monthly contractual base rent and recoveries from tenants under existing leases as of December 31, 2007 multiplied by twelve. This amount reflects total rent before any rent abatements and includes expense reimbursements, which may be estimates as of such date.

Table of Contents

Property	Location	Acres
Land Tracts		
1013 Common	New Orleans, LA	0.41
2301 Valley Branch	Farmers Branch, TX	23.76
Alliance 52	Tarrant County, TX	51.90
Alliance 8	Tarrant County, TX	8.00
Alliance Airport	Tarrant County, TX	12.70
Audubon Terrace	Adams County, MS	48.20
Backlick	Springfield, VA	4.00
Betline 378/Geller Rd	Dallas County, TX	378.83
Bonneau	Dallas County, TX	8.39
Centura	Farmers Branch, TX	10.08
Chase Oaks	Plano, TX	9.93
Circle C Ranch	Austin, TX	1,092.00
Cooks Lane	Ft. Worth, TX	21.90
Creekside Land	Ft Worth, TX	30.00
Croslin	Dallas, TX	0.80
Crowley Land	Ft Worth, TX	24.90
Dalho	Farmers Branch, TX	3.44
Dedeaux Road	Gulfport, MS	10.00
Denton	Denton, TX	15.65
Denton-Andrew B	Denton, TX	22.90
Denton-Andrew C	Denton, TX	5.20
Desoto	Desoto, TX	21.90
Diplomat Drive	Farmers Branch, TX	14.40
Dominion	Dallas, TX	11.65
Elm Fork	Denton County, TX	44.03
Ewing 8	Addison, TX	16.79
Fiesta	San Angelo, TX	0.70
Folsom	Dallas, TX	36.38
Forney land	Kaufman County, TX	34.80
Fort Wayne	Fort Wayne, IN	18.90
Fruitland	Fruitland Park, FL	0.15
GNB Land ARI	Farmers Branch, TX	11.50
GNB Land Edina	Farmers Branch, TX	34.00
Hines Meridan	Las Colinas, TX	36.09
Hollywood Casino	Farmers Branch, TX	28.78
HSM	Farmers Branch, TX	6.16
Jackson Multi-Tract	Jackson, MS	1.71
JHL Connell	Carrollton, TX	3.93
Kaufman Cogen	Kaufman County, TX	2,567.00
Kaufman Taylor	Kaufman County, TX	31.00
Keenan Bridge	Farmers Branch, TX	7.50
Keller Springs Lofts	Addison, TX	7.40
Kelly Lots	Collin County, TX	0.75
Kinwest (Hackberry Creek)	Irving, TX	7.98
Lacy Longhorn	Farmers Branch, TX	17.12
LaDue	Farmers Branch, TX	99.00
Lakeshore Villas	Humble, TX	19.51

Table of Contents

Property	Location	Acres
Land Tracts (Continued)		
Lamar/Parmer	Austin, TX	17.07
Las Colinas	Las Colinas, TX	1.57
Las Colinas	Las Colinas, TX	4.70
Las Colinas Apts/Lofts	Irving, TX	4.77
Las Colinas High Rise Apartments	Irving, TX	1.65
Las Colinas High Rise Office	Irving, TX	3.49
Las Colinas Townhomes	Irving, TX	15.56
LCLLP	Las Colinas, TX	45.49
Leone	Irving, TX	8.23
Los Colinas-Walnut Hill	Irving, TX	1.58
Lubbock	Lubbock, TX	2.86
Luna	Farmers Branch, TX	2.60
Mandahl Bay	US Virgin Island	91.10
Manhattan	Farmers Branch, TX	108.90
Mansfield	Mansfield, TX	7.83
Marine Creek	Ft. Worth, TX	44.17
Mason/Goodrich	Houston, TX	13.00
McKinney 36	Collin County, TX	34.48
McKinney Corners II	Collin County, TX	18.53
McKinney Ranch	McKinney, TX	252.90
Meloy	Kent, OH	52.95
Mendoza	Dallas, TX	0.40
Mira Lago	Farmers Branch, TX	4.20
Nashville ARI	Nashville, TN	16.57
Nashville TCI	Nashville, TN	58.62
Ocean Estates	Gulfport, MS	12.00
Pac Trust	Farmers Branch, TX	7.07
Palmer Lane	Austin, TX	367.43
Pantaze	Dallas, TX	6.00
Payne I	Las Colinas, TX	149.70
Pioneer Crossing	Austin, TX	375.80
Pulaski	Pulaski County, AR	21.90
Railroad	Dallas, TX	0.29
Ridgepoint Drive	Irving, TX	0.60
Ritchie Road	Waco, TX	350.70
Seminary West	Ft. Worth, TX	5.36
Senlac	Farmers Branch, TX	11.94
Senlac 3.976	Farmers Branch, TX	3.98
Senlac Hutton	Farmers Branch, TX	5.86
Senlac VHP	Farmers Branch, TX	3.90
Sheffield Village	Grand Prairie, TX	13.90
Siskiyou	Siskiyou County, CA	20.70
Sladek Land	Travis County, TX	63.28
Southwood Plantation	Tallahassee, FL	12.90
Southwood Plantation	Tallahassee, FL	14.52
Texas Land Plaza	Irving, TX	10.33
Thompson	Farmers Branch, TX	3.99
Thompson II	Dallas County, TX	3.32
Tomlin	Farmers Branch, TX	9.20
Valley Ranch	Irving, TX	30.00
Valley Ranch 20	Irving, TX	20.62
Valley View 34 (Mercer Crossing)	Farmers Branch, TX	33.90

Table of Contents

Property	Location	Acres
Land Tracts (Continued)		
Valwood	Dallas, TX	235.00
Vineyards II	Grapevine, TX	7.20
Vineyards(Grapevine)	Grapevine, TX	3.94
Vista Ridge	Lewisville, TX	5.18
Waco 151	Waco, TX	151.40
Waco 42	Waco, TX	42.80
Walker	Dallas County, TX	41.79
West End	Dallas, TX	5.50
Whorton	Benton County, AR	79.70
Willowick Land	Pensacola, FL	39.78
Wilmer 88	Dallas, TX	87.60
Windmill Farms	Kaufman County, TX	3,034.51
Woodmont Fairway	Dallas, TX	5.87
Woodmont Galleria East	Dallas, TX	15.00
Woodmont Galleria West	Farmers Branch, TX	9.15
Woodmont Merit Drive	Dallas, TX	9.28
	Total Acres	11,008.23

ITEM 3. ***LEGAL PROCEEDINGS***

On October 19, 2007, the Company and Basic Capital Management, Inc. (BCM) participated in mediation proceedings which resulted in a Stipulation of Settlement with The Fansler Foundation (Fansler) in a case then pending in the United States District Court, Eastern District of California. Pursuant to the Stipulation of Settlement (which is now embodied in a final Settlement Agreement and Mutual Release finally executed on January 7, 2008 by the last party), Fansler surrendered, assigned transferred to BCM 1,600,000 shares of Series A Cumulative Convertible Preferred Stock (the Series A Stock) originally issued to Fansler in exchange for a payment commitment by BCM to Fansler of $26,000,000. $4.5 million was paid by BCM on February 6, 2008, $4 million is to be paid in April 2008 with the balance to be paid in ten quarterly payments of $1,750,000 each beginning June 1, 2008 with 8% simple interest per annum with a provison that if the full outstanding balance is paid on or before September 1, 2008, all interest is waived. BCM became the owner of the 1,600,000 of Series A Stock and has the payment obligation to the plaintiff. The Company is relieved of the payment obligation to the plaintiff unless BCM fails to make a payment. In the event BCM defaults in the payment schedule, the plaintiff is to give notice of default to both BCM and the Company which will then have five business days to cure such default. The Settlement Agreement, which has no effect upon any other holder of Series A Stock issued by the Company, brings an end to litigation existing between the parties since February 2004.

The ownership of property and provision of services to the public as tenants entails an inherent risk of liability. Although the Company and its subsidiaries are involved in various items of litigation incidental to and in the ordinary course of its business, in the opinion of Management, the outcome of such litigation will not have a material adverse impact upon the Company s financial condition, results of operations or liquidity.

Table of Contents

ITEM 4. ***SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS***

The Annual Meeting of Stockholders was held on November 16, 2007, at which proxies were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934, as amended (the Exchange Act). There was no solicitation in opposition to Management s nominees listed in the Proxy Statement, all of which were elected. At the Annual Meeting, stockholders were asked to consider and vote upon the election of Directors and the ratification of the selection of the independent public accountants for ARI for the fiscal year ending December 31, 2007. At the Meeting, stockholders elected the following individuals as Directors:

	Shares Voting	
Director	**For**	**Withheld Authority**
Henry A. Butler	10,809,378	65,137
Sharon Hunt	10,810,017	64,498
Robert A. Jakuszewski	10,810,126	64,389
Ted R. Munselle	10,809,998	64,517
Ted P. Stokely	10,809,296	65,219

There were no abstentions or broker non-votes on the election of Directors. With respect to the ratification of the appointment of Farmer, Fuqua & Huff, P.C. as independent auditors of the Company for the fiscal year ending December 31, 2007, and any interim period, at least 10,829,578 votes were received in favor of such proposal, 27,977 votes were received against such proposal, and 16,960 votes abstained.

Table of Contents

PART II

ITEM 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

ARI s common stock is listed and traded on the New York Stock Exchange under the symbol ARL. The following table sets forth the high and low sales prices as reported in the consolidated reporting system of the New York Stock Exchange.

Quarter Ended	High	Low
March 31, 2008 (through March 20, 2008)	$ 8.22	$ 8.20
December 29, 2007	10.50	7.25
September 26, 2007	8.25	7.00
June 30, 2007	10.00	8.08
March 31, 2007	8.59	7.69
December 30, 2006	9.19	7.50
September 28, 2006	9.05	8.00
June 30, 2006	9.71	8.25
March 31, 2006	10.50	7.51

On March 20, 2008, the closing market price of ARI s common stock on the New York Stock Exchange was $8.20 per share.

As of March 20, 2008, ARI s common stock was held by approximately 2,542 stockholders of record.

During the second quarter of 1999, the Board of Directors established the policy that dividend declarations on ARI s common stock would be determined on an annual basis following the end of each year. In accordance with that policy, the Board determined not to pay any dividends in 2007. Future distributions to common stockholders will be dependent upon ARI s realized income, financial condition, capital requirements and other factors deemed relevant by the Board.

15,000,000 shares of Series A 10.0% Cumulative Convertible Preferred Stock are authorized under ARI s Amended Articles of Incorporation, with a par value of $2.00 per share and a liquidation preference of $10.00 per share plus accrued and unpaid dividends. Dividends are payable at the annual rate of $1.00 per share, or $.25 per share quarterly, to stockholders of record on the last day of each March, June, September, and December, when and as declared by the Board of Directors. The Series A Preferred Stock may be converted into common stock at 90.0% of the average daily closing price of ARI s common stock for the prior 20 trading days. At December 31, 2007, 3,390,916 shares of Series A Preferred Stock were outstanding and 869,808 shares were reserved for issuance as future consideration in various business transactions. Of the outstanding shares, 300,000 shares are owned by ART Edina, Inc., and 600,000 shares are owned by ART Hotel Equities, Inc., wholly-owned subsidiaries of ARI. Dividends are not paid on the shares owned by ARI subsidiaries.

231,750 shares of Series C Cumulative Convertible Preferred Stock are authorized under ARI s Amended Articles of Incorporation, with a par value of $2.00 per share and liquidation preference of $100.00 per share plus accrued and unpaid dividends. The Series C Preferred Stock bears a quarterly dividend of $2.50 per share to stockholders of record on the last day of March, June, September and December when and as declared by the Board of Directors. The Series C Preferred Stock is reserved for conversion of the Class A limited partner units of ART Palm, L.P. (Art Palm). At December 31, 2006, 5,192,870 Class A units were outstanding. The Class A units may be exchanged for Series C Preferred Stock at the rate of 100 Class A units for each share of Series C Preferred Stock. After December 31, 2005, all outstanding shares of Series C Preferred Stock may be converted into ARI common stock. All conversions of Series C Preferred Stock into ARI common stock will be at 90.0% of the average daily closing price of ARI s common stock for the prior 20 trading days. In January 2006, 1.6 million Class A limited partner units were redeemed for $1,620,880 million in cash. At March 20, 2007, no shares of Series C Preferred Stock was outstanding.

91,000 shares of Series D 9.50% Cumulative Preferred Stock are authorized under ARI s Amended Articles of Incorporation, with a par value of $2.00 per share, and a liquidation preference of $20.00 per share. Dividends are payable at the annual rate of $1.90 per year or $.475 per quarter to stockholders of record on the last day of each March, June, September and December when and as declared by the Board of Directors. The Series D Preferred Stock is reserved for the conversion of the Class A limited partner units of Ocean Beach Partners, L.P. The Class A units may be exchanged for Series D Preferred Stock at the rate of 20 Class A units for each share of Series D Preferred Stock. No more than one-third of the Class A units could be exchanged prior to May 31, 2001. Between June 1, 2001 and May 31, 2006, all unexchanged Class A units are exchangeable. At March 20, 2007, no shares of Series D Preferred Stock was outstanding.

500,000 shares of Series E 6.0% Cumulative Preferred Stock are authorized under ARI s Amended Articles of Incorporation, with a par value $2.00 per share and a liquidation preference of $10.00 per share. Dividends are payable at the annual rate of $.60 per share or $.15 per quarter to stockholders of record on the last day of each March, June, September and December when and as declared by the Board of Directors. At March 20, 2007, no Series E Preferred Stock was outstanding.

100,000 shares of Series J 8% Cumulative Convertible Preferred Stock have been designated pursuant to a Certificate of Designation filed March 16, 2006, as an instrument amendatory to ARI s Amended Articles of Incorporation, with a par value of $2.00 per share, and a liquidation preference of $1,000 per share. Dividends are payable at the annual rate of $80 per share, or $20 per quarter, to stockholders of record on the last day of each of March, June, September and December, when and as declared by the Board of Directors. Although the Series J 8% Cumulative Convertible Preferred Stock has been designated, no shares have been issued as of March 20, 2007.

The following table sets forth information regarding purchases made by ARI of shares of ARI common stock on a monthly basis during the fourth quarter of 2007:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program
Balance at September 30			886,965	113,035
October, 2007	1,300	$ 7.38	888,265	111,735
November, 2007	2,200	8.38	890,465	109,535
December, 2007	2,600	9.41	893,065	106,935
Total	6,100	$ 8.39	893,065	106,935

(1) The repurchase program was announced in September 2000. 1,000,000 shares may be repurchased through the program. The program has no expiration date.

Table of Contents

Performance Graph

The following graph compares the cumulative total stockholder return on ARI s shares of common stock with the Dow Jones Equity Market Index (Dow Jones US Total Market) and the Dow Jones Real Estate Investment Index (Dow Jones US Real Estate). The comparison assumes that $100 was invested on December 31, 2002 in shares of common stock and in each of the indices and further assumes the reinvestment of all dividends. Past performance is not necessarily an indicator of future performance.

	12/02	12/03	12/04	12/05	12/06	12/07
American Realty Investors, Inc.	**100.00**	**112.86**	**119.90**	**99.13**	**97.28**	**121.14**
Dow Jones US	**100.00**	**130.75**	**146.45**	**155.72**	**179.96**	**190.77**
Dow Jones US Real Estate	**100.00**	**136.90**	**179.63**	**196.94**	**266.84**	**218.41**

Table of Contents

ITEM 6. ***SELECTED FINANCIAL DATA***

	Years Ended December 31,				
	2007	2006	2005	2004	2003
	(dollars in thousands)				
EARNINGS DATA					
Total Operating Revenues	$ 176,930	$ 147,563	$ 123,147	$ 28,909	$ 31,382
Total Operating Expenses	(167,748)	(142,597)	(123,435)	(62,324)	(63,167)
Operating (loss)/income	9,182	4,966	(288)	(33,415)	(31,785)
Other income (expense)	(45,589)	(38,859)	(47,265)	(27,880)	(23,417)
Loss before gain on real estate sales, minority interest, and equity in earnings of investees	(36,407)	(33,893)	(47,553)	(61,295)	(55,202)
Gain on land sales	20,468	23,973	39,926	11,781	43,831
Minority interest	(2,652)	672	(3,056)	(7,270)	(771)
Equity in income (loss) of investees	286	1,540	397	(41)	(4,441)
Income Tax benefit	15,703	7,271	20,196	31,507	9,956
Net Income (loss) from continuing operations	(2,602)	(437)	9,910	(25,318)	(6,627)
Net Income (loss) from discontinued operations	29,164	13,503	37,507	58,512	18,490
Net Income (loss)	26,562	13,066	47,417	33,194	11,863
Preferred dividend requirement	(2,490)	(2,491)	(2,572)	(2,601)	(2,351)
Income (loss) applicable to common shares	$ 24,072	$ 10,575	$ 44,845	$ 30,593	$ 9,512
PER SHARE DATA					
Basic earnings per share					
Net Income (loss) from continuing operations	$ (0.50)	$ (0.29)	$ 0.72	$ (2.63)	$ (0.83)
Net Income (loss) from discontinued operations	2.85	1.33	3.70	5.53	1.71
Net Income (loss) applicable to common shares	$ 2.35	$ 1.04	$ 4.42	$ 2.90	$ 0.88
Weighted Average shares outstanding	10,227,593	10,149,000	10,149,000	10,559,571	10,789,352
Diluted earnings per share					
Net Income (loss) from continuing operations	$ (0.50)	$ (0.29)	$ 0.56	$ (2.63)	$ (0.83)
Net Income (loss) from discontinued operations	2.85	1.33	2.86	5.53	1.71
Net Income (loss) applicable to common shares	$ 2.35	$ 1.04	$ 3.42	$ 2.90	$ 0.88
Weighted Average shares outstanding	10,227,593	10,149,000	13,106,000	10,559,571	10,789,352
BALANCE SHEET DATA					
Real Estate, net	$ 1,485,859	$ 1,272,424	$ 1,113,105	$ 983,422	$ 1,054,835
Notes and interest receivable, net	83,467	52,631	81,440	72,661	70,595
Total Assets	1,777,854	1,493,671	1,345,795	1,190,843	1,240,880
Notes and interest payable	1,400,877	1,124,765	1,021,822	939,921	986,769
Stock-secured notes payable	17,546	22,452	22,549	18,663	21,194
Stockholder s equity	192,386	160,489	148,397	103,009	76,871
Book value per share	$ 18.81	$ 15.81	$ 12.80	$ 8.89	$ 6.75

Table of Contents

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*
The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

This Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws, principally, but not only, under the captions Business, Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations. We caution investors that any forward-looking statements in this report, or which management may make orally or in writing from time to time, are based on management s beliefs and on assumptions made by, and information currently available to, management. When used, the words anticipate, believe, expect, intend, may, might, plan, estimate, project, should, will, result and similar expressions whicl historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties, and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties, and factors, that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution you that, while forward-looking statements reflect our good faith beliefs when we make them, they are not guarantees of future performance and are impacted by actual events when they occur after we make such statements. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

- general risks affecting the real estate industry (including, without limitation, the inability to enter into or renew leases, dependence on tenants financial condition, and competition from other developers, owners and operators of real estate);
- risks associated with the availability and terms of financing and the use of debt to fund acquisitions and developments;
- failure to manage effectively our growth and expansion into new markets or to integrate acquisitions successfully;
- risks and uncertainties affecting property development and construction (including, without limitation, construction delays, cost overruns, inability to obtain necessary permits and public opposition to such activities);
- risks associated with downturns in the national and local economies, increases in interest rates, and volatility in the securities markets;
- costs of compliance with the Americans with Disabilities Act and other similar laws and regulations;
- potential liability for uninsured losses and environmental contamination;
- risks associated with our dependence on key personnel whose continued service is not guaranteed; and
- the other risk factors identified in this Form 10-K, including those described under the caption Risk Factors.

The risks included here are not exhaustive. Other sections of this report, including PART I, ITEM 1A. RISK FACTORS, include additional factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can we assess the impact of

all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Investors should also refer to our quarterly reports on Form 10-Q for future periods and current reports on Form 8-K as we file them with the SEC, and to other materials we may furnish to the public from time to time through Forms 8-K or otherwise.

Overview

ARI was organized in 1999. In August 2000, ARI acquired American Realty Trust, Inc. (ART) and National Realty, L.P. (NRLP). ART was the successor to a business trust organized in 1961 to provide investors with a professionally managed, diversified portfolio of real estate and mortgage loan investments selected to provide opportunities for capital appreciation as well as current income. The business trust merged into ART in 1987. ART owns a portfolio of real estate and mortgage loan investments. NRLP was organized in 1987, and subsequently acquired all of the assets and assumed all of the liabilities of 35 public and private limited partnerships. NRLP also owned a portfolio of real estate and mortgage loan investments.

ARI subsidiaries owned approximately 82% of the outstanding shares of common stock of Transcontinental Realty Investors, Inc., a Nevada corporation (TCI), which has its common stock listed and traded on the New York Stock Exchange, Inc. (NYSE). The ownership of the TCI shares was achieved through a series of transactions, including a cash tender offer completed March 19, 2003, an exchange by certain ARI subsidiaries of securities with Basic Capital Management, Inc. (BCM) and a sale of a participating interest in a line of credit receivable from One Realco Corporation (One Realco) to BCM, as well as certain open market purchases of TCI shares in December 2003. See Note 1 to the Consolidated Financial Statements. ARI has consolidated TCI s accounts and operations since March 31, 2003. At December 31, 2007, TCI owned approximately 25% of the outstanding common stock of Income Opportunity Realty Investors, Inc., (IORI), a public company whose shares are listed and traded on the American Stock Exchange. In addition, TCI owns 746,972 shares of common stock of ARI.

ARI is an externally advised and managed real estate investment company that owns a diverse portfolio of income-producing properties and land held for development. The Company s portfolio of income-producing properties includes residential apartment communities, office buildings, hotels, a trade mart located in Denver, Colorado and other commercial properties. ARI s investment strategy includes acquiring existing income-producing properties as well as developing new properties on land already owned or acquired for a specific development project. ARI acquires land primarily in in-fill locations or high-growth suburban markets. ARI is an active buyer and seller and during 2007 acquired over $145 million and sold over $181 million of land and income-producing properties. As of December 31, 2007, the Company owned approximately 12,788 units in 69 residential apartment communities, 31 commercial properties comprising almost 5.8 million rentable square feet and 9 hotels containing a total of 1,125 rooms. In addition, at December 31, 2007, ARI owned 11,000 acres of land held for development and had over 2,400 apartment units in 19 projects under construction. The Company currently owns income-producing properties and land in 19 states as well as in the U.S. Virgin Islands and Wroclaw, Poland. ARI finances its acquisitions primarily through operating cash flow, proceeds from the sale of land and income-producing properties and debt financing primarily in the form of property-specific first-lien mortgage loans from commercial banks and institutional lenders. ARI finances it development projects principally with short-term, variable interest rate construction loans that are converted to long-term, fixed rate amortizing mortgages when the development project is completed and occupancy has been stabilized. The Company will, from time to time, also enter into partnerships with various investors to acquire income-producing properties or land and to sell interests in certain of its wholly owned properties. When the Company sells assets, it may carry a portion of the sales price generally in the form of a short-term, interest bearing seller-financed note receivable. The Company generates operating revenues primarily by leasing apartment units to residents; leasing office, retail and industrial space to commercial tenants; and renting hotel rooms to guests. ARI is advised by Prime under a contractual arrangement that is reviewed annually by ARI s Board of Directors. ARI s commercial

Table of Contents

properties are managed by Regis Commercial while the Company s hotels are managed by Regis Hotel. ARI currently contracts with five third-party companies to manage the Company s apartment communities. Approximately 62% of ARI s common stock is owned by BCM; an additional 13% is owned by Prime and TCI owns approximately seven percent of the outstanding common shares of ARI. Other affiliated companies own approximately two percent of ARI s outstanding common shares. ARI is a C Corporation for U.S. federal income tax purposes and files an annual consolidated income tax return with TCI. ARI does not qualify as a Real Estate Investment Trust (REIT) for federal income tax purposes primarily due to ARI s majority ownership of the Company.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or GAAP, requires management to use judgment in the application of accounting policies, including making estimates and assumptions. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of our financial statements. From time to time, we evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. Below is a discussion of accounting policies that we consider critical in that they may require complex judgment in their application or require estimates about matters that are inherently uncertain.

Real Estate

Upon acquisitions of real estate, ARI assesses the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, above- and below-market leases, origination costs, acquired in-place leases, other identified intangible assets and assumed liabilities in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and allocates the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

We assess and consider fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates, as well as available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known and anticipated trends, and market and economic conditions. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant. We also consider an allocation of purchase price of other acquired intangibles, including acquired in-place leases that may have a customer relationship intangible value, including (but not limited to) the nature and extent of the existing relationship with the tenants, the tenants credit quality and expectations of lease renewals. Based on our acquisitions to date, our allocation to customer relationship intangible assets has been immaterial.

We record acquired above- and below-market leases at their fair values (using a discount rate which reflects the risks associated with the leases acquired) equal to the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) management s estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market fixed rate renewal options for below-market leases.

Other intangible assets acquired include amounts for in-place lease values that are based on our evaluation of the specific characteristics of each tenant s lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar

leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider leasing commissions, legal and other related expenses.

Real estate is stated at depreciated cost. The cost of buildings and improvements includes the purchase price of property, legal fees and other acquisition costs. Costs directly related to the development of properties are capitalized. Capitalized development costs include interest, property taxes, insurance, and other project costs incurred during the period of development.

Management reviews its long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates impairment in value. An impairment loss is recognized if the carrying amount of its assets is not recoverable and exceeds its fair value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The evaluation of anticipated cash flows is highly subjective and is based in part on assumptions regarding future occupancy, rental rates and capital requirements that could differ materially from actual results in future periods.

SFAS No. 144 requires that qualifying assets and liabilities and the results of operations that have been sold, or otherwise qualify as held for sale, be presented as discontinued operations in all periods presented if the property operations are expected to be eliminated and the Company will not have significant continuing involvement following the sale. The components of the property s net income that is reflected as discontinued operations include the net gain (or loss) upon the disposition of the property held for sale, operating results, depreciation and interest expense (if the property is subject to a secured loan). We generally consider assets to be held for sale when the transaction has been approved by our Board of Directors, or a committee thereof, and there are no known significant contingencies relating to the sale, such that the property sale within one year is considered probable. Following the classification of a property as held for sale, no further depreciation is recorded on the assets.

A variety of costs are incurred in the acquisition, development and leasing of properties. After determination is made to capitalize a cost, it is allocated to the specific component of a project that is benefited. Determination of when a development project is substantially complete and capitalization must cease involves a degree of judgment. Our capitalization policy on development properties is guided by SFAS No. 34 Capitalization of Interest Cost and SFAS No. 67 Accounting for Costs and the Initial Rental Operations of Real Estate Properties. The costs of land and buildings under development include specifically identifiable costs. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. We consider a construction project as substantially completed and held available for occupancy upon the receipt of certificates of occupancy, but no later than one year from cessation of major construction activity. We cease capitalization on the portion (1) substantially completed and (2) occupied or held available for occupancy, and we capitalize only those costs associated with the portion under construction.

Investment in Unconsolidated Real Estate Ventures

Except for ownership interests in variable interest entities, ARI accounts for our investments in unconsolidated real estate ventures under the equity method of accounting because the Company exercises significant influence over, but does not control, these entities. These investments are recorded initially at cost, as investments in unconsolidated real estate ventures, and subsequently adjusted for equity in earnings and cash contributions and distributions. Any difference between the carrying amount of these investments on the Company s balance sheet and the underlying equity in net assets is amortized as an adjustment to equity in earnings of unconsolidated real estate ventures over the life of the related asset. Under the equity method of accounting, ARI s net equity is reflected within the Consolidated Balance Sheets, and our share of net income or loss from the joint ventures is included within the Consolidated Statements of Operations. The joint venture

agreements may designate different percentage allocations among investors for profits and losses; however, ARI s recognition of joint venture income or loss generally follows the joint venture s distribution priorities, which may change upon the achievement of certain investment return thresholds. For ownership interests in variable interest entities, the Company consolidates those in which we are the primary beneficiary.

Recognition of Rental Income

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. In accordance with SFAS 141, we recognize rental revenue of acquired in-place above- and below-market leases at their fair values over the terms of the respective leases. On our Consolidated Balance Sheets, we include as a receivable the excess of rental income recognized over rental payments actually received pursuant to the terms of the individual commercial lease agreements.

Reimbursements of operating costs, as allowed under most of our commercial tenant leases, consist of amounts due from tenants for common area maintenance, real estate taxes and other recoverable costs, and are recognized as revenue in the period in which the recoverable expenses are incurred. We record these reimbursements on a gross basis, since we generally are the primary obligor with respect to purchasing goods and services from third-party suppliers, have discretion in selecting the supplier and have the credit risk with respect to paying the supplier.

Rental income for residential property leases is recorded when due from residents and is recognized monthly as earned, which is not materially different than on a straight-line basis as lease terms are generally for periods of one year or less.

For hotel properties, revenues for room sales and guest services are recognized as rooms are occupied and services are rendered.

An allowance for doubtful accounts is recorded for all past due rents and operating expense reimbursements considered to be uncollectible.

Revenue Recognition on the Sale of Real Estate

Sales of real estate are recognized when and to the extent permitted by Statement of Financial Accounting Standards No. 66, Accounting for Sales of Real Estate (SFAS No. 66), as amended by SFAS No. 144. Until the requirements of SFAS No. 66 for full profit recognition have been met, transactions are accounted for using the deposit, installment, cost recovery or financing method, whichever is appropriate. When ARI provides seller financing, gain is not recognized at the time of sale unless the buyer s initial investment and continuing investment are deemed to be adequate as determined by SFAS 66 guidelines.

Non-performing Notes Receivable

ARI considers a note receivable to be non-performing when the maturity date has passed without principal repayment and the borrower is not making interest payments. Any new note receivable that results from a modification or extension of a note considered non-performing will also be considered non-performing, without regard to the borrower s adherence to payment terms.

Interest Recognition on Notes Receivable

Interest income is not recognized on notes receivable that have been delinquent for 60 days or more. In addition, accrued but unpaid interest income is only recognized to the extent that the net realizable value of the underlying collateral exceeds the carrying value of the receivable.

Table of Contents

Allowance for Estimated Losses

A valuation allowance is provided for estimated losses on notes receivable considered to be impaired. Impairment is considered to exist when it is probable that all amounts due under the terms of the note will not be collected. Valuation allowances are provided for estimated losses on notes receivable to the extent that the investment in the note exceeds management s estimate of fair value of the collateral securing such note.

Fair Value of Financial Instruments

The following assumptions were used in estimating the fair value of ARI s notes receivable, marketable equity securities and notes payable. For performing notes receivable, the fair value was estimated by discounting future cash flows using current interest rates for similar loans. For non-performing notes receivable, the estimated fair value of ARI s interest in the collateral property was used. For marketable equity securities, fair value was based on the year-end closing market price of each security. For notes payable, the fair value was estimated using current rates for mortgages with similar terms and maturities

Results of Operations

The following discussion is based on our Consolidated Financial Statements for the years ended December 31, 2007, 2006, and 2005.

At December 31, 2007, 2006, and 2005, we owned or had interests in a portfolio (the Total Property Portfolio) of 110, 130, and 116 income producing properties, respectively.

Comparison of the year ended December 31, 2007 to the year ended December 31, 2006.

We define Same Property Portfolio for each income-producing asset type (apartments, commercial properties and hotels) as properties with stabilized occupancy owned and operated for the entire two-year period being compared. A stabilized property is defined as a newly developed project whose occupancy has reached greater than approximately 85%. The Same Property Portfolio consists of 51 apartments, 27 commercial properties, and 6 hotels.

We had net income of $24.1 million in 2007, which includes gains of land sales of $20.5 million, and net income from discontinued operations of $29.1 million, compared to net income of $10.5 million in 2006, including gains on land sales totaling $23.9 million and net income from discontinued operations of $13.5 million.

Rents and other property revenues were $176.9 million in 2007 as compared to $147.6 million in 2006 and an increase of $29.3 million. Rents and other property revenues from our same property portfolio was $136.7 million in 2007 as compared to $136.1 million in 2006, an increase of $600.000. This was due to an increase in apartments and hotel revenues of $2.5 million and $400,000, respectively, offset by a decrease in commercial property revenues of $2.3 million. The remaining increase of $28.8 million was due to revenues associated with the acquisition of commercial (ParkWest I & II) and hotel properties of $22.0 million and $2.2 million, respectively, and developed properties of $5.8 million, offset by a decrease in revenues from land and other of $1.2 million.

Property operations expenses were $112.5 million in 2007 as compared to $98.6 million in 2006, an increase of $13.9 million. Property operations expenses from our same property portfolio were $85.0 in 2007 as compared to 86.3 million in 2006, a decrease of $1.3 million. This is attributable to a decrease in the operating costs of our hotels and apartments of $1.8 million and $100,000 respectively, offset by an increase in our commercial portfolio of $600,000. The remaining increase of $15.2 million is from the acquisition of commercial properties of $9.4 million, increased costs in our hotel operations in Poland of $2.2 million, Developed properties of $3.3 million, and land holding and other costs of $300,000.

Depreciation and amortization expenses were $24.4 million in 2007 as compared to $21.9 million in 2006, an increase of $2.5 million. The acquisition of the Park West I & II building increase depreciation by $2.5 million. The completion of Developed Properties not stabilized accounted for another $1.0 million of depreciation expense. This was offset by a decrease of ($1.0 million) from the Same Property Portfolio which consisted of; an increase in apartments of $148,000, a decrease in Commercial of ($1.2 million), and a decrease in Hotels of (77,000).

General and administrative expenses were $15.9 million in 2007 as compared to $9.3 million in 2007, an increase of $6.6 million. The 2007 amount includes 2.0 million in legal settlement fees, and higher cost reimbursements to the advisor. The 2006 amount includes credits for litigation reimbursements of $3.3 million, and overall lower legal and professional fees.

Advisory fees to affiliate were $14.9 million in 2007 as compared to 12.7 million in 2006, an increase of $2.2 million. The increase was due to was due to higher gross assets in 2007 than 2006.

Gain on foreign currency translation was $2.4 million in 2007 as compared to $2,000 in 2006, an increase of $2.4 million. The increase was due to the translation of currency associated with our hotel in Poland. The devaluation of the dollar has increased the gain on our currency translation.

Mortgage loan interest expenses were $89.8 million in 2007, as compared to $67.9 million in 2006, an increase of $21.9 million. The increase is due increase in debt due to refinancings, new loans on acquisitions, and construction draws. Refinancings on the Same Property Portfolio accounted for $4.4 million of the increase, which consists of: Apartments $1.2 million and Hotels $3.2 million. The refinancing of land accounted for $6.3 million. Additional debt incurred in the acquisition of commercial properties accounted for $6.5 million, and Construction draws accounted for $3.3 million.

Gain on involuntary conversion was $34.7 million in 2007 as compared to 20.5 million in 2006, an increase of 14.2 million. The gain of $34.7 million in 2007 relates to the subsequent collection of insurance proceeds from the damages sustained at our new Orleans commercial properties from Hurricane Katrina during 2005. In the prior year, we recorded a gain of 20.5 million from the collection of insurance proceeds related to Hurricane Katrina. The remaining $2.2 million gain on involuntary conversion relates to various individual claims under $500,000 each related to collections of insurance proceeds.

In 2007, we determined that an impairment write down was need for the Executive Court of $206,000 and the Encon Warehouse of $797,000. There were no impairments in 2006.

In 2007, we paid $1.3 million in expense towards the settlement of the Sunset litigation that were not previously accrued. The Sunset litigation was settled September 18, 2007. There were no significant litigation settlement expenses in 2006.

Gain on land sales was $20.5 million in 2007 as compared to $24.0 million in 2006. In 2007, we sold 252 acres of land in 18 separate transactions with an aggregate sales price of $36.0 million, receiving $13.1 million in cash. The average sales price was $142,000 per acre. The sales relate to the land properties known as; Desoto Ranch(easement), 28.9 acres of McKinney Ranch, 3.4 acres Mandahl Bay, 2.3 acres West End, 3.0 acres Miro Lago, 4.0 acres Hines Meridian, 86.0 acres RB, 4.6 acres Grapevine Vineyards, 75.4 acres Metro Center, 1.2 acres Katrina, 39.2 acres Windmill Farm, and 4.0 acres Vista Ridge. In 2006, we sold 317 acres of land in 19 separate transactions for at an average sales price of $195,000 per acre.

Net income from discontinued operations was $29.2 million in 2007 as compared $13.5 in 2006. For 2007 and 2006, income from discontinued operations relates to 59 properties of which 20 were sold in 2006, 18 sold in 2007 and 21 were held for sale and subsequently sold in 2008.

Table of Contents

	For the twelve months ending Dec 31, 2007	2006
Revenue		
Rental	$ 41,541	$ 52,346
Restaurant Income		34,199
Total Income	41,541	86,545
Cost of Sales		
Property operations	29,626	36,427
Restaurant Expenses		25,503
Total Expenses	29,626	61,930
	11,915	24,615
Other		
Interest	(15,804)	(15,403)
G&A	(82)	(3,467)
Depreciation	(4,537)	(7,130)
Income (Loss) from Disc Operations	(8,508)	(1,385)
Gain on sale of discontinued operations	53,375	22,159
Income (Loss) from Disc Operations	44,867	20,774
Tax Expense (Benefit)	(15,703)	(7,271)
Net Income (loss)	$ 29,164	$ 13,503

Comparison of the year ended December 31, 2006 to the year ended December 31, 2005.

We define Same Property Portfolio for each income-producing asset type (apartments, commercial properties and hotels) as properties with stabilized occupancy owned and operated for the entire two-year period being compared. The Same Property Portfolio consists of 67 apartments, 27 commercial properties, and 11 hotels.

ARI had net income applicable to common shares of $10.5 million in 2006, including gains on land sales totaling $24.0 million and net income from discontinued operations of $13.5 million, compared to net income applicable to common shares of $44.8 million in 2005, including gains on land sales of $39.9 million and income from discontinued operations of $37.5 million.

Rents and other property revenues were $147.6 million in 2006 as compared to $123.1 million in 2005, an increase of $24.5 million. Rents and other property revenues from our same property portfolio was $136.1 in 2006 as compared to $116.8 in 2005, an increase of $19.3 million. This is attributable to an overall increase in rents from apartments, commercial properties and hotels of $10.6 million, $8.0 million, and $700,000, respectively. The remaining $5.2 million is due to the acquisition of commercial properties (ParkWest I & II) and hotel properties of $2.4 and $1.0 million, respectively. In addition, revenues from developed properties and land increased $1.5 million and $300,000, respectively.

Property operations expense were $98.6 million in 2006 as compared to $82.6 million in 2005, an increase of $16.0 million. Property operations expense from the same property portfolio was 85.8 million in 2006 as compared to $72.5 million in 2005, an increase of $13.3 million. This increase is attributable to an overall increase in costs across the board on all of our apartments, commercial and hotel properties of $4.8 million, $7.4 million, and $1.1 million, respectively. The remaining $2.7 million Is due to costs from acquired properties and develop properties of $1.4 million and $1.4 million, respectively.

Depreciation and amortization expenses were $21.9 million in 2006 as compared to $17.4 million in 2005, an increase of $4.5 million. Depreciation for the Same Property Portfolio increased $3.9 million, which consisted of: Apartment Portfolio of $1.9 million, Commercial Portfolio of 1.8 million, and Hotel Portfolio of $300,000. The increases were due to depreciation associated with the purchase new assets. The remaining increase is due the depreciation of $300,000 on land improvements, and $300,000 on the acquisition of properties within the commercial Portfolio in the current year.

General and administrative expenses were $9.3 million in 2006 as compared to $14.0 million in 2005. The decrease in 2006 was due to lower legal and professional fees and reduced state income tax expense, combined with the proceeds of a litigation settlement received in 2006.

Advisory fee expense were $12.7 million in 2006 as compared to $9.3 million in 2005. The increase from 2005 was due to higher gross assets in 2006 and a 2005 refund of 2004 Advisor cost reimbursements received from Prime. ARI s advisory agreement with Prime limits the amount of cost reimbursements payable by ARI to Prime. See NOTE 12. ADVISORY AGREEMENT.

Mortgage and loan interest expenses were $67.9 million in 2006 as compared to $50.7 in 2005, an increase of $17.2 million. Refinancing of existing debt within the Same Property Portfolio accounted for $5.2 million of the increase which consisted of; Apartment Portfolio of $2.4 million and the Commercial Portfolio of $2.7 million. The acquisition of a commercial building accounted for $400,000. The refinancings and increases in variable interest rates on the land Portfolio accounted for $11.6 million.

The 2006 gain on involuntary conversion of $20.5 million relates to damage sustained at the Company s New Orleans commercial properties from Hurricane Katrina during 2005. ARI s 225 Baronne property was closed immediately after the storm and the Company intends to redevelop 225 Baronne as a residential property. ARI s 1010 Common and Amoco buildings suffered hurricane damage as well but have been repaired and have reopened. 1010 Common is presently 77% occupied and Amoco is 89% occupied. In 2005, the Company received $4.2 million in business interruption insurance proceeds, which was included in 2005 rental revenues. ARI received approximately $45 million of insurance proceeds in 2006, of which $4.0 million related to business interruption claims and has been included in 2006 rental revenues.

Gain on land sales were $23.9 million in 2006 as compared to 39.9 million in 2005, a decrease of $16.0 million. During 2006, ARI sold approximately 318 acres of land in 19 separate transactions at an average sales price of $347,000 per acre. The largest land sales in 2006 were the sale of a) 123.9 acres in McKinney, Texas for $134,000 per acre, generating net cash proceeds of $6.0 million and a recognized gain of $3.4 million and b) 44.5 acres in McKinney, Texas for $231,000 per acre, generating net cash proceeds of $10.0 million and a recognized gain of $5.3 million. In 2005, the Company sold 411 acres of land in 27 separate transactions at an average sales price of $235,000 per acre, generating net cash proceeds of $23.8 million.

Minority interest was $672,000 in 2006 compared to $(3.1) million in 2005. Fully consolidated ventures where ARI owns less than 100 percent ownership swung to a net loss in 2006 compared to net income in 2005.

Table of Contents

Income from discontinued operations was $13.5 million in 2006 as compared to $37.5 million in 2005. For 2006 and 2005, income from discontinued operations relates to 71 properties of which 21 were held for sale and sold in 2008, 10 sold in 2007, 20 sold in 2006 and 21 sold in 2005. A summary of the discontinued operations for 2006 and 2005 is listed below:

	For the twelve months ending Dec 31, 2006	2005
Revenue		
Rental	$ 52,346	$ 64,152
Restaurant Income	34,199	36,818
Total Income	86,545	100,970
Cost of Sales		
Property operations	36,427	47,439
Restaurant Expenses	25,503	27,905
Total Expenses	61,930	75,344
	24,615	25,626
Other		
Interest	(15,403)	(20,338)
G&A	(3,467)	(3,643)
Depreciation	(7,130)	(6,559)
Income (Loss) from Disc Operations before income tax	(1,385)	(4,914)
Gain on sale of discontinued operations	22,159	62,617
Income (Loss) from Disc Operations	20,774	57,703
Tax Expense (Benefit)	(7,271)	(20,196)
Net Income (loss)	$ 13,503	$ 37,507

Liquidity and Capital Resources

General

Our principal liquidity needs are:

fund normal recurring expenses;

meet debt service and principal repayment obligations including balloon payments on maturing debt;

fund capital expenditures, including tenant improvements and leasing costs;

fund development costs not covered under construction loans;

fund possible property acquisitions

Our principal sources of cash have been and will continue to be property operations, proceeds from land and income-producing property sales, collection of mortgage notes receivable, collections of receivables from affiliated companies, refinancing of existing debt and additional borrowings, including mortgage notes payable, lines of credit. We may also issue additional equity securities, including common stock and preferred stock. Management anticipates that our cash at December 31, 2007, along with cash that will be generated in 2008 from property operations, may not be sufficient to meet all of our cash requirements. Management intends to selectively sell land and income producing assets, refinance or extend real estate debt and seek additional borrowings secured by real estate to meet its liquidity requirements. Historically, management has been successful at extending a portion of the Company s current maturity obligations.

Table of Contents

Cash flow summary

The following summary discussion of our cash flows is based on the consolidated statements of cash flows in item 8 . Consolidated Financial Statements and Supplementary Data and is not meant to be an all-inclusive discussion of the changes in our cash flows for the periods presented below.

Cash and cash equivalents were $11.6 million at December 31, 2007 as compared to $7.0 million at December 31, 2006, an increase in cash of $4.6 million. The increase was the results of a decrease in cash from operating activities of ($23.5) million, a decrease in cash from investing activities of ($224.5) million, and an increase in cash from financing activities of $252.5 million.

Our cash from operating activities which consists primarily of income from the operations of our Apartments, Hotels, and Commercial properties was not sufficient to support our current operations. We had a cash shortfall of ($23.5) million in 2007. This was primarily due to our increased costs associated with land holding costs, increased interest rates on existing debt, and the increased interest expense associated with the acquisition of new and refinanced debt. Management anticipates on selling selected land tracts and income producing properties to finance our continuing operations. In the past, management has been successful at meeting our cash flow needs.

Our primary use of cash was for investing activities of ($224.5) million. We currently have 19 apartment communities under construction, which used ($204.7) million in cash for construction and development. We purchased 677 acres of land using ($25.0) million in cash, and two commercial buildings using ($114.3) million in cash. These cash requirements were partially funded from the sale of income producing properties providing $55.3 million in cash, which included the sale of one Hotel, four Commercial buildings, and seven apartments. In addition, we sold 252 acres of land providing $65.5 million in cash proceeds. We also invested $15.1 million in cash on improvements on existing income producing properties.

Our financing activities provided us with $252.5 million in cash. Our primary source of cash was from new and refinanced debt, which provided us with $529.1 million in cash. We refinanced 30 existing mortgage notes payable and obtained 12 new notes associated with the purchase of ten tracts of land and two buildings. This was offset by payments on maturing notes of $240.2 million.

We anticipate that funds from existing cash resources, aggressive sales of land and selected income producing property sales, refinancing of real estate, and borrowings against our real estate will be sufficient to meet the cash requirements associated with our current and anticipated level of operations, maturing debt obligations and existing commitments. To the extent that our liquidity permits or financing sources are available, We will continue to make investments in real estate, primarily in improved and unimproved land, real estate entities and marketable equity securities, and will develop and construct income-producing properties.

Equity Investments. Since 1988, ARI has from time to time purchased shares of IORI and TCI, both of which had the same advisor as ARI until June 2003. The Company may purchase additional equity securities of IORI and TCI through open market and negotiated transactions to the extent ARI s liquidity permits.

Equity securities of TCI held by ARI (and of IORI held by TCI) may be deemed restricted securities under Rule 144 of the Securities Act of 1933 (Securities Act). Accordingly, ARI may be unable to sell such equity securities other than in a registered public offering or pursuant to an exemption under the Securities Act for a one-year period after they are acquired. Such restrictions may reduce ARI s ability to realize the full fair market value of such investments if ARI attempted to dispose of such securities in a short period of time.

In 2007, ARI declared dividends to its preferred stockholders totaling $2.5 million, of which approximately $1 million was paid.

Table of Contents

Management reviews the carrying values of ARI s properties and mortgage notes receivable at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow from the property (undiscounted and without interest) is less than the carrying amount of the property. For notes receivable, impairment is considered to exist if it is probable that all amounts due under the terms of the note will not be collected. If impairment is found to exist, a provision for loss is recorded by a charge against earnings to the extent that the investment in the note exceeds management s estimate of the fair value of the collateral securing such note. The mortgage note receivable review includes an evaluation of the collateral property securing each note. The property review generally includes: (1) selective property inspections, (2) a review of the property s current rents compared to market rents, (3) a review of the property s expenses, (4) a review of maintenance requirements, (5) a review of the property s cash flow, (6) discussions with the manager of the property, and (7) a review of properties in the surrounding area.

Contractual Obligations

ARI has contractual obligations and commitments primarily with regards to the payment of mortgages. The following table aggregates ARI s expected contractual obligations and commitments subsequent to December 31, 2007.

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
		(dollars in thousands)			
Long-Term Debt Obligations	$ 1,382,613	$ 434,900	$ 250,074	$ 125,404	$ 572,235
Capital Lease Obligations					
Operating Lease Obligations					
Purchase Obligations					
Other Long-Term Liabilities Reflected on the Registrant s Balance Sheet under GAAP	3,067	3,067			
Total	$ 1,385,680	$ 437,967	$ 250,074	$ 125,404	$ 572,235

(1) ARI s long-term debt may contain financial covenants that, if certain thresholds are not met, could allow the lender to accelerate principal payments or cause the note to become due immediately.

Other long-term liabilities represent ARI s intentions to purchase the interests of general and limited purchases of partnerships formed to construct residential properties.

Environmental Matters

Under various federal, state and local environmental laws, ordinances and regulations, ARI may be potentially liable for removal or remediation costs, as well as certain other potential costs relating to hazardous or toxic substances (including governmental fines and injuries to persons and property) where property-level managers have arranged for the removal, disposal or treatment of hazardous or toxic substances. In addition, certain environmental laws impose liability for release of asbestos-containing materials into the air, and third parties may seek recovery for personal injury associated with such materials.

Management is not aware of any environmental liability relating to the above matters that would have a material adverse effect on ARI s business, assets or results of operations.

Inflation

The effects of inflation on ARI s operations are not quantifiable. Revenues from property operations tend to fluctuate proportionately with inflationary increases and decreases in housing costs. Fluctuations in the rate of inflation also affect the sales values of properties and the ultimate gains to be realized from property sales. To the extent that inflation affects interest rates, earnings from short-term investments and the cost of new financings as well as the cost of variable interest rate debt will be affected.

Table of Contents

ITEM 7A. ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.***

ARI s future operations, cash flow and fair values of financial instruments are partially dependent upon the then existing market interest rates and market equity prices. Market risk is the change in the market rates and prices and the affect of the changes on the future operations. Market risk is managed by matching a property s anticipated net operating income to an appropriate financing.

ARI is exposed to interest rate risk associated with variable rate notes payable and maturing debt that has to be refinanced. ARI does not hold financial instruments for trading or other speculative purposes, but rather issues these financial instruments to finance its portfolio of real estate assets. ARI s interest rate sensitivity position is managed by ARI s capital markets department. Interest rate sensitivity is the relationship between changes in market interest rates and the fair value of market rate sensitive assets and liabilities. ARI s earnings are affected as changes in short-term interest rates impact its cost of variable rate debt and maturing fixed rate debt. A large portion of ARI s market risk is exposure to short-term interest rates from variable rate borrowings. The impact on ARI s financial statements of refinancing fixed debt that matured during 2007 was not material. As permitted, management intends to convert a significant portion of those borrowings from variable rates to fixed rates. If market interest rates for variable rate debt average 100 basis points more in 2008 than they did during 2007, ARI s interest expense would increase and net income would decrease by $2.3 million. This amount is determined by considering the impact of hypothetical interest rates on ARI s borrowing cost. The analysis does not consider the effects of the reduced level of overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management would likely take actions to further mitigate its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity analysis assumes no change in ARI s financial structure.

The following table contains only those exposures that existed at December 31, 2007. Anticipation of exposures of risk on positions that could possibly arise was not considered. ARI s ultimate interest rate risk and its effect on operations will depend on future capital market exposures, which cannot be anticipated with a probable assurance level. All Dollars are in thousands.

	2008	2009	2010	2011	2012	Thereafter	Total
Assets							
Marketable securities at fair value							$ 14,442
Notes Receivable							
Variable interest rate-fair value							$ 23,875
Instrument s maturities	$ 5,633	$ 13,561	$ 6,553	$	$	$	$ 25,747
Instrument s amortization							
Interest	2,712	1,889	331				4,932
Average rate	9.6%	9.0%	8.8%	0.0%	0.0%	0.0%	
Fixed interest rate-fair value							$
Instrument s maturities	$ 19,449	$ 6,430	$ 9,323	$ 627	$	$ 24,981	$ 60,810
Instrument s amortization	6						6
Interest	4,917	4,053	3,341	3,211	3,157	5,878	24,557
Average rate	11.0%	12.1%	12.8%	13.8%	13.8%	9.4%	
Liabilities							
Notes Payable							
Variable interest rate-fair value							$ 387,349
Instrument s maturities	$ 180,534	$ 80,492	$ 39,187	$ 12,031	$ 4,340	$ 27,736	$ 344,320
Instrument s amortization	39,136	2,960	800	729	354	10,889	54,868
Interest	23,152	8,474	6,000	3,491	2,858	15,738	59,713
Average rate	8.0%	7.7%	7.6%	7.6%	12.3%		
Fixed interest rate-fair value							$
Instrument s maturities	$ 197,411	$ 50,420	$ 23,908	$ 19,276	$ 63,493	$ 89,501	$ 444,009
Instrument s amortization	38,211	40,023	12,284	12,505	12,675	444,109	559,807
Interest	68,553	50,911	43,605	37,803	34,290	481,629	716,791
Average rate	8.1%	10.3%	9.5%	7.2%	7.9%		

Table of Contents

ITEM 8. ***CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Financial Statements	
Reports of Independent Registered Public Accounting Firms	43
Consolidated Balance Sheets December 31, 2007 and 2006	44
Consolidated Statements of Operations Years Ended December 31, 2007, 2006 and 2005	45
Consolidated Statements of Stockholders Equity Years Ended December 31, 2007, 2006 and 2005	46
Consolidated Statements of Cash Flows Years Ended December 31, 2007, 2006 and 2005	47
Notes to Consolidated Financial Statements	48
Financial Statement Schedules	
Schedule III Real Estate and Accumulated Depreciation	76
Schedule IV Mortgage Loans on Real Estate	91

All other schedules are omitted because they are not required, are not applicable, or the information required is included in the Consolidated Financial Statements or the notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of and

Stockholders of American Realty Investors, Inc.

Dallas, Texas

We have audited the accompanying consolidated balance sheets of American Realty Investors, Inc. and Subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity, and cash flows each for each of the years in the three-year period ended December 31, 2007. American Realty Investors, Inc s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 21, American Realty Investors, Inc. s management intends to sell land and income producing properties and refinance or extend debt secured by real estate to meet the Company s liquidity needs.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Realty Investors, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. Schedules III and IV are presented for the purpose of complying with the Securities and Exchange Commission s rules and is not a required part of the basic consolidated financial statements. These schedules have been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, fairly state, in all material respects, the financial data required to be set forth therein in relation to the basic consolidated financial statements taken as a whole.

Farmer, Fuqua & Huff, PC

Plano, Texas

March 31, 2008

Table of Contents

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
	(dollars in thousands)	
Assets		
Real estate held for investment	$ 1,508,815	$ 1,249,833
Less accumulated depreciation	(148,404)	(178,029)
	1,360,411	1,071,804
Real estate held for sale, net of depreciation	61,128	134,593
Real estate subject to sales contracts	64,320	66,027
Notes and interest receivable		
Performing ($16,485 in 2007 and 25,578 in 2006 from affiliates)	69,977	50,668
Non-performing ($16,246 million in 2007 and $2,963 in 2006 from affiliates)	16,468	2,963
	86,445	53,631
Less allowance for estimated losses	(2,978)	(1,000)
	83,467	52,631
Marketable securities, at market value	13,157	9,038
Cash and cash equivalents	11,560	7,035
Restricted cash	2,556	6,000
Investments in equity investees	23,867	25,056
Other assets ($54,439 in 2007 and $52,793 in 2006 from affiliates)	157,388	121,487
	$ 1,777,854	$ 1,493,671
Liabilities and Stockholders Equity		
Liabilities:		
Notes and interest payable ($8,269 in 2007 and $7,499 in 2006 to affiliates)	$ 1,221,987	$ 1,022,370
Liabilities related to assets held-for-sale	116,377	43,579
Liabilities subject to sales contracts	62,513	58,816
Stock-secured notes payable	17,546	22,452
Accounts payable and other liabilities ($1,873 in 2007 and $10,452 in 2006 to affiliates)	104,884	107,771
	1,523,307	1,254,988
Commitments and contingencies		
Minority interest	62,161	78,194
Stockholders equity		
Preferred Stock, $2.00 par value, authorized 15,000,000 shares, issued and outstanding Series A, 3,390,316 shares in 2007 and 2006 (liquidation preference $33,909), including 900,000 shares in 2007 and 2006 held by subsidiaries	4,979	4,979
Common Stock, $.01 par value, authorized 100,000,000 shares; issued 11,592,272 shares in 2007 and 2006	114	114
Treasury stock, at cost;1,129,530 and 1,443,272 shares in 2007 and 2006, respectively	(12,664)	(15,146)
Paid-in capital	100,277	93,378
Retained earnings	99,452	75,380
Accumulated other comprehensive income (loss)	228	1,784
	192,386	160,489

	$ 1,777,854	$ 1,493,671

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31, 2007		
	2007	**2006**	**2005**
	(dollars in thousands)		
Revenues:			
Rental and other property revenues ($1,197 in 2007, $1,423 in 2006 and $1,091 in 2005 from affiliates)	$ 176,930	$ 147,563	$ 123,147
Expenses:			
Property operating expenses ($9,239 in 2007, $8,212 in 2006 and $5,182 in 2005 from affiliates)	112,454	98,649	82,638
Depreciation and amortization	24,430	21,949	17,421
General and administrative ($3,657 in 2007, $4,481 in 2006 and $4,407 in 2005 from affiliates)	15,966	9,321	14,040
Advisory fee to affiliate	14,898	12,678	9,336
Total operating expenses	167,748	142,597	123,435
Operating income (loss)	9,182	4,966	(288)
Other income (expense):			
Interest income ($1,196 in 2007, $2,692 in 2006 and $2,379 in 2005 from affiliates)	6,156	6,000	5,439
Gain on foreign currency transaction	2,368	2	292
Other income	8,406	6,181	2,652
Mortgage and loan interest ($603 in 2007, $1,857 in 2006 and $2,510 in 2005 from affiliates)	(89,848)	(67,904)	(50,663)
Net income fee to affiliate	514	(972)	(3,712)
Incentive fee to affiliate	(5,599)	(1,490)	(1,128)
Discount on notes receivable	0	(1,170)	(15)
Gain on involuntary conversion	34,771	20,479	0
Provision for impairment	(1,003)	0	0
Litigation settlement	(1,354)	15	(130)
Total other income (expense)	(45,589)	(38,859)	(47,265)
Loss before gain on land sales, minority interest, and equity in earnings of investees	(36,407)	(33,893)	(47,553)
Gain on land sales	20,468	23,973	39,926
Minority interest	(2,652)	672	(3,056)
Equity in income (loss) of investees	286	1,540	397
Income (loss) from continuing operations before income tax benefit	(18,305)	(7,708)	(10,286)
Income tax benefit (expense)	15,703	7,271	20,196
Net income (loss) from continuing operations	(2,602)	(437)	9,910
Income from discontinued operations before tax expense	44,867	20,774	57,703
Income tax benefit (expense)	(15,703)	(7,271)	(20,196)
Net income (loss) from discontinuing operations	29,164	13,503	37,507
Net income	26,562	13,066	47,417
Preferred dividend requirement	(2,490)	(2,491)	(2,572)
Net income applicable to common shares	$ 24,072	$ 10,575	$ 44,845
Earnings per share basic			
Income (loss) from continuing operations	$ (0.50)	$ (0.29)	$ 0.72
Discontinued operations	2.85	1.33	3.70

Net income applicable to common shares	$ 2.35	$ 1.04	$ 4.42
Earnings per share diluted			
Income (loss) from continuing operations	$ (0.50)	$ (0.29)	$ 0.56
Discontinued operations	2.85	1.33	2.86
Net income applicable to common shares	$ 2.35	$ 1.04	$ 3.42
Weighted average common share used in computing earnings per share	10,227,593	10,149,000	10,149,000
Weighted average common share used in computing diluted earnings per share	10,227,593	10,149,000	13,106,000

The accompanying notes are an integral part of these Consolidated Financial Statements.

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Series A Preferred Stock	Series E Preferred Stock	Common Stock	Treasury Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Stockholders Equity
				(dollars in thousands)				
Balance, January 1, 2005	$ 5,139	$ 100	$ 114	$ (15,146)	$ 94,416	$ 19,934	$ (1,548)	$ 103,009
Unrealized gain on foreign currency translation							935	935
Unrealized gain on marketable securities							866	866
Net income						47,417		47,417
Common Stock dividends (pre-merger)						(1)		(1)
Repurchase of series A preferred stock	(157)				(1,027)	27		(1,157)
Repurchase of series E preferred stock		(100)						(100)
Series A preferred stock cash dividend ($1.00 per share)						(2,550)		(2,550)
Series E preferred stock cash dividend ($0.60 per share)						(22)		(22)
Balance, December 31, 2005	$ 4,982	$	$ 114	$ (15,146)	$ 93,389	$ 64,805	$ 253	$ 148,397
Unrealized gain on foreign currency translation							(790)	(790)
Unrealized gain on marketable securities							2,321	2,321
Net income						13,066		13,066
Repurchase of series A preferred stock	(3)				(11)			(14)
Series A preferred stock cash dividend ($1.00 per share)						(2,491)		(2,491)
Balance, December 31, 2006	$ 4,979	$	$ 114	$ (15,146)	$ 93,378	$ 75,380	$ 1,784	$ 160,489
Unrealized gain on foreign currency translation							(5,983)	(5,983)
Unrealized gain on marketable securities							4,427	4,427
Unrealized gain								
Net income						26,562		26,562
Acquisition of Minority Interest					6,899			6,899
Sale of Common Stock				3,779				3,779
Cancelled Preferred shares								
Repurchase of Common Stock				(1,297)				(1,297)
Series B preferred stock dividend								
Series A preferred stock cash dividend ($1.00 per share)						(2,490)		(2,490)
Balance, December 31, 2007	$ 4,979	$	$ 114	$ (12,664)	$ 100,277	$ 99,452	$ 228	$ 192,386

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

AMERICAN REALTY INVESTORS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2007		
	2007	2006	2005
	(dollars in thousands)		
Cash Flow From Operating Activities:			
Net income (loss) applicable to common shares	$ 24,072	$ 10,575	$ 44,845
Adjustments to reconcile net loss applicable to common shares to net cash (used in)/provided by operating activities:			
Gain on sale of land	(20,468)	(23,973)	(20,777)
Depreciation and amortization	28,967	32,524	28,887
Discount on sale of notes receivable		1,183	15
Amortization of deferred borrowing costs	7,157	3,049	6,671
Equity in (income) loss of investees	(286)	(1,540)	(397)
Gain (loss) on foreign currency transaction	(2,368)	(2)	(292)
Gain on sale of income producing properties	(53,375)	(22,159)	(62,617)
Provision for asset impairment	1,003		
(Increase) decrease in assets:			
Accrued interest receivable	(2,347)	1,022	1,008
Other assets	3,935	(2,918)	(8,322)
Prepaid expense	(1,890)		
Escrow	(1,022)		
Earnest Money	6,544	(9,386)	(2,670)
Rent receivables	(7,641)		
(Increase) decrease in liabilities:			
Accrued interest payable	(5,556)	2,233	(1,984)
Minority interest	2,652	(5,551)	1,469
Other liabilities ($14,500 in 2007, $10,542 in 2006, and $2,110 in 2005 from affiliates)	(2,888)	(10,503)	24,006
Net cash (used in) provided by operating activities	$ (23,511)	$ (25,446)	$ 9,842
Cash Flow From Investing Activities:			
Collections on notes receivables($2,248 in 2007, $1,931 in 2006, and $2,490 in 2005 from affiliates)	$ 8,186	$ 12,368	$ 6,277
Proceeds from sale of notes receivable	10,126	6,828	33,265
Funding of notes receivable	(1,770)	(5,060)	(12,139)
Acquisition of land held for development	(24,965)		
Proceeds from sales of income producing properties	55,256	66,722	166,254
Proceeds from sale of land	65,516	4,617	
Investment in unconsolidated real estate entities	960	(44,293)	(4,849)
Improvement to land held for development	(3,728)		
Improvement of income producing properties	(15,135)	(567)	(59,806)
Investments in marketable equity securities			84
Construction and development of new properties	(204,672)		
Acquisitions of income producing properties	(114,258)	(142,527)	(170,333)
Net cash used in investing activities	$ (224,484)	$ (101,912)	$ (41,247)
Cash Flow From Financing Activities:			
Proceeds from notes payable	$ 529,058	$ 245,848	$ 227,877
Recurring amortization of principal on notes payable	(12,872)		
Increase in due from affiliates	(11,601)	(9,927)	(32,827)
Payments on maturing notes payable	(240,209)	(102,940)	(170,228)
Deferred financing costs	(10,394)	(6,477)	(4,417)

Restricted cash	3,444	(6,000)	
Secured stock borrowings	(4,906)		3,878
Purchase of treasury stock		(15)	(1,375)
Net cash provided by financing activities	$ 252,520	$ 120,489	$ 22,908
Net increase (decrease) in cash and cash equivalents	4,525	(6,869)	(8,497)
Cash and cash equivalents, beginning of period	7,035	13,904	22,401
Cash and cash equivalents, end of period	$ 11,560	$ 7,035	$ 13,904

The accompanying notes are an integral part of these Consolidated Financial Statements.

AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying Consolidated Financial Statements of American Realty Investors, Inc. and consolidated subsidiaries have been prepared in conformity with accounting principles generally accepted in the United States of America, the most significant of which are described in NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. These, along with the remainder of the Notes to Consolidated Financial Statements, are an integral part of the Consolidated Financial Statements. The data presented in the Notes to Consolidated Financial Statements are as of December 31 of each year and for the year then ended, unless otherwise indicated. Dollar amounts in tables and accompanying footnotes are in thousands, except per share amounts.

Certain balances for 2006 and 2005 have been reclassified to conform to the 2007 presentation.

NOTE 1. ***SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***

Organization and Business. In November 1999, American Realty Investors, Inc. (ARI), a Nevada corporation, was formed, and in August 2000, ARI acquired American Realty Trust, Inc. (ART), a Georgia corporation and National Realty, L.P. (NRLP), a Delaware partnership. ARI primarily invests in real estate and real estate-related entities and purchases and originates mortgage loans.

Effective July 1, 2003, Prime Asset Management, Inc. (PAMI) became the advisor to ARI and TCI. PAMI is owned by Realty Advisors (80.0%) and Syntek West, Inc. (Syntek West) (20.0%), related parties. Syntek West is owned by Gene E. Phillips. Effective August 18, 2003, PAMI changed its name to Prime Income Asset Management, Inc. (PIAMI). On October 1, 2003, Prime Income Asset Management, LLC (Prime), which is 100% owned by PIAMI, replaced PIAMI as the advisor to ARI and TCI.

Basis of consolidation. The accompanying Consolidated Financial Statements include the accounts of the Company, its subsidiaries, generally all of which are wholly-owned, and all entities in which the Company has a controlling interest, including where the Company has been determined to be a primary beneficiary of a variable interest entity in accordance with the provisions and guidance of Interpretation No. 46(R), Consolidation of Variable Interest Entities (FIN 46(R)) or meets certain criteria of a sole general partner or managing member as identified in accordance with Emerging Issues Task Force (EITF) Issue 04-5, Investor s Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Rights (EITF 04-5). Controlling interest in an entity is normally determined by the ownership of a majority of the entity s voting interests; however, other determining factors include, but may not be limited to, whether the Company provides significant financial support and bears a majority of the financial risks, authorizes certain capital transactions such as the purchase, sale or financing of material assets or makes operating decisions that materially affect the entity s financial results. All intercompany balances and transactions have been eliminated in consolidation.

Accounting estimates. In the preparation of these Consolidated Financial Statements, in conformity with accounting principles generally accepted in the United States of America, it is necessary for management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expense for the year then ended. Actual results could differ materially from these estimates.

Non-performing notes receivable. ARI considers a note receivable to be non-performing when the maturity date has passed without principal repayment and the borrower is not making interest payments. Any new note receivable that results from a modification or extension of a note considered non-performing will also be considered non-performing, without regard to the borrower s adherence to payment terms.

AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Interest recognition on notes receivable. Interest income is not recognized on notes receivable that have been delinquent for 60 days or more. In addition, accrued but unpaid interest income is only recognized to the extent that the net realizable value of the underlying collateral exceeds the carrying value of the receivable.

Allowance for estimated losses. A valuation allowance is provided for estimated losses on notes receivable considered to be impaired. Impairment is considered to exist when it is probable that all amounts due under the terms of the note will not be collected. Valuation allowances are provided for estimated losses on notes receivable to the extent that the investment in the note exceeds management s estimate of fair value of the collateral securing such note.

Recent Accounting pronouncements. In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 was effective for fiscal years beginning after December 15, 2006. FIN No. 48, which was adopted by the Company effective January 1, 2007, did not have a material impact on the Company s cash flows, results of operations, financial position or liquidity.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB deferred the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The FASB also removed certain leasing transactions from the scope of SFAS No. 157. The Company does not expect the adoption of SFAS No. 157 to have a material impact on the Company s cash flows, results of operations, financial position or liquidity.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS No. 159 to have a material impact on the Company s cash flows, results of operations, financial position or liquidity.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)), which establishes principles and requirements for how the acquirer shall recognize and measure in its financial statements the identifiable assets acquired, liabilities assumed, any noncontrolling interest in the acquiree and goodwill acquired in a business combination. SFAS No. 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently assessing the potential impact that the adoption of SFAS No. 141(R) will have on its financial position and results of operations.

Table of Contents

AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (SFAS No. 160), which establishes and expands accounting and reporting standards for minority interests, which will be recharacterized as non-controlling interests, in a subsidiary and the deconsolidation of a subsidiary. SFAS No. 160 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. This statement is effective for fiscal years beginning on or after December 15, 2008. The Company is currently assessing the potential impact that the adoption of SFAS No. 160 will have on its financial position and results of operations.

Real estate held for investment and depreciation. Real estate held for investment is carried at cost. Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), requires that a property be considered impaired if the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the property. If impairment exists, an impairment loss is recognized, by a charge against earnings, equal to the amount by which the carrying amount of the property exceeds the fair value less cost to sell the property. If impairment of a property is recognized, the carrying amount of the property is reduced by the amount of the impairment, and a new cost for the property is established. Such new cost is depreciated over the property s remaining useful life. Depreciation is provided by the straight-line method over estimated useful lives, which range from five to 40 years.

Real estate held-for-sale. Foreclosed real estate is initially recorded at new cost, defined as the lower of original cost or fair value minus estimated costs of sale. SFAS No. 144 also requires that properties held for sale be reported at the lower of carrying amount or fair value less costs of sale. If a reduction in a held for sale property s carrying amount to fair value less costs of sale is required, a provision for loss is recognized by a charge against earnings. Subsequent revisions, either upward or downward, to a held for sale property s estimated fair value less costs of sale are recorded as an adjustment to the property s carrying amount, but not in excess of the property s carrying amount when originally classified as held for sale. A corresponding charge against or credit to earnings is recognized. Properties held for sale are not depreciated.

Investments in equity investees. ARI may be considered to have the ability to exercise significant influence over the operating and investment policies of certain of its investees. Those investees are accounted for using the equity method. Under the equity method, an initial investment, recorded at cost, is increased by a proportionate share of the investee s operating income and any additional investment and decreased by a proportionate share of the investee s operating losses and distributions received.

Present value premiums/discounts. Present value premiums and discounts are provided on notes receivable or payable that have interest rates that differ substantially from prevailing market rates and such premiums and discounts are amortized by the interest method over the lives of the related notes. The factors considered in determining a market rate for notes receivable include the borrower s credit standing, nature of the collateral and payment terms of the note.

Foreign currency translation. Foreign currency denominated assets and liabilities of subsidiaries with local functional currencies are translated to United States dollars at year-end exchange rates. The effects of translation are recorded in the cumulative translation component of shareholders equity. Subsidiaries with a United States dollar functional currency remeasure monetary assets and liabilities at year-end exchange rates and non-monetary assets and liabilities at historical exchange rates. The effects of re-measurement are included in income. Exchange gains and losses arising from transactions denominated in foreign currencies are translated at average exchange rates.

AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recognition of rental income. Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. Rental income for residential property leases is recorded when due from residents and is recognized monthly as earned, which is not materially different than on a straight-line basis as lease terms are generally for periods of one year or less. For hotel properties, revenues for room sales and guest services are recognized as rooms are occupied and services are rendered.

Revenue recognition on the sale of real estate. Sales of real estate are recognized when and to the extent permitted by Statement of Financial Accounting Standards No. 66, Accounting for Sales of Real Estate (SFAS No. 66), as amended by SFAS No. 144. Until the requirements of SFAS No. 66 for full profit recognition have been met, transactions are accounted for using either the deposit, the installment, the cost recovery, or the financing method, whichever is appropriate. When ARI provides seller financing, gain is not recognized at the time of sale unless the buyer s initial investment and continuing investment are deemed to be adequate, as determined by SFAS 66 guidelines.

Operating segments. Management has determined reportable operating segments to be those that are used for internal reporting purposes, which disaggregates operations by type of real estate.

Fair value of financial instruments. The following assumptions were used in estimating the fair value of its notes receivable, marketable equity securities and notes payable. For performing notes receivable, the fair value was estimated by discounting future cash flows using current interest rates for similar loans. For non-performing notes receivable, the estimated fair value of ARI s interest in the collateral property was used. For marketable equity securities, fair value was based on the year-end closing market price of each security. For notes payable, the fair value was estimated using current rates for mortgages with similar terms and maturities.

Cash equivalents. For purposes of the Consolidated Statements of Cash Flows, all highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

Earnings (loss) per share. Income (loss) per share is presented in accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share. Income (loss) per share is computed based upon the weighted average number of shares of common stock outstanding during each year.

Stock-based employee compensation. The Company previously accounted for its stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment , which revised SFAS 123, Accounting for Stock-Based Compensation. SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements and forfeitures to be estimated at the grant date rather than as they occur. The Company previously based its estimated forfeiture rate on historical forfeitures of all stock option grants. The Company adopted SFAS 123(R) effective January 1, 2006 using the modified-prospective method and applied the provisions of SFAS 123(R) to all share-based compensation. All of ARI s stock options were fully vested as of January 1, 2006 and ARI had no outstanding stock option grants that were modified or settled after January 1, 2006; therefore, the adoption of SFAS 123(R) had no material effect on the Company s results of operations for the year ended December 31, 2007. The director s stock option plan was terminated in December of 2005.

Table of Contents

AMERICAN REALTY INVESTORS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2. ***REAL ESTATE***

A summary of our real estate transactions for the year ended December 31, 2007 is listed below:

	Cost Beginning of Year	Acquisitions	Capital Improvements	Development Costs	Completed Development	Property Sales	Impairment Charges	Reclassifications and Other Adjustments	Cost 12/31/2007	Accumulated Depreciation 12/31/2007
Apartments	$ 474,481	$ 3,974	$ 59	$	$ 89,985	$ (3,560)	$ (1,003)	$ (48,404)	$ 515,532	$ 41,939
Apartments under construction	61,583			172,581	(89,985)			9,035	153,214	70
Other developments in progress	78,230			32,091				&nb		