Howard Hughes Corp
Form 10-Q
November 06, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

or

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

Commission file number 001-34856

THE HOWARD HUGHES CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive offices, including zip code)

(214) 741-7744

(Registrant's telephone number, including area code)

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

Yes No

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

Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The number of shares of common stock, $0.01 par value, outstanding as of October 27, 2017 was 43,253,764

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

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(In thousands, except share amounts)	September 30, 2017	December 31, 2016
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,667,496	$ 1,669,561
Buildings and equipment	2,155,071	2,027,363
Less: accumulated depreciation	(303,887)	(245,814)
Land	314,383	320,936
Developments	1,124,079	961,980
Net property and equipment	4,957,142	4,734,026
Investment in Real Estate and Other Affiliates	89,155	76,376
Net investment in real estate	5,046,297	4,810,402
Cash and cash equivalents	601,934	665,510
Accounts receivable, net	9,654	10,038
Municipal Utility District receivables, net	193,100	150,385
Deferred expenses, net	76,692	64,531
Prepaid expenses and other assets, net	796,019	666,516
Total assets	$ 6,723,696	$ 6,367,382
Liabilities:		
Mortgages, notes and loans payable	$ 2,993,448	$ 2,690,747
Deferred tax liabilities	237,013	200,945
Warrant liabilities	—	332,170
Accounts payable and accrued expenses	462,853	572,010
Total liabilities	3,693,314	3,795,872
Commitments and Contingencies (see Note 15)		
Equity:		
Preferred stock: $.01 par value; 50,000,000 shares authorized, none issued	—	—
Common stock: $.01 par value; 150,000,000 shares authorized, 43,222,932 shares issued and 43,206,550 outstanding as of September 30, 2017 and 39,802,064 shares issued and 39,790,003 outstanding as of December 31, 2016	433	398

Additional paid-in capital	3,295,586	2,853,269
Accumulated deficit	(258,629)	(277,912)
Accumulated other comprehensive loss	(9,017)	(6,786)
Treasury stock, at cost, 16,382 shares as of September 30, 2017 and 12,061 shares as of December 31, 2016, respectively	(1,763)	(1,231)
Total stockholders' equity	3,026,610	2,567,738
Noncontrolling interests	3,772	3,772
Total equity	3,030,382	2,571,510
Total liabilities and equity	$ 6,723,696	$ 6,367,382

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

UNAUDITED

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(In thousands, except per share amounts)	Three Months Ended September 30, 2017	2016	Nine Months Ended September 30, 2017	2016
Revenues:				
Condominium rights and unit sales	$ 113,852	$ 115,407	$ 342,208	$ 362,613
Master Planned Community land sales	54,906	44,128	177,531	147,168
Minimum rents	44,654	44,910	136,053	128,255
Tenant recoveries	11,586	11,657	34,627	33,108
Hospitality revenues	17,776	14,088	57,190	46,126
Builder price participation	5,472	4,483	14,613	15,631
Other land revenues	4,561	4,053	19,606	12,225
Other rental and property revenues	5,929	3,538	17,309	11,335
Total revenues	258,736	242,264	799,137	756,461
Expenses:				
Condominium rights and unit cost of sales	86,531	83,218	253,209	237,759
Master Planned Community cost of sales	29,043	21,432	88,288	66,128
Master Planned Community operations	8,180	10,674	24,881	30,454
Other property operating costs	21,354	16,535	60,153	47,513
Rental property real estate taxes	7,678	7,033	21,765	21,110
Rental property maintenance costs	3,380	3,332	10,016	9,217
Hospitality operating costs	13,525	12,662	41,534	37,379
Provision for doubtful accounts	448	1,940	1,728	4,629
Demolition costs	175	256	303	1,218
Development-related marketing costs	5,866	4,716	14,787	15,586
General and administrative	22,362	21,128	63,423	61,505
Depreciation and amortization	35,899	23,322	96,193	71,246
Total expenses	234,441	206,248	676,280	603,744
Operating income before other items	24,295	36,016	122,857	152,717
Other:				
Provision for impairment	—	(35,734)	—	(35,734)
Gains on sales of properties	237	70	32,452	140,549
Other (loss) income, net	(160)	432	750	9,858
Total other	77	(35,232)	33,202	114,673

Operating income	24,372	784	156,059	267,390
Interest income	1,764	196	3,171	900
Interest expense	(17,241)	(16,102)	(49,547)	(48,628)
Loss on redemption of senior notes due 2021	—	—	(46,410)	—
Warrant liability loss	—	(7,300)	(43,443)	(21,630)
Gain on acquisition of joint venture partner's interest	—	27,087	5,490	27,087
Equity in earnings from Real Estate and Other Affiliates	7,467	13,493	25,821	35,700
Income before taxes	16,362	18,158	51,141	260,819
Provision for income taxes	5,846	10,162	31,846	102,088
Net income	10,516	7,996	19,295	158,731
Net income attributable to noncontrolling interests	(12)	(23)	(12)	(23)
Net income attributable to common stockholders	$ 10,504	$ 7,973	$ 19,283	$ 158,708
Basic income per share:	$ 0.25	$ 0.20	$ 0.47	$ 4.02
Diluted income per share:	$ 0.24	$ 0.19	$ 0.45	$ 3.72

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Net income	$ 10,516	$ 7,996	$ 19,295	$ 158,731
Other comprehensive income (loss):				
Interest rate swaps (a)	180	497	(2,070)	(14,876)
Capitalized swap interest expense (b)	(40)	154	(161)	(163)
Pension adjustment (c)	—	(317)	—	(890)
Other comprehensive income (loss)	140	334	(2,231)	(15,929)
Comprehensive income	10,656	8,330	17,064	142,802
Comprehensive income attributable to noncontrolling interests	(12)	(23)	(12)	(23)
Comprehensive income attributable to common stockholders	$ 10,644	$ 8,307	$ 17,052	$ 142,779

(a) Net of deferred tax expense of $0.1 million and $0.2 million for the three months ended September 30, 2017 and 2016, respectively. Amount is net of deferred benefit of $1.3 million and $8.1 million for the nine months ended September 30, 2017 and 2016, respectively.
(b) The deferred tax impact was immaterial for the three months ended September 30, 2017 and 2016, respectively. Amount is net of deferred tax benefit of $0.1 million for the nine months ended September 30, 2017 and 2016, respectively.
(c) Net of deferred tax benefit of $0.1 million and $0.5 million for the three and nine months ended September 30, 2016, respectively.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

UNAUDITED

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	Common Stock		Additional Paid-In	Accumulated	Accumulated Other Comprehensive	Treasury Stock		N
(In thousands, except shares)	Shares	Amount	Capital	Deficit	(Loss)	Shares	Amount	I
Balance December 31, 2015	39,714,838	$ 398	$ 2,847,823	$ (480,215)	$ (7,889)	-	$ -	$
Net income	-	-	-	158,708	-	-	-	
Preferred dividend payment on behalf of subsidiary	-	-	-	-	-	-	-	
Interest rate swaps, net of tax $8,120	-	-	-	-	(14,876)	-	-	
Pension adjustment, net of tax of $543	-	-	-	-	(890)	-	-	
Capitalized swap interest, net of tax $88	-	-	-	-	(163)	-	-	
Stock plan activity	136,198	-	8,512	-	-	-	-	
Treasury stock activity	-	-	-	-	-	(12,061)	(1,295)	
Balance, September 30, 2016	39,851,036	398	2,856,335	(321,507)	(23,818)	(12,061)	(1,295)	
Balance December 31, 2016	39,802,064	398	2,853,269	(277,912)	(6,786)	(12,061)	(1,231)	
Net income	-	-	-	19,283	-	-	-	
Preferred dividend payment on behalf of subsidiary	-	-	-	-	-	-	-	
Interest rate swaps, net of tax of $1,409	-	-	-	-	(2,070)	-	-	
Capitalized swap interest, net of tax of $86	-	-	-	-	(161)	-	-	
Stock plan activity	368,415	4	16,735	-	-	(4,321)	(532)	

Exercise of warrants	3,052,453	31	375,582	-	-	-	-	
Issuance of management warrants	-	-	50,000	-	-	-	-	
Balance, September 30, 2017	43,222,932	$ 433	$ 3,295,586	$ (258,629)	$ (9,017)	(16,382)	$ (1,763)	$

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

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(In thousands)	Nine Months Ended September 30, 2017	2016
Cash Flows from Operating Activities:		
Net income	$ 19,295	$ 158,731
Adjustments to reconcile net income to cash used in operating activities:		
Depreciation	84,083	60,834
Amortization	12,110	10,412
Amortization of deferred financing costs	4,306	5,385
Amortization of intangibles other than in-place leases	(1,071)	(1,333)
Straight-line rent amortization	(6,625)	(6,668)
Deferred income taxes	33,484	102,088
Restricted stock and stock option amortization	4,954	6,324
Gains on sales of properties	(32,452)	(140,549)
Gain on acquisition of joint venture partner's interest	(5,490)	(27,087)
Warrant liability loss	43,443	21,630
Loss on redemption of senior notes due 2021	46,410	—
Equity in earnings from Real Estate and Other Affiliates, net of distributions	(20,200)	(21,952)
Provision for doubtful accounts	1,728	4,629
Master Planned Community land acquisitions	(1,415)	(69)
Master Planned Community development expenditures	(136,745)	(106,501)
Master Planned Community cost of sales	78,424	60,600
Condominium development expenditures	(293,183)	(245,547)
Condominium rights and unit cost of sales	253,209	237,759
Provision for impairment	—	35,734
Percentage of completion revenue recognition from sale of condominium rights and unit sales	(342,208)	(362,613)
Net changes:		
Accounts receivable	1,602	(33)
Prepaid expenses and other assets	(11,143)	(753)
Condominium deposits received	250,352	440,076
Deferred expenses	(11,215)	(3,349)
Accounts payable and accrued expenses	(36,607)	(19,019)
Condominium deposits held in escrow	(250,352)	(440,076)
Condominium deposits released from escrow	187,540	17,574
Other, net	245	(4,510)
Cash used in operating activities	(127,521)	(218,283)

Cash Flows from Investing Activities:		
Property and equipment expenditures	(5,936)	(8,649)
Operating property improvements	(12,591)	(12,184)
Property developments and redevelopments	(258,850)	(301,843)
Acquisition of partner's interest in Las Vegas 51s	(15,404)	—
Proceeds for reimbursement of development costs	11,165	4,945
Proceeds from sales of properties	36,560	378,257
Proceeds from insurance claims	—	3,107
Acquisition of partner's interest in Millennium Six Pines Apartments (net of cash acquired)	—	(3,105)
Distributions from Real Estate and Other Affiliates	—	16,550
Note issued to Real Estate Affiliate	—	(25,000)
Proceeds from repayment of note to Real Estate Affiliate	—	25,000
Investments in Real Estate and Other Affiliates, net	(3,579)	(10,947)
Change in restricted cash	(3,854)	(215)
Cash (used in) provided by investing activities	(252,489)	65,916
Cash Flows from Financing Activities:		
Proceeds from mortgages, notes and loans payable	1,433,437	422,661
Principal payments on mortgages, notes and loans payable	(1,130,337)	(62,996)
Premium paid to redeem 2021 senior notes	(39,966)	—
Preferred dividend payment on behalf of REIT subsidiary	(12)	(23)
Special Improvement District bond funds released from (held in) escrow	6,099	6,258
Deferred financing costs	(13,305)	(4,678)
Taxes paid on stock options exercised and restricted stock vested	(9,201)	(1,295)
Stock options exercised	19,719	180
Issuance of management warrants	50,000	—
Cash provided by financing activities	316,434	360,107
Net change in cash and cash equivalents	(63,576)	207,740
Cash and cash equivalents at beginning of period	665,510	445,301
Cash and cash equivalents at end of period	$ 601,934	$ 653,041

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30,	
	2017	2016
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 110,034	$ 77,666
Interest capitalized	55,895	46,198
Income taxes paid	(12,419)	6,234
Non-Cash Transactions:		
Exercise of Sponsor and Management Warrants	375,613	—
Special Improvement District bond transfers associated with land sales	9,864	5,528
Accrued interest on construction loan borrowing	4,978	3,748
Capitalized stock compensation	584	2,008
Acquisition of Las Vegas 51s		
Building	87	—
Developments	65	—
Accounts receivable	633	—
Other assets	33,313	—
Other liabilities	(2,294)	—
Acquisition of Millennium Six Pines Apartments		
Land	—	(11,225)
Building	—	(54,492)
Other assets	—	(1,261)
Mortgage, notes and loans payable	—	37,700
Other liabilities	—	(913)

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

NOTE 1 BASIS OF PRESENTATION AND ORGANIZATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), with intercompany transactions between consolidated subsidiaries eliminated. In accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the Securities and Exchange Commission (the "SEC"), these Condensed Consolidated Financial Statements do not include all of the information and disclosures required by GAAP for complete financial statements. Readers of this Quarterly Report on Form 10-Q ("Quarterly Report") should refer to The Howard Hughes Corporation's ("HHC" or the "Company") audited Consolidated Financial Statements, which are included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (the "Annual Report"), filed on February 23, 2017 with the SEC. Certain amounts in 2016 have been reclassified to conform to the 2017 presentation. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial position, results of operations, comprehensive income (loss), cash flows and equity for the interim periods have been included. The results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ended December 31, 2017 and future years.

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

NOTE 2 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

The following is a summary of recently issued and other notable accounting pronouncements which relate to our business.

In August 2017, the Financial Accounting Standards Board's ("FASB") issued Accounting Standards Update ("ASU") 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities to enable entities to better portray the economic results of their risk management activities in its financial statements.

The ASU expands an entity's ability to hedge nonfinancial and financial risk components and reduce complexity in fair value hedges of interest rate risk and eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. The ASU also eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2018. The new standard must be adopted using a modified retrospective approach with early adoption permitted. We are currently evaluating the potential impact of this ASU on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting to provide clarity and reduce the diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation–Stock Compensation. Stakeholders observed that the definition of the term "modification" is broad and that its interpretation results in diversity in practice. The ASU states that when an entity concludes that a change is not substantive, then modification accounting does not apply. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. The new standard must be adopted prospectively to an award modified on or after the adoption date. Early adoption is permitted. Once adopted, HHC will apply this guidance to any modifications made to either the stock option or restricted stock award plans.

In February 2017, the FASB issued ASU 2017-05, Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20). The standard defines an "in-substance non-financial asset" as a financial asset promised to a counterparty in a contract if substantially all the fair value of the assets is concentrated in nonfinancial assets. The ASU also provides guidance for accounting for partial sales of non-financial assets such as real estate. The effective

date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. The new standard must be adopted retrospectively with early adoption permitted. We are currently evaluating the potential impact of this ASU on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350). This standard is intended to simplify the subsequent measurement of goodwill by eliminating step two from the goodwill impairment test. Instead, an entity will perform only step one of its quantitative goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and then recognizing the impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. An entity will still have the option to perform a qualitative assessment for a reporting unit to determine if the quantitative step one impairment test is necessary. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2019. The new standard must be adopted prospectively with early adoption permitted. We do not expect the adoption of this ASU to have a material impact on our consolidated financial statements.

In January 2017, the FASB formally issued, and we early adopted ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business, as permitted, on a prospective basis. The standard provides criteria to determine when an integrated set of assets and activities is not a business. The criteria requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. However, to be considered a business, the set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Under the new guidance, the acquisition of a property with an in-place lease generally will no longer be accounted for as an acquisition of a business, but instead as an asset acquisition, meaning the transaction costs of such an acquisition will now be capitalized instead of expensed. Our adoption did not have a material impact on our accounting for acquisitions.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows – Restricted Cash, which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period, but any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The new standard must be adopted retrospectively. ASU 2016-18 will impact our presentation of operating, investing and financing

activities related to restricted cash on our consolidated statements of cash flows.

In October 2016, the FASB issued ASU 2016-17, Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control. The standard requires reporting entities to evaluate whether they should consolidate a variable interest entity ("VIE") in certain situations involving entities under common control. Specifically, the standard changes the evaluation of whether a reporting entity is the primary beneficiary of a VIE by changing how a reporting entity that is a single decision maker of a VIE treats indirect interests in the entity held through related parties that are under common control with the reporting entity. The new standard was effective January 1, 2017, and must be adopted retrospectively. We currently have no VIEs involving entities under common control, and accordingly, adoption of this ASU had no impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The standard addresses how certain cash receipts and payments are presented and classified in the statement of cash flows, including debt extinguishment costs, distributions from equity method investees and contingent consideration payments made after a business combination. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted. The new standard must be adopted retrospectively. ASU 2016-15 will impact our presentation of operating, investing and financing activities related to certain cash receipts and payments on our consolidated statements of cash flows.

THE HOWARD HUGHES CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses. The standard modifies the impairment model for most financial assets, including trade accounts receivables and loans, and will require the use of an "expected loss" model for instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The effective date of the standard is for fiscal years, and for interim periods within those years, beginning after December 15, 2019, with early adoption permitted. We are currently evaluating the adoption of ASU 2016-13 on our consolidated financial statements but do not anticipate significant impact.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting. The standard amends several aspects of accounting for share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. We adopted the ASU as of January 1, 2017, and it did not have a material impact on our accounting for excess tax benefits and tax deficiencies as our stock compensation plans, which permit net-share settlement, had minimal vesting and exercise activity prior to January 1, 2017. The new guidance requires entities to recognize all income tax effects of awards in the income statement when the awards vest or are settled, in contrast to prior guidance wherein such effects are recorded in additional paid-in capital ("APIC"). The amounts recorded in APIC prior to our adoption remain in APIC per the new standard. The new standard also allows an employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. Our plans allow us, at the employee's request, to withhold shares with a fair value up to the amount of tax owed using the maximum statutory tax rate for the employee's applicable jurisdiction. We elected to continue to estimate forfeitures as allowed by an election under the new guidance. Our condensed consolidated statements of cash flows for the nine months ended September 30, 2017 and 2016 present excess tax benefits as an operating activity and employee taxes paid as a financing activity as required by ASU 2016-09.

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02 is codified in Accounting Standards Codification ("ASC") 842. The standard amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2018, with early adoption permitted. The standard requires a modified retrospective transition approach for all

leases existing at, or entered into after, the date of initial application. We are currently evaluating the impact of adopting ASU 2016-02 on our consolidated financial statements. We anticipate a material increase to our assets and liabilities as we will be required to capitalize our ground leases, office leases and certain office equipment where we are the lessee. We will also be considering certain services that are considered non-lease components such as common area maintenance under the new guidance. Upon adoption of ASC 842, these services will be accounted for under ASU 2014-09, Revenues from Contracts with Customers (Topic 606), which is further discussed below.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities which will require entities to recognize changes in equity investments with readily determinable fair values in net income. For equity investments without readily determinable fair values, the ASU permits the application of a measurement alternative using the cost of the investment, less any impairments, plus or minus changes resulting from observable price changes for an identical or similar investment of the same issuer. The effective date of the standard is for fiscal periods, and interim periods within those years, beginning after December 15, 2017, and must be adopted via a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. We are currently evaluating the potential impact of this ASU on our consolidated financial statements.

In May 2014, the FASB and International Accounting Standards Board issued ASU 2014-09. The standard’s core principle

is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The ASU requires companies to identify performance obligations in the contract, estimate the amount of variable consideration to include in the transaction price and allocate the transaction price to each separate performance obligation. The effective date of this standard is for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted. We have concluded that after adoption we will not be able to recognize revenue for condominium projects on a percentage of completion basis, and generally revenue will be recognized when the units close and the title has transferred to the buyer. Adoption of the ASU will also impact the timing of recognition and classification of certain real estate selling costs, such as the costs related to our condominium model units. Currently, these selling costs are capitalized as real estate project costs and recognized as costs of sales on a percentage of completion basis in our consolidated financial statements. Under the new guidance, some of these costs may need to be expensed immediately or will be capitalized as property and equipment and depreciated over their estimated useful life. Entities have the option of using either a full retrospective or a modified retrospective approach. We have elected to apply a modified retrospective approach of adoption. We are continuing to evaluate the new guidance to determine all impacts to our consolidated financial statements.

NOTE 3 WARRANTS

On November 9, 2010, we entered into warrant agreements at an exercise price of $50.00 per share to purchase 1,916,667 shares of our common stock (the “Sponsor Warrants”) to certain funds of Pershing Square Capital Management, L.P. (“Pershing Square”). In November 2010 and February 2011, we entered into certain warrant agreements (the “Management Warrants”) with David R. Weinreb, our Chief Executive Officer, Grant Herlitz, our President, and Andrew C. Richardson, our former Chief Financial Officer, in each case prior to his appointment to such position, to purchase 2,367,985, 315,731 and 178,971 shares, respectively, of our common stock. The Management Warrants were granted at fair value in exchange for a combined total of approximately $19.0 million in cash from such executives at the commencement of their respective employment. Mr. Weinreb and Mr. Herlitz’s warrants became exercisable in November 2016 and had an exercise price of $42.23 per share, and Mr. Richardson’s warrants became exercisable in February 2017 and had an exercise price of $54.50 per share.

Pershing Square exercised its Sponsor Warrants on June 30, 2017, resulting in a net issuance of 1,136,517 shares in accordance with the warrant provisions. Mr. Herlitz exercised his Management Warrants in early January 2017,

resulting in the net issuance of 198,184 shares in accordance with the warrant provisions. Mr. Herlitz also donated 6,850 shares to a charitable trust, which were net share settled for 4,400 shares in accordance with the warrant provisions. In February, March and June 2017, Mr. Richardson exercised his Management Warrants, resulting in the net issuance of 98,549 shares in accordance with the warrant provisions. In June 2017, Mr. Weinreb exercised his Management Warrants, resulting in the net issuance of 1,614,803 shares in accordance with the warrant provisions.

As of September 30, 2017, all Sponsor Warrants and Management Warrants have been exercised. The fair values for the Sponsor Warrants and Management Warrants as of December 31, 2016 were recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsor Warrants and Management Warrants were $123.5 million and $208.7 million, respectively, as of December 31, 2016. The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data, as further discussed in Note 7 – Fair Value of Financial Instruments in our Condensed Consolidated Financial Statements. Decreases and increases in the fair value of the Sponsor and Management Warrants were recognized as warrant liability gains or losses in the Condensed Consolidated Statements of Operations.

On October 7, 2016, we entered into a warrant agreement with our new Chief Financial Officer, David R. O’Reilly (the “O’Reilly Warrant”), prior to his appointment to the position. Upon exercise of the O’Reilly Warrant, Mr. O’Reilly may

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acquire 50,125 shares of common stock at an exercise price of $112.08 per share. The O'Reilly Warrant was issued at fair value in exchange for a $1.0 million payment in cash from Mr. O'Reilly. The O'Reilly Warrant becomes exercisable on April 6, 2022, subject to earlier exercise upon certain change in control, separation and termination provisions. On June 16, 2017, we also entered into a new warrant agreement (the "Weinreb Warrant") with Mr. Weinreb to acquire 1,965,409 shares of common stock for the purchase price of $50.0 million. On August 29, 2017, Mr. Weinreb paid the $50.0 million purchase price in cash in accordance with the terms of the warrant agreement. The Weinreb Warrant becomes exercisable on June 15, 2022, at an exercise price of $124.64 per share, subject to earlier exercise upon certain change in control, separation and termination provisions. The O'Reilly Warrant and the Weinreb Warrant, which qualify as equity instruments, are included within additional paid-in capital in the Condensed Consolidated Balance Sheets at September 30, 2017 and December 31, 2016. On October 4, 2017, we entered into a new warrant agreement with Mr. Herlitz to acquire 87,951 shares of common stock for the purchase price of $2.0 million (the "Herlitz Warrant"). The Herlitz Warrant becomes exercisable on October 3, 2022, at an exercise price of $117.01 per share, subject to earlier exercise upon certain change in control, separation and termination provisions.

NOTE 4 EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted EPS is computed after adjusting the numerator and denominator of the basic EPS computation for the effects of all potentially dilutive common shares. The dilutive effect of options and nonvested stock issued under stock based compensation plans is computed using the treasury stock method. The dilutive effect of the warrants is computed using the if converted method prior to their exercise.

Information related to our EPS calculations is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2017	2016	2017	2016
Basic EPS:				
Numerator:				

Net income	$	10,516	$	7,996	$	19,295	$	158,731
Net income attributable to noncontrolling interests		(12)		(23)		(12)		(23)
Net income attributable to common stockholders	$	10,504	$	7,973	$	19,283	$	158,708
Denominator:								
Weighted average basic common shares outstanding	$	42,845	$	39,502	$	40,860	$	39,489
Diluted EPS:								
Numerator:								
Net income attributable to common stockholders	$	10,504	$	7,973	$	19,283	$	158,708
Denominator:								
Weighted average basic common shares outstanding		42,845		39,502		40,860		39,489
Restricted stock and stock options		420		366		455		338
Warrants		2		2,892		1,783		2,892
Weighted average diluted common shares outstanding		43,267		42,760		43,098		42,719
Basic income per share:	$	0.25	$	0.20	$	0.47	$	4.02
Diluted income per share:	$	0.24	$	0.19	$	0.45	$	3.72

The diluted EPS computation for the three and nine months ended September 30, 2017 excludes 311,500 and 317,000 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and nine months ended September 30, 2017 excludes 185,573 shares of restricted stock, because market conditions have not been met.

The diluted EPS computation for the three and nine months ended September 30, 2016 excludes 343,500 and 404,000 stock options, respectively, because their inclusion would have been anti-dilutive. The diluted EPS computation for the three and nine months ended September 30, 2016 excludes 153,781 shares of restricted stock, respectively, because performance conditions have not been met.

NOTE 5 RECENT TRANSACTIONS

On May 4, 2017, we announced that Bank of America will serve as the lead anchor tenant to the 51-story, Class A downtown office building at 110 North Wacker Drive in Chicago, Illinois. The lease accounts for more than a third of the Goettsch-designed 1.35 million square-foot high-rise. Construction is scheduled to start in the spring of 2018, with a late 2020 opening expected. In conjunction with this transaction, on April 28, 2017, we exercised our termination option in the current lease with the tenant who occupies the existing 110 North Wacker building. The tenant will continue to occupy the building until January 2018 but will no longer pay the $6.1 million annual rent or any operating expenses which were previously paid 100% by the tenant.

On March 16, 2017, we offered, sold and issued $800.0 million in aggregate principal amount of 5.375% senior notes due March 15, 2025 (the “2025 Notes”) to Qualified Institutional Buyers (as defined in the Securities Act of 1933) in accordance with Rule 144A and non-U.S. persons in accordance with Regulation S and completed a tender offer and consent solicitation for any and all of our $750.0 million existing 6.875% senior notes due October 1, 2021. We used the net proceeds from the sale of our 2025 Notes to redeem all of the 6.875% senior notes and to pay related transaction fees and expenses. On June 12, 2017, we issued an additional $200.0 million of the 2025 Notes at a premium to par of 2.25%. We used a portion of the proceeds to repay construction financings and fund ongoing

development projects and general corporate needs. Interest on the 2025 Notes is paid semi-annually, on March 15th and September 15th of each year, beginning on September 15, 2017. At any time prior to March 15, 2020, we may redeem all or a portion of the 2025 Notes at a redemption price equal to 100% of the principal plus a “make-whole” declining call premium. At any time prior to March 15, 2020, we may also redeem up to 35% of the 2025 Notes at a price of 105.375% with net cash proceeds of certain equity offerings, plus accrued and unpaid interest. The 2025 Notes contain customary terms and covenants and have no financial maintenance covenants.

On March 1, 2017 (the “Acquisition Date”), we acquired our joint venture partner’s 50.0% interest in the Las Vegas 51s minor league baseball team for $16.4 million and became the sole owner of this Triple-A baseball team. We recognized a gain of $5.4 million in Gain on acquisition of joint venture partner's interest in conjunction with this acquisition relating to the step-up to fair value of the assets acquired. The estimated fair values of the assets acquired and liabilities assumed disclosed as of March 31, 2017 were provisional as they were pending final determinations of the fair value of the intangible assets existing as of the Acquisition Date. Using the income approach, the final adjustments made as of September 30, 2017 to the allocated fair values included a $0.4 million contingent liability recorded in Accounts payable and accrued expenses per the terms of the purchase agreement relating to a credit for the use of seats in a future stadium for the team, if and when constructed by us, and an adjustment to allocate $7.9 million to finite-lived intangibles, which have a weighted average amortization period of 11 years, and $24.9 million to indefinite-lived intangibles, primarily related to the franchise relationship agreement, all of which is recorded in Prepaid expenses and other assets, net. Accordingly, the adjusted values of assets acquired and liabilities assumed and consolidated into our financial statements total $36.0 million and $3.2 million, respectively, and are included in our Operating Assets segment. Prior to the acquisition, we

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accounted for our investment in the Las Vegas 51s under the equity method within Investment in Real Estate and Other Affiliates and recognized a loss of $0.2 million in equity in earnings for the nine months ended September 30, 2017. Included in the Condensed Consolidated Statements of Operations from the Acquisition Date through September 30, 2017 are revenues of $6.8 million and pre-tax net income from operations of $0.5 million.

NOTE 6 IMPAIRMENT

We review our real estate assets for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment or disposal of long lived assets in accordance with ASC 360 requires that if impairment indicators exist and expected undiscounted cash flows generated by the asset over our anticipated holding period are less than its carrying amount, an impairment provision should be recorded to write down the carrying amount of the asset to its fair value. The impairment analysis does not consider the timing of future cash flows and whether the asset is expected to earn an above or below market rate of return.

Each investment in Real Estate and Other Affiliates as discussed in Note 8 – Real Estate and Other Affiliates is evaluated periodically for recoverability and valuation declines that are other-than-temporary. If the decrease in value of our investment in a Real Estate and Other Affiliate is deemed to be other-than-temporary, our investment in such Real Estate and Other Affiliate is reduced to its estimated fair value.

No impairment charges were recorded during the three and nine months ended September 30, 2017. During the third quarter of 2016, we implemented a plan to sell Park West, a non-core, 249,177 square foot open-air shopping, dining and entertainment destination in Peoria, Arizona and recognized a $35.7 million impairment charge during the third quarter of 2016 due to our shorter than previously anticipated holding period. The $34.9 million net carrying value of Park West, after the impairment, represented our best estimate of its current fair market value at September 30, 2016. On December 29, 2016, we sold Park West for $32.5 million, recognized a loss of $1.1 million, net of transaction costs, in conjunction with the sale and redeployed the net cash proceeds from this unleveraged asset into our existing developments.

The following table summarizes our provision for impairment:

Impaired Asset	Location	Method of Determining Fair Value	Provision for impairment as of September 30, 2017	2016
			(In thousands)	
Operating Assets:				
Park West	Peoria, AZ	Discounted cash flow analysis using capitalization rate of 6.75%	$ —	$ 35,734

NOTE 7 FAIR VALUE

ASC 820, Fair Value Measurement, emphasizes that fair value is a market-based measurement that should be determined using assumptions market participants would use in pricing an asset or liability. The standard establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring assets or liabilities at fair value. Market price observability is impacted by a number of factors, including the type of investment and the characteristics specific to the asset or liability. Assets or liabilities with readily available active quoted prices, or for which fair value can be measured from actively quoted prices, generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

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The following table presents the fair value measurement hierarchy levels required under ASC 820 for each of our assets and liabilities that are measured at fair value on a recurring basis:

	September 30, 2017 Fair Value Measurements Using				December 31, 2016 Fair Value Measurements Using			
(In thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:								
Cash equivalents	$ 50,041	$ 50,041	$ —	$ —	$ 18	$ 18	$ —	$ —
Interest rate swap derivative assets	3,244	—	3,244	—	—	—	—	—
Liabilities:								
Interest rate swap derivative liabilities	7,742	—	7,742	—	(149)	—	(149)	—
Warrants	—	—	—	—	332,170	—	—	332,170

Cash equivalents consist of registered money market mutual funds which are invested in United States Treasury bills that are valued at the net asset value of the underlying shares in the funds as of the close of business at the end of each period.

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

The following table presents a rollforward of the valuation of our Sponsor Warrants and Management Warrants:

(In thousands)	2017	2016
Balance as of January 1	$ 332,170	$ 307,760
Warrant liability loss (a)	43,443	21,630
Exercises of Sponsor and Management Warrants	(375,613)	—
Balance as of September 30	$ —	$ 329,390

(a) Represents losses recognized during 2017 relating to each warrant prior to the respective exercise date. For 2016, represents unrealized losses recorded for outstanding warrants at the end of the period. Changes in the fair value of the Sponsor Warrants and Management Warrants prior to exercise were recognized in net income as a warrant liability gain or loss.

The valuation of warrants is based on an option pricing valuation model, utilizing inputs which were classified as Level 3 due to the unavailability of comparable market data. The inputs to the valuation model included the fair value of stock related to the warrants, exercise price and term of the warrants, expected volatility, risk-free interest rate and dividend yield. Generally, an increase in expected volatility would increase the fair value of the liability, but the impact of the volatility on fair value diminishes as the market value of the stock increases above the strike price. As the period of restriction lapses, the marketability discount reduces to zero and increases the fair value of the warrants.

All Sponsor and Management Warrants were exercised as of September 30, 2017. The significant unobservable inputs used in the fair value measurement of our warrant liabilities as of December 31, 2016 were as follows:

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	Unobservable Inputs	
	Expected Volatility (a)	Marketability Discount (b)
September 30, 2017 (c)	N/A	N/A
December 31, 2016	31.0%	0.0% - 1.0%

(a) Based on our implied equity volatility.
(b) Represents the discount rate for lack of marketability of the Management Warrants which decreases as the current date approaches the dates of contractual expiration of the marketability restrictions.
(c) See Note 3 – Warrants for additional information.

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

		September 30, 2017		December 31, 2016	
(In thousands)	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:					
Cash	Level 1	$ 551,893	$ 551,893	$ 665,492	$ 665,492
Accounts receivable, net (a)	Level 3	9,654	9,654	10,038	10,038
Liabilities:					
Fixed-rate debt (b)	Level 2	$ 1,508,746	$ 1,529,282	$ 1,184,141	$ 1,224,573
Variable-rate debt (b)	Level 2	1,505,534	1,505,534	1,524,319	1,524,319

(a) Accounts receivable, net, is shown net of an allowance of $8.6 million and $7.9 million at September 30, 2017 and December 31, 2016, respectively.
(b) Excludes related unamortized financing costs.

The fair value of our 2025 Notes, included in fixed-rate debt in the table above, is based upon the trade price closest to the end of the period presented. The fair value of other fixed-rate debt in the table above (please refer to Note 9 –

Mortgages, Notes and Loans Payable in our Condensed Consolidated Financial Statements), was estimated based on a discounted future cash payment model, which includes risk premiums and a risk free rate derived from the current London Interbank Offered Rate ("LIBOR") or U.S. Treasury obligation interest rates. The discount rates reflect our judgment as to what the approximate current lending rates for loans or groups of loans with similar maturities and credit quality would be if credit markets were operating efficiently and assuming that the debt is outstanding through maturity.

The carrying amounts for our variable-rate debt approximate fair value given that the interest rates are variable and adjust with current market rates for instruments with similar risks and maturities.

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

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NOTE 8 REAL ESTATE AND OTHER AFFILIATES

Our investments in Real Estate and Other Affiliates that are reported in accordance with the equity and cost methods are as follows:

	Economic/Legal Ownership		Carrying Value		Share of Earnings/Dividends			
					Three Months Ended		Nine Months Ended	
	September 30,	December 31,	September 30,	December 31,	September 30,		September 30,	
($ in thousands)	2017	2016	2017	2016	2017	2016	2017	2016
Equity Method Investments								
Master Planned Communities:								
The Summit (a)	— %	— %	$ 54,203	$ 32,653	$ 6,480	$ 13,700	$ 21,552	$ 22,574
Operating Assets:								
Las Vegas 51s, LLC (b)	100.00	50.00	—	11,062	—	2	(152)	297
Constellation (a) (c)	50.00	50.00	2,175	2,730	107	—	(215)	—
The Metropolitan Downtown Columbia (d)	50.00	50.00	—	(1,064)	82	(351)	356	(863)
Millennium Six Pines Apartments (e)	100.00	100.00	—	—	—	9	—	44
Stewart Title of Montgomery County, TX	50.00	50.00	3,834	3,611	113	221	322	477
	20.00	20.00	2,688	2,683	15	26	45	121

Woodlands Sarofim #1								
Strategic Developments:								
Circle T Ranch and Power Center (a)	50.00	50.00	5,106	4,956	650	—	650	10,498
HHMK Development	50.00	50.00	10	10	—	—	—	—
KR Holdings	50.00	50.00	744	707	20	3	36	12
m.flats/TEN.M (a)	50.00	50.00	6,849	6,379	—	—	—	—
33 Peck Slip (a) (f)	35.00	35.00	9,139	8,243	—	(117)	(156)	(76)
			84,748	71,970	7,467	13,493	22,438	33,084
Cost method investments			4,407	4,406	—	—	3,383	2,616
Investment in Real Estate and Other Affiliates			$ 89,155	$ 76,376	$ 7,467	$ 13,493	$ 25,821	$ 35,700

(a) Please refer to the discussion below for a description of the joint venture ownership structure.
(b) On March 1, 2017, we acquired our joint venture partner's interest and have fully consolidated the assets and liabilities of the entity.
(c) Equity method VIE as of September 30, 2017. Constellation and Las Vegas 51s were also VIEs as of December 31, 2016.
(d) The Metropolitan Downtown Columbia was in a deficit position of $2.0 million at September 30, 2017 and December 31, 2016 due to distributions from operating cash flows in excess of basis. This deficit balance is presented in Accounts payable and accrued expenses at September 30, 2017.
(e) On July 20, 2016, we acquired our joint venture partner's interest in Millennium Six Pines Apartments and fully consolidated the assets and liabilities of the entity.
(f) The 33 Peck Slip hotel was closed in December 2016 for redevelopment and was transferred to the Strategic Developments segment as of January 1, 2017. The prior year share of earnings for the three and nine months ended September 30, 2016 was recorded in the Operating Assets segment but is reflected here for comparative purposes.

As of September 30, 2017, we are not the primary beneficiary of the Constellation VIE listed above because we do not have the power to direct activities that most significantly impact the economic performance of the joint venture, and therefore, we report our interests in accordance with the equity method. Our maximum exposure to loss as a result of this investment is limited to the aggregate carrying value of the investment as we have not provided any guarantees or otherwise made firm commitments to fund amounts on behalf of this VIE. The aggregate carrying value of unconsolidated VIEs (inclusive of Las Vegas 51s at December 31, 2016, prior to our acquisition) was $2.2 million and $13.8 million as of September 30, 2017 and December 31, 2016, respectively, and was classified as Investment in Real Estate and Other Affiliates in the Condensed Consolidated Balance Sheets.

As of September 30, 2017, approximately $190.1 million of indebtedness was secured by the properties owned by our Real Estate and Other Affiliates of which our share was approximately $88.0 million based upon our economic ownership. All of this indebtedness is without recourse to us.

We are the primary beneficiary of one VIE which is consolidated in the financial statements. The creditors of the consolidated VIE do not have recourse to us. As of September 30, 2017, the carrying values of the assets and liabilities associated with the operations of the consolidated VIE were $21.9 million and $1.5 million, respectively. As of December 31, 2016, the carrying values of the assets and liabilities associated with the operations of the consolidated VIE were $21.7

million and $1.4 million, respectively. The assets of the VIE are restricted for use only by the particular VIE and are not available for our general operations.

Activity for our significant investments in Real Estate Affiliates and the related accounting considerations are described below.

The Summit

During the first quarter of 2015, we formed DLV/HHPI Summerlin, LLC (“The Summit”) in a joint venture with Discovery Land Company (“Discovery”), and we contributed land with a book basis of $13.4 million and transferred Special Improvement District (“SID”) bonds related to such land with a carrying value of $1.3 million to the joint venture at the agreed upon capital contribution value of $125.4 million (“Our Capital Contribution”), or $226,000 per acre. Discovery is required to fund up to a maximum of $30.0 million of cash as their capital contribution and we have no further capital obligations. The gains on the contributed land will be recognized in Equity in earnings from Real Estate and Other Affiliates as the joint venture sells lots.

After receipt of Our Capital Contribution and a 5.0% preferred return, Discovery is entitled to cash distributions by the joint venture until it has received two times its equity contribution. Any further cash distributions are shared 50/50. Discovery is the manager on the project, and development began in the second quarter of 2015. Given the nature of the venture’s capital structure and the provisions for the liquidation of assets, our share of the venture’s income-producing activities will be recognized based on the Hypothetical Liquidation Book Value (“HLBV”) method. Under this method, we recognize equity in earnings from the joint venture based on the change in our underlying share of the venture’s net assets on a hypothetical liquidation basis as of the reporting date.

Relevant financial statement information for The Summit is summarized as follows:

(in thousands)	September 30, 2017	December 31, 2016
Total Assets	$ 163.6	$ 151.3
Total Liabilities	107.3	116.5
Total Equity	56.3	34.8

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2017	2016	2017	2016
Revenues (a)	$ 14.2	$ 24.7	$ 46.3	$ 41.6
Net income	6.5	13.7	21.6	22.6
Gross Margin	7.7	14.6	26.4	25.1

(a) Revenues related to land sales at the joint venture are recognized on a percentage of completion basis.

Constellation

On January 24, 2014, we entered into a joint venture with a national multi-family real estate developer, The Calida Group, to construct, own and operate a 124-unit gated luxury apartment development in Summerlin. We and our partner each own 50% of the venture, and unanimous consent of the partners is required for all major decisions. This project represents the first residential development in Summerlin's 400-acre downtown. In the first quarter of 2015, we contributed a 4.5-acre parcel of land with an agreed value of $3.2 million in exchange for a 50% interest in the venture. Our partner contributed $3.2 million of cash for their 50% interest. Additionally, our partner is the development manager, funded all pre-development activities, obtained construction financing in the first quarter of 2015 and provided guarantees required by

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the lender. The project is financed by a $15.8 million construction loan which is fully drawn as of September 30, 2017. The loan is non-recourse to us. In the fourth quarter of 2015, we each contributed an additional $1.0 million to the joint venture to fund development costs. Upon a sale of the property, we are entitled to 50% of the proceeds up to, and 100% of the proceeds in excess of, an amount determined by applying a 7.0% capitalization rate to net operating income. The venture commenced construction in February 2015 and is being completed in phases. New tenants began to take occupancy in the third quarter of 2016. This venture was moved to the Operating Assets segment in the fourth quarter of 2016. As of September 30, 2017, the project is 87.9% occupied and 95.2% leased.

m.flats/TEN.M

On October 4, 2013, we entered into a joint venture agreement with a local developer, Kettler, Inc. ("Kettler"), to construct an apartment complex with ground floor retail in Downtown Columbia, Maryland. We contributed approximately five acres of land having a book value of $4.0 million to the joint venture and subsequently incurred an additional $3.1 million in capitalized development costs for a total book value contribution of $7.1 million. Our land was valued at $23.4 million, or $53,500 per constructed unit. In January 2016, the venture closed on an $88.0 million construction loan which is non-recourse to us and bears interest at one-month LIBOR plus 2.40% with an initial maturity date of February 2020, with three, one-year extension options. At loan closing, Kettler contributed $16.1 million in cash and $7.3 million was distributed to us, of which we subsequently reinvested $6.3 million in the project in 2016. We accounted for this transaction as a partial sale of the land for which we recognized a net profit of $0.2 million at December 31, 2016.

33 Peck Slip

In January 2016, we entered into a joint venture to purchase a hotel located at 33 Peck Slip in the Seaport District of New York with a capital contribution of $6.0 million. We advanced a bridge loan of $25.0 million at a 5.0% interest rate to the joint venture at closing to expedite the acquisition, which was repaid in full in June 2016. In the second quarter of 2016, upon completion of a refinancing of the property with a $36.0 million redevelopment loan, we made additional capital contributions of $2.3 million in 2016 and $0.7 million in 2017. The 33 Peck Slip hotel was closed in December 2016 for redevelopment and was transferred to the Strategic Developments segment. Our total investment

in the joint venture is $9.1 million as of September 30, 2017.

Circle T Ranch and Power Center

On June 1, 2016, the Westlake Retail Associates venture closed on a 72-acre land sale with an affiliate of Charles Schwab Corporation. The nine months ended September 30, 2016 reflects the recognition of $10.5 million in Equity in earnings from Real Estate and Other Affiliates resulting from the land sale.

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NOTE 9 MORTGAGES, NOTES AND LOANS PAYABLE

Mortgages, notes and loans payable are summarized as follows:

(In thousands)	September 30, 2017	December 31, 2016
Fixed-rate debt:		
Collateralized mortgages, notes and loans payable	$ 1,476,480	$ 1,140,118
Special Improvement District bonds	32,266	44,023
Variable-rate debt:		
Collateralized mortgages, notes and loans payable (a)	1,505,534	1,524,319
Unamortized bond issuance costs	(7,089)	(5,779)
Deferred financing costs	(13,743)	(11,934)
Total mortgages, notes and loans payable	$ 2,993,448	$ 2,690,747

(a) As more fully described below, $179.3 million and $182.1 million of variable rate debt has been swapped to a fixed-rate for the term of the related debt as of September 30, 2017 and December 31, 2016, respectively.

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The following table presents our mortgages, notes, and loans payable by property, presented within each segment in order of extended maturity date:

($ in thousands)	Initial / Extended Maturity (a)	Interest Rate			Maximum Facility Amount	Carrying Value September 30, 2017	Carrying Value December 31, 2016
Master Planned Communities							
Summerlin South SID Bonds - S124	December 2019	5.95	%			$ 104	$ 123
Summerlin South SID Bonds - S128	December 2020	7.30	%			390	440
Summerlin South SID Bonds - S132	December 2020	6.00	%			1,082	1,268
The Woodlands Master Credit Facility	April 2020 / April 2021	3.98	%	(b)	$ 180,000	150,000	150,000
Bridgeland Credit Facility	November 2020 / November 2022	4.60	%	(b)	65,000	65,000	65,000
Summerlin South SID Bonds - S151	June 2025	6.00	%			3,964	4,159
Summerlin South SID Bonds - S128C	December 2030	6.05	%			4,467	4,600
Summerlin South SID Bonds - S159	June 2035	6.00	%			2,353	2,389
Summerlin West SID Bonds - S812	October 2035	6.00	%			17,019	27,459
Master Planned Communities Total						244,379	255,438
Operating Assets							
1701 Lake Robbins	April 2017	5.81	%			—	4,600
Outlet Collection at Riverwalk	October 2017 / October 2018	3.98	%	(b)	54,325	54,325	55,778
1725-35 Hughes Landing Boulevard	June 2018 / June 2019	2.88	%	(b)	143,000	115,999	105,647

The Westin at The Woodlands (c)	August 2018 / August 2019	3.88	% (b)	57,946	57,946	58,077
110 North Wacker	October 2019	5.21	% (e)		19,870	22,704
Three Hughes Landing (c)	December 2017 / December 2019	3.58	% (b)	65,455	43,661	35,053
Lakeland Village Center at Bridgeland	May 2018 / May 2020	3.58	% (b)	14,000	11,292	9,979
Embassy Suites at Hughes Landing	October 2018 / October 2020	3.73	% (b)	37,100	31,245	29,461
The Woodlands Resort & Conference Center	December 2018 / December 2020	4.48	% (b)		67,000	70,000
One Merriweather	February 2020 / February 2021	3.38	% (b)	49,900	41,271	23,588
Downtown Summerlin	September 2020 / September 2021	3.38	% (b) (d)	275,885	275,883	302,981
HHC 242 Self-Storage	October 2019 / October 2021	3.83	% (b)	6,658	6,137	3,708
HHC 2978 Self-Storage Facility	January 2020 / January 2022	3.83	% (b)	6,368	5,521	1,715
70 Columbia Corporate Center	May 2020 / May 2022	3.23	% (b)(f)		20,000	20,000
One Mall North	May 2020 / May 2022	3.48	% (b)(f)		14,463	—
10-60 Columbia Corporate Centers	May 2020 / May 2022	3.20	% (b)(f)(g)		80,000	80,000
20/25 Waterway Avenue	May 2022	4.79	%		13,708	13,886
Millennium Waterway Apartments	June 2022	3.75	%		55,344	55,584
Ward Village	September 2021 / September 2023	3.69	% (b)(h)		238,718	238,718
9303 New Trails	December 2023	4.88	%		12,098	12,378
4 Waterway Square	December 2023	4.88	%		35,431	36,249
3831 Technology Forest Drive	March 2026	4.50	%		22,088	22,383
Kewalo Basin Harbor	September 2027	3.98	% (b)	11,562	—	—
Millennium Six Pines Apartments	August 2028	3.39	%		42,500	42,500
3 Waterway Square	August 2028	3.94	%		50,647	51,590
One Hughes Landing	December 2029	4.30	%		52,000	52,000
Downtown Summerlin SID Bonds - S128	December 2030	6.05	%		2,887	3,350
Two Hughes Landing	December 2030	4.20	%		48,000	48,000
One Lakes Edge	March 2029 / March 2031	4.50	%		69,440	68,874
Hughes Landing Retail	December 2036	3.50	%		35,000	35,000
Columbia Regional Building	February 2037	4.48	%		25,000	22,188
Other					—	235
Capital lease obligations	Various	3.60	%		—	1
Operating Assets Total					1,547,474	1,526,227

Strategic Developments						
Waiea and Anaha (i)	November 2017 / November 2019	7.98	% (b)	410,000	195,269	160,847
Ke Kilohana	December 2019 / December 2020	4.48	% (b)	142,656	—	—
Two Merriweather	October 2020 / October 2021	3.73	% (b)	33,156	11,932	—
Ae`o	December 2019 / December 2021	5.23	% (b)	230,000	1	—
100 Fellowship Drive	May 2022	2.73	% (b)	51,426	1	—
Strategic Developments Total					207,203	160,847
Other corporate financing arrangements	July 2018	3.00	%		15,224	15,948
Senior Notes	October 2021	6.88	%		—	750,000
Senior Notes	March 2025	5.38	%		1,000,000	—
Unamortized bond issuance costs					(7,089)	(5,779)
Deferred financing costs					(13,743)	(11,934)
Total mortgages, notes, and loans payable					$ 2,993,448	$ 2,690,747

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(a) Maturity dates presented include initial maturity date as well as the extended or final maturity date as contractually stated. Extension periods generally can be exercised at our option at the initial maturity date, subject to customary extension terms that are based on property performance at the initial maturity date. Such extension terms may include, but are not limited to, minimum debt service coverage, minimum occupancy levels or condominium sales levels, as applicable and other performance criteria. In certain cases due to property performance not meeting covenants, we may have to pay down a portion of the loan in order to obtain the extension.
(b) The interest rate presented is based on the one month LIBOR rate, which was 1.23% at September 30, 2017.
(c) Based on current performance of Three Hughes Landing and The Westin at The Woodlands, a paydown may be required in order to exercise the extension options.
(d) On July 14, 2017, the Downtown Summerlin loan’s original maturity date of July 2017 was modified to be September 13, 2020, at which time we made a $30.0 million paydown on the facility and further extended the new maturity date and extension date. Additionally, the interest rate was reduced from LIBOR plus 2.25% to LIBOR plus 2.15%.
(e) The $19.9 million outstanding principal balance is swapped to a 5.21% fixed-rate through maturity.
(f) These three notes are part of one master facility, with all three respective properties collateralizing the total $114.5 million indebtedness.
(g) $40.0 million of the outstanding principal balance is swapped to a 3.41% fixed-rate through maturity.
(h) $119.4 million of the outstanding principal balance is swapped to a 3.64% fixed-rate through maturity.
(i) The Waiea and Anaha facility was repaid in full on October 27, 2017.

The weighted average interest rate on our mortgages, notes and loans payable, excluding interest rate hedges, was 4.64% and 4.71% as of September 30, 2017 and December 31, 2016, respectively.

Except for the items listed below, all of the mortgage debt is secured by the individual properties listed in the table above and is non-recourse to HHC:

(i) $1.0 billion of Senior Notes;
(ii) $275.9 million financing for the Downtown Summerlin development which has maximum recourse of 35% of the outstanding balance, which will reduce to 15.0% upon achievement of a 1.15:1.0 debt service coverage ratio. The recourse further reduces to 10% upon achievement of a 1.25:1.0 debt service coverage ratio, a 90% occupancy level, and average tenant sales of at least $500.00 per net rentable square foot. As of September 30, 2017, 35% of the outstanding loan balance remains recourse to HHC;

(iii) $27.2 million, or 50% of the Outlet Collection at Riverwalk outstanding loan balance is recourse to HHC;
(iv) $15.2 million of Other Corporate Financing Arrangements; and
(v) $19.9 million of the 110 North Wacker mortgage.

Certain of our loans contain provisions which grant the lender a security interest in the operating cash flow of the property that represents the collateral for the loan. Certain mortgage notes may be prepaid subject to a prepayment penalty equal to a yield maintenance premium, defeasance, or a percentage of the loan balance. As of September 30, 2017, land, buildings and equipment and developments with a net book value basis of $3.5 billion have been pledged as collateral for our mortgages, notes and loans payable.

As of September 30, 2017, we were in compliance with all financial covenants included in the debt agreements governing our indebtedness.

Master Planned Communities

The Woodlands Master Credit Facility was amended and restated on July 31, 2015 to a $200.0 million maximum facility amount consisting of a $100.0 million term loan and a $100.0 million revolver (together, the “TWL Facility”). The TWL Facility bears interest at one-month LIBOR plus 2.75% and had an August 2016 initial maturity date with two, one–year extension options. In July 2016, we exercised our first one-year extension option, which reduced the total commitment to $175.0 million. Semi-annual principal payments of $25.0 million began on December 31, 2016 and continue through the second, optional one-year extension period. The TWL Facility and The Woodlands Resort & Conference Center loans are

recourse to the entities that directly own The Woodlands operations. The TWL Facility also contains certain covenants that, among other things, require the maintenance of specified financial ratios, limit the incurrence of additional recourse indebtedness at The Woodlands, and limit distributions from The Woodlands to us based on a loan to value test. The amendment also modified certain covenants to allow for more construction loan guarantees by the entities that directly own The Woodlands than would otherwise have been permitted by the prior facility. On April 27, 2017, TWL Facility was refinanced to increase the facility by $30.0 million for a total of $180.0 million, providing the ability to fund the development of Creekside Park Apartments or for other corporate purposes. The new facility bears interest at one-month LIBOR plus 2.75% with an initial maturity date of April 27, 2020 and a one-year extension option.

The Summerlin MPC uses SID bonds to finance certain common infrastructure improvements. These bonds are issued by the municipalities and are secured by the assessments on the land. The majority of proceeds from each bond issued is held in a construction escrow and disbursed to us as infrastructure projects are completed, inspected by the municipalities and approved for reimbursement. Accordingly, the SID bonds have been classified as debt, and the Summerlin MPC pays the debt service on the bonds semi annually. As Summerlin sells land, the buyers assume a proportionate share of the bond obligation at closing, and the residential sales contracts provide for the reimbursement of the principal amounts that we previously paid with respect to such proportionate share of the bond. In the nine months ended September 30, 2017, no new SID bonds were issued and $9.9 million in obligations were assumed by buyers.

Operating Assets

On October 24, 2017, we exercised our one-year extension option on our $54.3 million Outlet Collection at Riverwalk facility which extended the maturity date to October 24, 2018.

On September 13, 2017, we modified and extended our $311.8 million Downtown Summerlin facility with a $30.0 million paydown. The modified loan has a maximum facility of $275.9 million and bears interest at one-month LIBOR plus 2.15% with a maturity of September 13, 2020, with one, one-year extension option.

On August 11, 2017, we closed on a construction loan totaling $11.6 million for Kewalo Harbor, located in Honolulu, Hawai‘i, to be used for improvements benefitting our Ward Village development. The loan bears interest at one-month LIBOR plus 2.75% with a maturity of September 1, 2027. As of September 30, 2017, we had not drawn any proceeds under this loan.

On June 27, 2017, we modified our $94.5 million non-recourse mortgage financing for the 10-60 Columbia Corporate Center and One Mall North office buildings with a $114.5 million loan. This amendment added 70 Columbia Corporate Center, a 170,741 square foot office building in Columbia, Maryland, to the collateral pool and allowed us to draw $20.0 million and fully repay the outstanding balance of the existing indebtedness on the 70 Columbia Corporate Center note.

On April 6, 2017, we paid off a $4.6 million maturing mortgage loan that we assumed as part of the acquisition of 1701 Lake Robbins in July 2014.

On January 19, 2017, we closed on a non-recourse financing totaling $25.0 million replacing the $23.0 million construction loan on the Columbia Regional Building, a retail building located in Columbia, Maryland. The loan, which matures on February 11, 2037, bears interest at 4.48% and is interest only for two years, then begins amortizing on a 30-year basis.

On November 25, 2016, we amended and extended our $73.5 million construction loan for One Lakes Edge with a $71.9 million mortgage. Contemporaneously with this amendment, we made a $3.0 million principal reduction payment as required by the loan agreement. The loan bears interest at one-month LIBOR plus 3.50%. On February 23, 2017, we refinanced the One Lakes Edge construction loan with a $69.4 million Fannie Mae loan with an initial maturity of March

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2029 and two, one year-extensions. The new loan has a fixed rate of 4.50% and is interest only for four years, then begins amortizing on a 30-year basis.

Strategic Developments

As of October 27, 2017, we repaid the $195.3 million outstanding on our construction loan relating to Waiea and Anaha in conjunction with closing on the sales of units at Anaha.

On October 19, 2017, we closed on a construction loan totaling $64.6 million to be used for Aristocrat and Two Summerlin. The loan bears interest at Wall Street Journal Prime plus 0.40% with a maturity of October 19, 2022.

On May 31, 2017, we closed on a $51.4 million construction loan for 100 Fellowship Drive, located in The Woodlands. The loan bears interest at one-month LIBOR plus 1.50% with a maturity of May 31, 2022.

NOTE 10 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to interest rate risk related to our variable interest rate debt, and we manage this risk by utilizing interest rate derivatives. To add stability to interest costs by reducing our exposure to interest rate movements, we use interest rate swaps, forward-starting swaps, and caps as part of our interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for our fixed rate payments over the life of the agreements without exchange of the underlying notional amount. Forward-starting interest rate swaps were designated as cash flow hedges of the variability of anticipated future fixed-rate debt issuance for long-term financing needs at our Downtown Summerlin property. Interest rate caps designated as cash flow hedges involve the receipt of variable amounts from a counterparty if interest rates rise above the strike rate on the contract in exchange for an up front premium. Our interest rate caps are not currently designated

as hedges, and therefore, any gain or loss is recognized in current period earnings. These derivatives are recorded on a gross basis at fair value.

The effective portion of changes in the fair value of derivatives designated and qualifying as cash flow hedges is recorded in Accumulated Other Comprehensive Income ("AOCI") and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the three and nine months ended September 30, 2017 and 2016 the ineffective portion recorded was insignificant.

Assessments of hedge effectiveness are performed quarterly using regression analysis and the measurement of hedge ineffectiveness is based on the hypothetical derivative method. We are exposed to credit risk in the event of non-performance by our derivative counterparties. We evaluate counterparty credit risk through monitoring the creditworthiness of counterparties, which includes review of debt ratings and financial performance. To mitigate its credit risk, we enter into agreements with counterparties we consider credit-worthy, such as large financial institutions with favorable credit ratings. As of September 30, 2017 and 2016, there were no termination events or events of default related to the interest rate swaps.

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

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The following table summarizes details related to our derivative contracts:

(In thousands)		Balance Sheet Location	Notional Amount	Fixed Interest Rate	Effective Date	Maturity Date	Fair Value Asset (Liability) September 30, 2017	December 31, 2016
Currently-paying contracts:								
Interest Rate Swap	(a)	Accounts payable and accrued expenses	$ 19,870	2.96 %	5/10/2011	10/31/2019	$ (427)	$ (740)
Interest Rate Swap	(a)	Prepaid expenses and other assets, net	40,000	1.66	5/6/2015	5/1/2020	30	(143)
Interest Rate Swap	(a)	Prepaid expenses and other assets, net	119,359	1.14	10/3/2016	9/12/2021	3,069	3,368
Interest Rate Cap	(b)	Accounts payable and accrued expenses	75,000	5.00	9/1/2017	8/31/2019	—	—
Interest Rate Cap	(c)	Prepaid expenses and other assets, net	230,000	2.50	12/22/2016	12/23/2019	145	768
Forward-starting contracts:								
Interest Rate Swap	(a)	Accounts payable	50,000	2.65	12/31/2017	12/31/2027	(1,452)	(610)

		and accrued expenses						
Interest Rate Swap	(a)	Accounts payable and accrued expenses	100,000	2.68	12/31/2017	12/31/2027	(3,165)	(1,479)
Interest Rate Swap	(a)	Accounts payable and accrued expenses	100,000	2.62	12/31/2017	12/31/2027	(2,698)	(1,015)
Total fair value derivative assets							$ 3,244	$ 4,136
Total fair value derivative liabilities							$ (7,742)	$ (3,987)

(a) Denotes derivatives designated as hedging instruments.
(b) As of December 31, 2016, our $100.0 million interest rate cap with a 5.00% interest rate and an August 31, 2017 maturity date was in place and matured as scheduled. A new interest rate cap was entered into as detailed above and is not currently designated as a hedging instrument. Interest (income) expense included in the condensed consolidated statement of operations for the three months ended September 30, 2017 related to this contract is not material.
(c) Denotes derivative contract that could not be designated as a hedging instrument as of September 30, 2017 as this cap hedges debt that is not yet drawn. Interest (income) expense of $(0.1) million is included in the condensed consolidated statement of operations for the three months ended September 30, 2017, related to this contract. Interest (income) expense of $(0.6) million is included in the condensed consolidated statement of operations for the nine months ended September 30, 2017, related to this contract.

The tables below present the effect of our derivative financial instrument on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 and 2016:

	Amount of Loss Recognized in AOCI on Derivative (Effective Portion) Three Months Ended September 30,		Amount of Loss Recognized in AOCI on Derivative (Effective Portion) Nine Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationships	2017	2016	2017	2016
Interest rate swaps	$ (7)	$ (203)	$ (272)	$ (1,409)
Forward-Starting Swaps	—	344	(2,316)	(14,566)
	$ (7)	$ 141	$ (2,588)	$ (15,975)

Location of Loss Reclassified from AOCI into Operations	Amount of Loss Reclassified from AOCI into Operations (Effective Portion) Three Months Ended September 30, 2017	2016	Amount of Loss Reclassified from AOCI into Operations (Effective Portion) Nine Months Ended September 30, 2017	2016
Interest expense	$ (68)	$ (356)	$ (399)	$ (1,099)

NOTE 11 INCOME TAXES

We have significant permanent differences, primarily from warrant liability gains and losses, stock compensation deductions and changes in valuation allowances that cause our effective tax rate to deviate from statutory rates. The effective tax rates, based upon actual operating results, were 35.8% and 62.3% for the three and nine months ended September 30, 2017, respectively, compared to 56.0% and 39.1% for the three and nine months ended September 30, 2016, respectively. The changes in the tax rates were primarily attributable to changes in the warrant liability, valuation allowance related to our deferred tax assets, stock compensation deduction and other items which are permanent differences for tax purposes.

The increase in deferred tax liabilities between December 31, 2016 and September 30, 2017 is due primarily to the

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utilization of federal tax assets to offset income before taxes exclusive of the warrant liability loss.

NOTE 12 STOCK BASED PLANS

Our stock based plans are described and informational disclosures are provided in the Notes to the Consolidated Financial Statements included in our Annual Report.

Stock Options

The following table summarizes our stock option plan activity for the nine months ended September 30, 2017:

	Stock Options	Weighted Average Exercise Price
Stock Options outstanding at December 31, 2016	1,176,640	$ 78.87
Granted	54,000	119.18
Exercised	(357,247)	58.45
Forfeited	(47,000)	104.82
Expired	(1,000)	57.77
Stock Options outstanding at September 30, 2017	825,393	88.89

Compensation costs related to stock options were $0.6 million and $1.6 million for the three and nine months ended September 30, 2017, respectively, of which $0.2 million and $0.4 million of costs were capitalized to development projects during the same periods. Compensation costs related to stock options were $1.2 million and $3.5 million for the three and nine months ended September 30, 2016, respectively, of which $0.3 million and $1.1 million were

capitalized to development projects during the same periods.

Restricted Stock

The following table summarizes restricted stock activity for the nine months ended September 30, 2017:

	Restricted Stock	Weighted Average Grant Date Fair Value
Restricted stock outstanding at December 31, 2016	289,112	$ 88.88
Granted	124,621	87.11
Vested	(23,629)	84.20
Forfeited	(31,370)	85.56
Restricted stock outstanding at September 30, 2017	358,734	88.86

Compensation expense related to restricted stock awards were $1.2 million and $4.1 million for the three and nine months ended September 30, 2017, respectively, of which $(0.3) million related to forfeitures and $0.2 million were capitalized to development projects during the same periods. Compensation costs related to restricted stock awards was $1.2 million and $4.4 million for the three and nine months ended September 30, 2016, respectively, of which $0.3 million and $0.9 million were capitalized to development projects during the same periods.

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NOTE 13 OTHER ASSETS AND LIABILITIES

Prepaid Expenses and Other Assets

The following table summarizes the significant components of Prepaid expenses and other assets:

(In thousands)	September 30, 2017	December 31, 2016
Condominium deposits	$ 320,097	$ 193,197
Condominium receivables (a)	213,158	210,219
Special Improvement District receivable	55,841	61,603
Straight-line rent	36,365	31,518
In-place leases	11,209	16,015
Below-market ground leases	18,732	18,986
Above-market tenant leases	1,786	2,457
Equipment, net of accumulated depreciation of $6.5 million and $4.9 million, respectively	17,364	17,556
Security and escrow deposits	48,277	61,304
Tenant incentives and other receivables	8,976	8,773
Prepaid expenses	13,197	11,177
Federal income tax receivable	8,513	15,763
Intangibles	35,368	4,046
Interest rate swap derivative assets	3,244	—
Other	3,892	13,902
	$ 796,019	$ 666,516

(a) We expect $140.5 million of the Condominium receivables outstanding at September 30, 2017 to be collected in 2017 upon closing Anaha and the remaining contracted units at Waiea. Of the remaining, $71.4 million related to Ae`o will be collected in 2018, and $1.3 million relating to Ke Kilohana will be collected in 2019.

The $129.5 million net increase primarily relates to the following increases: a $126.9 million increase in condominium deposits recorded with respect to sales at Anaha, Ae`o and Ke Kilohana; a $31.3 million increase in intangibles primarily due to our acquisition of our partner's 50.0% interest in the Las Vegas 51s; $4.8 million increase in straight-line rent due to additional Operating Assets placed in service during the year; $3.2 million increase in derivative asset; a $2.9 million increase in condominium receivables recorded with respect to sales recognized on a percentage of completion basis and $2.4 million in other increases related to prepaid expenses and tenant incentives and other receivables due to various tenant activities.

These increases were partially offset by the following decreases: a $13.0 million decrease in security and escrow deposits due primarily to the utilization of escrowed sales proceeds to fund remaining construction costs at Waiea; a $10.0 million decrease in Other assets primarily relating to third party reimbursements received for improvements made on the Merriweather Post Pavilion in 2016; a $7.3 million decrease in federal income tax receivable due to the receipt of an IRS tax refund; a $5.8 million decrease in Special Improvement District receivables due to reimbursements received related to our Summerlin MPC; a $4.8 million decrease in in-place leases and $1.1 million in other decreases related to Below-market ground leases, Above-market tenant leases and Equipment, net.

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Accounts Payable and Accrued Expenses

The following table summarizes the significant components of Accounts payable and accrued expenses:

(In thousands)	September 30, 2017	December 31, 2016
Construction payables	$ 183,585	$ 207,917
Condominium deposit liabilities	64,457	117,015
Deferred income	49,053	85,158
Accounts payable and accrued expenses	33,466	33,050
Tenant and other deposits	19,506	28,559
Accrued interest	8,256	16,897
Accrued payroll and other employee liabilities	26,685	36,937
Accrued real estate taxes	21,525	16,726
Interest rate swaps	7,742	(149)
Straight-line ground rent liability	14,493	13,126
Above-market ground leases	587	1,762
Other	33,498	15,012
	$ 462,853	$ 572,010

The $109.2 million net decrease in total accounts payable and accrued expenses primarily relates to the following decreases: $52.6 million in condominium deposit liabilities for the towers under construction at Ward Village as the projects move toward completion; $36.1 million in deferred income recognized in conjunction with revenue previously deferred at our Summerlin and Bridgeland MPCs; $24.3 million in construction payables; $10.3 million in accrued payroll and other employee liabilities due to payment in both the first quarters of annual incentive bonuses for 2016 and 2015, respectively; $9.1 million in tenant and other deposits due primarily to amortization of a tenant’s prepaid rent; $8.6 million in accrued interest due to lower interest accrual activity relating to the issuance of the 2025 Notes at a lower rate than the 6.875% senior notes and $1.2 million in other decreases related to above-market ground leases.

These decreases are partially offset by an increase of $18.5 million in other liabilities; an increase of $7.9 million in interest rate swaps liability primarily due to a decrease in fair value of the forward-starting swaps; a $4.8 million increase in accrued real estate taxes due to timing of payments; and $1.8 million in other increases related to accounts payable and accrued expenses and straight-line ground rent liability.

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NOTE 14 ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) ("AOCI")

The following tables summarize changes in Accumulated Other Comprehensive Income (Loss) by component, all of which are presented net of tax:

	For the Three Months Ended September 30,	
(In thousands)	2017	2016
Balance as of June 30	$ (9,157)	$ (24,152)
Other comprehensive income (loss) before reclassifications	72	(22)
Loss reclassified from accumulated other comprehensive loss to net income (loss)	68	356
Net current-period other comprehensive income (loss)	140	334
Balance as of September 30	$ (9,017)	$ (23,818)

	For the Nine Months Ended September 30,	
(In thousands)	2017	2016
Balance as of January 1	$ (6,786)	$ (7,889)
Other comprehensive loss before reclassifications	(2,630)	(17,028)
Loss reclassified from accumulated other comprehensive loss to net income (loss)	399	1,099
Net current-period other comprehensive loss	(2,231)	(15,929)
Balance as of September 30	$ (9,017)	$ (23,818)

The following tables summarize the amounts reclassified out of AOCI:

Accumulated Other Comprehensive Income (Loss) Components	Affected line items in the Statements of Operations	Amounts reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended	
(In thousands)		September 30, 2017	September 30, 2016
Losses on cash flow hedges	Interest expense	$ 108	$ 558
Interest rate swap contracts	Provision for income taxes	(40)	(202)
Total reclassifications of loss (income) for the period	Net of tax	$ 68	$ 356

Accumulated Other Comprehensive Income (Loss) Components	Affected line items in the Statements of Operations	Amounts reclassified from Accumulated Other Comprehensive Income (Loss) For the Nine Months Ended	
(In thousands)		September 30, 2017	September 30, 2016
Losses on cash flow hedges	Interest expense	$ 636	$ 1,752
Interest rate swap contracts	Provision for income taxes	(237)	(653)
Total reclassifications for the period	Net of tax	$ 399	$ 1,099

NOTE 15 COMMITMENTS AND CONTINGENCIES

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

We had outstanding letters of credit totaling $13.8 million and $6.5 million and surety bonds totaling $95.0 million and $112.4 million as of September 30, 2017 and December 31, 2016, respectively. These letters of credit and bonds were issued primarily in connection with insurance requirements, special real estate assessments and construction obligations.

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On June 27, 2013, the City of New York executed the amended and restated ground lease for South Street Seaport. The restated lease terms provide for annual fixed base rent of $1.2 million starting July 1, 2013 with an expiration of December 30, 2072, including our options to extend. The rent escalates at 3.0% compounded annually. On July 1, 2048 the base rent will be adjusted to the higher of fair market value or the then base rent. In addition to the annual base rent, we are required to make annual payments of $210,000 toward maintenance of the East River esplanade as additional rent through the term of the lease. The additional rent escalates annually at the Consumer Price Index. Simultaneously with the execution of the lease, we executed a completion guaranty for the redevelopment of Pier 17. On January 11, 2017, we executed an amendment of the lease which, pursuant to our lease option, added an additional premise to the lease and modified other related provisions. The 2017 amendment provides for an appraisal update to be performed on completion of construction for the purposes of determining any additional rent.

NOTE 16 SEGMENTS

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

- Master Planned Communities ("MPCs") – includes the development and sale of land, in large scale, long term community development projects in and around Las Vegas, Nevada; Houston, Texas; and Columbia, Maryland.

- Operating Assets – includes retail, office, hospitality and multi-family properties along with other real estate investments. These assets are currently generating revenues, and are comprised of commercial real estate properties recently developed or acquired by us, and properties where we believe there is an opportunity to redevelop, reposition, or sell to improve segment performance or to recycle capital.

- Strategic Developments – includes our residential condominium and commercial property projects currently under development and all other properties held for development which have no substantial operations.

Effective January 1, 2017, we moved the South Street Seaport assets under construction and related activities to the Strategic Developments segment from the Operating Assets segment. South Street Seaport operating properties and related operating results remain presented within the Operating Assets segment. The respective segment earnings and total segment assets presented in our interim financial statements and elsewhere in this Quarterly Report have been adjusted in all periods reported to reflect this change.

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The assets included in each segment as of September 30, 2017, are contained as follows:

Master Planned Communities	Operating Assets		Strategic Developments
	Retail	Office	Under Construction
• Bridgeland	Columbia Regional Building	10-70 Columbia Corporate Center	Ae`o
• Maryland	Cottonwood Square	Columbia Office Properties	Anaha
• Summerlin	Creekside Village Green	One Hughes Landing	Aristocrat
• The Woodlands	Downtown Summerlin	Two Hughes Landing	Creekside Park Apartments
• The Woodlands Hills	Hughes Landing Retail	Three Hughes Landing (b)	100 Fellowship Drive
	1701 Lake Robbins	1725-35 Hughes Landing Boulevard	Ke Kilohana
Other	Lakeland Village Center at Bridgeland (b)	2201 Lake Woodlands Drive	Two Merriweather
• The Summit (a)	Outlet Collection at Riverwalk	One Mall North	Two Summerlin
	South Street Seaport - Historic District / Uplands	One Merriweather (d)	m.flats/TEN.M (a)
	Ward Village Retail	110 North Wacker	33 Peck Slip (a) (f)
	20/25 Waterway Avenue	9303 New Trails	South Street Seaport - Pier 17 (f)
	Waterway Garage Retail	ONE Summerlin	Waiea
		3831 Technology Forest Drive	
	Multi-family	3 Waterway Square	Other
	Constellation (a) (b)	4 Waterway Square	AllenTowne
	Millennium Waterway Apartments	1400 Woodloch Forest	American City Building
	Millennium Six Pines Apartments (c)		Bridges at Mint Hill
	One Lakes Edge	Other	Century Plaza Mall

85 South Street	HHC 242 Self-Storage (d)	Circle T Ranch and Power Center (a)
The Metropolitan Downtown Columbia (a)	HHC 2978 Self-Storage (d)	Cottonwood Mall
	Las Vegas 51s (e)	Downtown Summerlin Apartments
	Kewalo Basin Harbor	The Elk Grove Collection (g)
Hospitality	Stewart Title of Montgomery County, TX (a)	80% Interest in Fashion Show Air Rights
Embassy Suites at Hughes Landing	Summerlin Hospital Medical Center (a)	Kendall Town Center
The Westin at The Woodlands (b)	The Woodlands Parking Garages	Lake Woodlands Crossing Retail Center
The Woodlands Resort & Conference Center	2000 Woodlands Parkway	Landmark Mall (f)
	Woodlands Sarofim #1 (a)	Maui Ranch Land
		Merriweather Apartments
		South Street Seaport - Tin Building
		Three Merriweather
		West Windsor

(a) A non-consolidated investment. Refer to Note 8 – Real Estate and Other Affiliates in our Condensed Consolidated Financial Statements.
(b) Asset was placed in service and moved from the Strategic Developments segment to the Operating Assets segment during 2016.
(c) Asset was held as a joint venture until our acquisition of our partner's 18.57% interest on July 20, 2016.
(d) Asset was placed in service and moved from the Strategic Developments segment to the Operating Assets segment during 2017.
(e) Asset was held as a joint venture until our acquisition of our partner's 50% interest on March 1, 2017.
(f) Asset is in redevelopment and moved from the Operating Assets segment to the Strategic Developments segment during 2017.
(g) Formerly known as The Outlet Collection at Elk Grove.

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

EBT, as it relates to each business segment, represents the revenues less expenses of each segment, including interest income, interest expense, and equity in earnings of real estate and other affiliates. EBT excludes corporate expenses and other items that are not allocable to the segments. We present EBT because we use this measure, among others,

internally to assess the core operating performance of our assets. We also present this measure because we believe certain investors use it as a measure of a company's historical operating performance and its ability to service and obtain financing. We believe that the inclusion of certain adjustments to net income (loss) to calculate EBT is appropriate to provide additional information to investors.

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Segment operating results are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Master Planned Communities				
Land sales	$ 54,906	$ 44,128	$ 177,531	$ 147,168
Builder price participation	5,472	4,483	14,613	15,631
Minimum rents	—	95	(8)	376
Other land revenues	4,551	4,043	19,575	12,195
Other rental and property revenues	—	13	—	33
Total revenues	64,929	52,762	211,711	175,403
Cost of sales – land	29,043	21,432	88,288	66,128
Land sales operations	8,180	10,674	24,881	30,454
Provision for doubtful accounts	—	—	2	—
Depreciation and amortization	76	72	247	236
Interest income	8	(5)	(1)	(26)
Interest expense (*)	(6,363)	(5,248)	(17,901)	(15,591)
Equity in (earnings) loss in Real Estate and Other Affiliates	(6,480)	(13,700)	(21,552)	(22,574)
Total expenses	24,464	13,225	73,964	58,627
MPC segment EBT	40,465	39,537	137,747	116,776
Operating Assets				
Minimum rents	44,579	44,736	135,564	127,663
Tenant recoveries	11,491	11,652	34,257	33,089
Hospitality revenues	17,776	14,088	57,190	46,126
Other rental and property revenues	5,687	3,471	16,487	10,974
Total revenues	79,533	73,947	243,498	217,852
Other property operating costs	17,473	15,611	51,041	43,524
Rental property real estate taxes	7,098	6,406	19,975	19,257
Rental property maintenance costs	3,288	3,247	9,601	8,893
Hospitality operating costs	13,525	12,662	41,534	37,379
Provision for doubtful accounts	453	1,940	1,728	4,566
Demolition costs	34	—	162	—

Provision for impairment	—	35,734	—	35,734
Development-related marketing costs	1,067	457	2,317	902
Depreciation and amortization	33,885	20,732	88,918	64,546
Other income, net	249	(11)	265	(3,126)
Interest income	3	(3)	—	(19)
Interest expense (*)	15,937	12,905	46,004	36,987
Equity in (earnings) loss in Real Estate and Other Affiliates	(317)	210	(3,739)	(2,616)
Total expenses	92,695	109,890	257,806	246,027
Operating Assets segment EBT	(13,162)	(35,943)	(14,308)	(28,175)
Strategic Developments				
Minimum rents	75	79	497	216
Tenant recoveries	95	5	370	19
Condominium rights and unit sales	113,852	115,407	342,208	362,613
Other land revenues	10	10	31	30
Other rental and property revenues	242	54	822	328
Total revenues	114,274	115,555	343,928	363,206
Condominium rights and unit cost of sales	86,531	83,218	253,209	237,759
Other property operating costs	3,881	924	9,112	3,989
Rental property real estate taxes	580	627	1,790	1,853
Rental property maintenance costs	92	85	415	324
Provision for doubtful accounts	(5)	—	(2)	63
Demolition costs	141	256	141	1,218
Development-related marketing costs	4,799	4,259	12,470	14,684
Depreciation and amortization	18	659	1,177	1,978
Other income, net	(122)	(298)	(137)	(542)
Interest income	(30)	(140)	(124)	(271)
Interest expense (*)	(6,953)	(4,866)	(18,197)	(12,710)
Equity in (earnings) loss in Real Estate and Other Affiliates	(670)	(3)	(530)	(10,510)
Gains on sales of properties	(237)	(70)	(32,452)	(140,549)
Total expenses	88,025	84,651	226,872	97,286
Strategic Developments segment EBT	26,249	30,904	117,056	265,920
Total consolidated segment EBT	$ 53,552	$ 34,498	$ 240,495	$ 354,521

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

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The following reconciles EBT to income before taxes:

Reconciliation of EBT to income before taxes	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
MPC segment EBT	$ 40,465	$ 39,537	$ 137,747	$ 116,776
Operating Assets segment EBT	(13,162)	(35,943)	(14,308)	(28,175)
Strategic Developments segment EBT	26,249	30,904	117,056	265,920
Total consolidated segment EBT	53,552	34,498	240,495	354,521
Corporate and other items:				
General and administrative	(22,362)	(21,128)	(63,423)	(61,505)
Corporate interest expense, net	(12,875)	(13,263)	(36,595)	(39,358)
Warrant liability loss	—	(7,300)	(43,443)	(21,630)
Gain on acquisition of joint venture partner's interest	—	27,087	5,490	27,087
Loss on redemption of senior notes due 2021	—	—	(46,410)	—
Corporate other (expense) income, net	(33)	123	878	6,190
Corporate depreciation and amortization	(1,920)	(1,859)	(5,851)	(4,486)
Total Corporate and other items	(37,190)	(16,340)	(189,354)	(93,702)
Income before taxes	$ 16,362	$ 18,158	$ 51,141	$ 260,819

The following reconciles segment revenues to consolidated revenues:

Reconciliation of Segment Basis Revenues to Revenues	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2017	2016	2017	2016
Master Planned Communities	$ 64,929	$ 52,762	$ 211,711	$ 175,403
Operating Assets	79,533	73,947	243,498	217,852

Strategic Developments	114,274	115,555	343,928	363,206
Total revenues	$ 258,736	$ 242,264	$ 799,137	$ 756,461

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

(In thousands)	September 30, 2017	December 31, 2016
Master Planned Communities	$ 2,054,621	$ 1,982,639
Operating Assets	2,450,306	2,344,949
Strategic Developments	1,708,327	1,451,460
Total segment assets	6,213,254	5,779,048
Corporate and other	510,442	588,334
Total assets	$ 6,723,696	$ 6,367,382

The increase in the Operating Assets segment asset balance as of September 30, 2017 compared to December 31, 2016 is primarily due to placing One Merriweather, HHC 242 and HHC 2978 Self-Storage in service as well as the acquisition of our joint venture partner's 50% interest in the Las Vegas 51s. These increases were partially offset by the transfer of Landmark Mall and our investment in 33 Peck Slip to Strategic Developments in January 2017.

The increase in the Strategic Developments segment asset balance as of September 30, 2017 compared to December 31, 2016 is primarily due to the transfers of Landmark Mall and 33 Peck Slip into the segment and increased development expenditures primarily at South Street Seaport and our Ward condominium projects under construction.

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

The following discussion and analysis by management should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes included in this Quarterly Report and in the Company’s Form 10-K for the year ended December 31, 2016 (the “Annual Report”). All references to numbered Notes are to specific notes to our unaudited Condensed Consolidated Financial Statements included in this Quarterly Report.

Forward-looking information

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

Forward-looking statements give our current expectations relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify forward-looking statements by the fact that they do not relate strictly to current or historical facts. These statements may include words such as “anticipate,” “believe,” “estimate,” “expect,” “forecast,” “intend,” “likely,” “may,” “plan,” “project,” “realize,” “should,” “transform,” “would,” and ot similar expression. Forward-looking statements should not be relied upon. They give our expectations about the future and are not guarantees.

Forward-looking statements include:

- budgeted costs, future lot sales and estimates and projections of Net Operating Income (“NOI”) and Earnings Before Taxes (“EBT”);
- forecasts of our future economic performance;
- expected capital required for our operations and development opportunities at our properties;
- expected performance of our MPC segment and other current income producing properties;
- expected commencement and completion for property developments and timing of sales or rentals of certain properties;
- estimates of our future liquidity, development opportunities, development spending and management plans; and
- descriptions of assumptions underlying or relating to any of the foregoing.

There are several factors, many beyond our control, which could cause results to differ materially from our expectations. These risk factors are described in our Annual Report on Form 10-K for the year ended December 31, 2016 (the "Annual Report") and are incorporated herein by reference. Any factor could, by itself, or together with one or more other factors, adversely affect our business, results of operations or financial condition. There may be other factors currently unknown to us that we have not described in this Quarterly Report or in our Annual Report that could cause results to differ from our expectations. These forward-looking statements present our estimates and assumptions as of the date of this Quarterly Report. Except as may be required by law, we undertake no obligation to modify or revise any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report.

Earnings Before Taxes

We use a number of operating measures for assessing operating performance of properties within our segments, some of which may not be common among all three of our segments. We believe that investors may find some operating measures more useful than others when separately evaluating each segment. One common operating measure used to assess operating results for our business segments is EBT. We believe EBT provides useful information about the operating performance of each segment and its properties as further discussed below. EBT may be calculated differently by other companies in our industry, limiting its usefulness as a comparative measure.

EBT, as it relates to each business segment, represents the revenues less expenses of each segment, including interest

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income, interest expense, and equity in earnings of real estate and other affiliates. EBT excludes corporate expenses and other items that are not allocable to the segments. See discussion herein at Corporate and other items for further details. For our Operating Assets, we also provide a measure of Adjusted Operating Assets EBT, which additionally excludes depreciation and amortization, development-related demolition and marketing costs and provision for impairment relating to the Operating Assets segment. We present EBT for each segment and Adjusted Operating Assets EBT for the Operating Assets segment because we use these measures, among others, internally to assess the core operating performance of our assets. We also present these measures because we believe certain investors use them as a measure of our Company's historical operating performance and our ability to service existing debt and incur new debt. We believe that the inclusion of certain adjustments to net income to calculate EBT and the exclusion of other non-operating items from EBT to calculate Adjusted Operating Assets EBT is appropriate to provide additional information to investors. A reconciliation of EBT to consolidated net income as computed in accordance with GAAP has been presented in Note 16 – Segments. A reconciliation of Adjusted Operating Assets EBT to Operating Assets EBT is included in the Operating Assets discussion.

EBT and Adjusted Operating Assets EBT should not be considered as alternatives to GAAP net income attributable to common stockholders or GAAP net income, as they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analysis of our results as reported under GAAP. EBT and Adjusted Operating Assets EBT do not include the following in our calculations:

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

Results of Operations

Our revenues are primarily derived from the sale of superpads and individual lots at our master planned communities to homebuilders, rents from tenants at our commercial and residential operating properties, room and other revenue and conference services at our hospitality properties, recoveries of operating expenses, the sale of condominium units and the opportunistic sale of non-core assets.

The following table reflects our results of operations for the three and nine months ended September 30, 2017 and 2016, respectively:

(In thousands, except per share amounts)	Three Months Ended September 30, 2017	2016	Change	Nine Months Ended September 30, 2017	2016	Change
Revenues						
MPC segment revenues	$ 64,929	$ 52,762	$ 12,167	$ 211,711	$ 175,403	$ 36,308
Operating Assets segment revenues	79,533	73,947	5,586	243,498	217,852	25,646
Strategic Developments segment revenues	114,274	115,555	(1,281)	343,928	363,206	(19,278)
Total revenues	$ 258,736	$ 242,264	$ 16,472	$ 799,137	$ 756,461	$ 42,676
MPC segment EBT	$ 40,465	$ 39,537	$ 928	$ 137,747	$ 116,776	$ 20,971
Operating Assets segment EBT	(13,162)	(35,943)	22,781	(14,308)	(28,175)	13,867
Strategic Developments segment EBT	26,249	30,904	(4,655)	117,056	265,920	(148,864)
Corporate and other items	(37,190)	(16,340)	(20,850)	(189,354)	(93,702)	(95,652)
Income before taxes	16,362	18,158	(1,796)	51,141	260,819	(209,678)
Provision for income taxes	(5,846)	(10,162)	4,316	(31,846)	(102,088)	70,242
Net income	10,516	7,996	2,520	19,295	158,731	(139,436)
Net income attributable to noncontrolling interests	(12)	(23)	11	(12)	(23)	11
Net income attributable to common stockholders	$ 10,504	$ 7,973	$ 2,531	$ 19,283	$ 158,708	$ (139,425)
Diluted income per share	$ 0.24	$ 0.19	$ 0.05	$ 0.45	$ 3.72	$ (3.27)

Total revenues for the three and nine months ended September 30, 2017 increased as compared to the same period in 2016 due to higher revenues in our MPC and Operating segments. The MPC segment revenue increases for the three months

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ended September 30, 2017 are primarily due to increased residential land sales at Bridgeland and at Summerlin. For the nine months ended September 30, 2017, the increase is due to higher residential land sales at all MPCs as well as a $6.4 million easement sale at Bridgeland. Operating Assets segment revenue increased for the three and nine month periods ended September 30, 2017 as compared to the 2016 periods primarily due to the acquisition and consolidation of our partner's 50.0% interest in the Las Vegas 51s baseball team and our partner's 18.57% interest in Millennium Six Pines apartments and due to the continued stabilization of office, multi-family and hospitality properties, offset by revenue declines at certain properties in preparation for redevelopment. Strategic Developments segment revenue decreased for the three and nine months ended September 30, 2017 primarily due to decreased revenue recognized on a percentage of completion basis at Waiea, which is nearing completion, as compared to the 2016 prior periods, offset by increased revenue at the Ae`o and Ke Kilohana condominium projects.

Total consolidated segment EBT for the three months ended September 30, 2017 increased as compared to the same period in 2016 primarily due to higher revenues related to MPC land sales at Bridgeland and Summerlin, higher total Operating Assets segment revenues, and a non-recurring $35.7 million impairment for Park West in 2016, offset by an increase in depreciation in our Operating Assets segment as properties prepare for redevelopment and a slight decline in condominium revenues recorded on a percentage of completion basis. Total consolidated segment EBT for the nine months ended September 30, 2017 decreased as compared to the same period in 2016 primarily due to the $140.5 million non-recurring gain on sale of 80 South Street Assemblage in March 2016, a $20.4 million decline in condominium rights and unit sales recorded on a percentage of completion basis, and a $10.5 million decline in Equity in Earnings from Real Estate and Other Affiliates due to a sale of land by our Circle T Ranch joint venture in the second quarter of 2016, offset by higher revenues related to MPC land sales at all MPCs, the $32.2 million gain on sale of Elk Grove in the first quarter of 2017 and a non-recurring $35.7 million impairment for Park West in 2016.

Net expenses for Corporate and other items increased for the three months ended September 30, 2017 as compared to the same period in 2016 primarily due to the $27.1 million Gain on acquisition of our joint venture partner's interest in 2016 which did not recur offset by a $7.3 million decrease in Warrant liability loss due to the settlement of outstanding warrant liabilities. Net expenses related to Corporate and other items increased for the nine months ended September 30, 2017 as compared to the same period in 2016 primarily due to a $21.8 million increase in the Warrant liability loss, a Loss on redemption of senior notes due 2021 of $46.4 million, and decline of $21.6 million in Gains on acquisitions. Please refer to the Corporate and other items section elsewhere in this Quarterly Report for additional discussion regarding the accounts comprising this line item.

The decrease in the provision for income taxes for the three months ended September 30, 2017 as compared to the same period in 2016 is attributable to permanent differences discussed further below, primarily a warrant liability loss of $7.3 million in the three month period ended September 30, 2016. The decrease in the provision for income taxes for the nine months ended September 30, 2017 as compared to the same period in 2016 is due to a decrease in income before tax of $209.7 million, arising primarily from the $140.5 million gain on sale of 80 South Street in 2016 as compared to the $32.2 million gain on sale of Elk Grove in the first quarter of 2017, and a $46.4 million Loss on redemption of senior notes due 2021 in 2017.

We have significant permanent differences for tax purposes, primarily from warrant liability losses, and changes in valuation allowances that cause our effective tax rate to deviate greatly from statutory rates. The effective tax rates, based upon actual operating results, were 35.8% and 62.3% for the three and nine months ended September 30, 2017, respectively, compared to 56.0% and 39.1% for the three and nine months ended September 30, 2016, respectively. The change in the effective tax rate from 2017 to 2016 was primarily attributable to the changes in the warrant liability, valuation allowance related to our deferred tax asset, stock compensation expense deduction and other items which are permanent differences for tax purposes. If changes in the warrant liability, valuation allowance, stock compensation deduction and other material discrete adjustments to deferred tax liabilities were excluded from the effective tax rate computation, the effective tax rates would have been 27.6% and 36.8% for the three and nine months ended September 30, 2017, respectively, compared to 42.6% and 37.4% for three and nine months ended September 30, 2016, respectively.

The increase in Net income attributable to common stockholders for the three months ended September 30, 2017 as compared to the same period in 2016 is primarily due to improvement in EBT in our Operating Assets and Strategic Developments segments, offset by gains which did not recur.

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The decrease in Net income attributable to common stockholders for the nine months ended September 30, 2017 as compared to the same period in 2016 is primarily due to a decrease in EBT in our Strategic Developments segment and 2017 losses included in Corporate and other items as discussed above, offset by an increase in EBT in our MPC and Operating Assets segments.

Please refer to the individual segment operations sections that follow for explanations of the results of each of our segments for the three and nine months ended September 30, 2017 and 2016.

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Master Planned Communities

Master Planned Communities Revenues and Expenses (*)

For the three months ended September 30, 2017 and 2016

	Bridgeland		Maryland Communities		Summerlin		The Woodlands		The Wood Hills
($ in thousands)	2017	2016	2017	2016	2017	2016	2017	2016	2017
Land sales (a)	$ 8,692	$ 7,209	$ —	$ —	$ 38,721	$ 26,337	$ 7,493	$ 10,582	$ —
Builder price participation (b)	49	160	—	—	5,298	4,221	125	102	—
Minimum rents	—	—	—	—	—	95	—	—	—
Other land revenues	162	97	413	413	2,231	1,973	1,738	1,554	7
Other rental and property revenue	—	—	—	—	—	17	—	—	—
Total revenues	8,903	7,466	413	413	46,250	32,643	9,356	12,238	7
Cost of sales - land	2,834	2,255	—	—	22,487	13,558	3,722	5,619	—
Land sales operations	1,785	1,784	703	643	570	2,742	4,859	5,395	263
Provision for doubtful accounts	—	—	—	—	—	—	—	—	—
Depreciation and amortization	19	23	1	3	26	16	30	30	—
Total expenses	4,638	4,062	704	646	23,083	16,316	8,611	11,044	263
Operating income	4,265	3,404	(291)	(233)	23,167	16,327	745	1,194	(256)
Interest (income) expense, net (c)	(2,698)	(2,367)	—	2	(4,616)	(3,981)	1,092	1,241	(133)

Equity in (earnings) loss in Real Estate and Other Affiliates (d)	—	—	—	—	(6,480)	(13,700)	—	—	—
MPC segment EBT*	$ 6,963	$ 5,771	$ (291) (e)	$ (235) (e)	$ 34,263	$ 34,008	$ (347)	$ (47)	$ (123)
(GAAP Basis) Residential Gross Margin %	66.1%	67.5%	NM	NM	41.9%	48.5%	50.3%	46.9%	NM
(GAAP Basis) Commercial Gross Margin %	71.0%	71.0%	NM	NM	43.2%	55.5%	NM	NM	NM

(*) For a reconciliation of MPC segment EBT to consolidated income before taxes, refer to Note 16 – Segments in our Condensed Consolidated Financial Statements.

(a) Land sales includes deferred revenue from land sales closed in a previous period which met criteria for recognition in the current period.

(b) Builder price participation revenue is based on an agreed-upon percentage of the sales price of homes closed relative to the base lot price which was paid by the homebuilders to us. This revenue fluctuates based upon the number of homes closed that qualify for builder price participation payments.

(c) Interest expense, net reflects the amount of interest that is capitalized at the project level. Negative interest expense amounts relate to interest capitalized relating to debt assigned to our Operating Assets segment and corporate debt.

(d) Equity in earnings in Real Estate and Other Affiliates is our share of earnings in The Summit joint venture which commenced lot sales in the second quarter of 2016.

(e) The negative MPC segment EBT in Maryland is due to our continuing to incur certain costs such as real estate taxes and administrative expenses even though we have not had any land sales in the three months ended September 2017 or 2016.

NM – Not Meaningful

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Master Planned Communities Revenues and Expenses (*)

For the nine months ended September 30, 2017 and 2016

	Bridgeland		Maryland Communities		Summerlin		The Woodlands		The Wo Hills
($ in thousands, except %)	2017	2016	2017	2016	2017	2016	2017	2016	2017
Land sales (a)	$ 30,444	$ 15,991	$ 500	$ —	$ 119,334	$ 106,341	$ 27,253	$ 24,836	$ —
Builder price participation (b)	296	595	—	—	13,660	13,535	657	1,501	—
Minimum rents	—	—	—	—	(8)	376	—	—	—
Other land revenues	6,840	206	445	416	6,969	7,396	5,299	4,166	22
Other rental and property revenue (c)	—	—	—	—	—	33	—	—	—
Total revenues	37,580	16,792	945	416	139,955	127,681	33,209	30,503	22
Cost of sales - land	9,797	5,234	219	—	65,517	49,603	12,755	11,291	—
Land sales operations	5,152	4,533	1,287	1,086	6,580	8,216	11,286	16,364	576
Provision for doubtful accounts	—	—	—	—	2	—	—	—	—
Depreciation and amortization	79	70	6	13	72	63	90	90	—
Total expenses	15,028	9,837	1,512	1,099	72,171	57,882	24,131	27,745	576
Operating income	22,552	6,955	(567)	(683)	67,784	69,799	9,078	2,758	(554)
Interest (income) expense, net (d)	(7,670)	(7,053)	3	(5)	(12,863)	(12,437)	3,044	4,307	(416)
Equity in (earnings) loss in Real	—	—	—	—	(21,552)	(22,574)	—	—	—

Estate and Other Affiliates (e)									
MPC segment EBT*	$ 30,222	$ 14,008	$ (570) (f)	$ (678) (f)	$ 102,199	$ 104,810	$ 6,034	$ (1,549)	$ (138)
(GAAP Basis) Residential Gross Margin %	66.8%	66.6%	NM	NM	45.1%	53.3%	49.5%	50.5%	NM
(GAAP Basis) Commercial Gross Margin %	71.1%	71.0%	56.2%	NM	44.9%	58.1%	76.3%	60.2%	NM

(*) For a reconciliation of MPC segment EBT to consolidated income before taxes, refer to Note 16 – Segments in our Condensed Consolidated Financial Statements.

(a) Land sales includes deferred revenue from land sales closed in a previous period which met criteria for recognition in the current period.

(b) Builder price participation revenue is based on an agreed-upon percentage of the sales price of homes closed relative to the base lot price which was paid by the homebuilders to us. This revenue fluctuates based upon the number of homes closed that qualify for builder price participation payments

(c) For the nine months ended September 30, 2017, Other land sales revenues includes the sale of a utility easement at our Bridgeland community recorded in the first quarter of 2017 for $10.1 million less related costs of $3.7 million.

(d) Interest expense, net reflects the amount of interest that is capitalized at the project level. Negative interest expense amounts relate to interest capitalized relating to debt assigned to our Operating Assets segment and corporate debt.

(e) Equity in earnings in Real Estate and Other Affiliates is our share of earnings in The Summit joint venture which commenced lot sales in the second quarter of 2016.

(f) The negative MPC segment EBT in Maryland is due to our continuing to incur certain costs such as real estate taxes and administrative expenses even though we have had only minimal land sales in the nine months ended September 2017 and zero in 2016.

NM – Not Meaningful

MPC revenues vary between periods based on economic conditions and several factors primarily, but not limited to, location, availability of land for sale, development density and residential or commercial use. Gross margin for each MPC may vary from period to period based on the locations of the land sold and the related costs associated with developing the land sold. Reported results may differ significantly from actual cash flows generated principally because cost of sales for GAAP purposes is derived from margins calculated using carrying values, projected future improvements and other capitalized project costs in relation to projected future land sale revenues. Carrying values,

generally, represent acquisition and development costs reduced by any previous impairment charges. Development expenditures are capitalized and generally not reflected in the Condensed Statements of Operations in the current period. Accordingly, Cost of sales – land includes both actual and estimated future costs allocated based upon relative sales value to the lots or land parcels in each of the villages and neighborhoods in our MPCs.

Although our business does not involve the sale or resale of homes, we believe that net new home sales are an important indicator of future demand for our superpad

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sites and finished lots. Therefore, we use this statistic where relevant in our presentation of our MPC operating results throughout this Quarterly Report on the following pages. Net new home sales reflect home sales made by homebuilders, less cancellations. Cancellations generally occur when a home buyer signs a contract to purchase a home, but later fails to qualify for a home mortgage or is unable to provide an adequate down payment to complete the home sale.

Summary of Residential MPC Land Sales Closed for the Three Months Ended September 30,

	Land Sales		Acres Sold		Number of Lots/Units		Price per acre		Price per lot	
($ in thousands)	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Bridgeland										
Single family - detached	$ 6,458	$ 4,687	17.5	12.2	80	69	$ 369	$ 384	$ 81	$ 68
$ Change	1,771		5.3		11		(15)		13	
% Change	37.8%		43.4%		15.9%		(3.9%)		19.1%	
Maryland Communities										
No residential land sales	—	—	—	—	—	—	—	—	—	—
Summerlin Residential										
Superpad sites	29,945	15,000	56.8	30.9	321	75	527	485	93	200
Custom lots	1,570	1,525	0.9	0.8	2	2	1,744	1,906	785	763
Total	31,515	16,525	57.7	31.7	323	77	546	521	98	215
$ Change	14,990		26.0		246		25		(117)	
% Change	90.7%		82.0%		319.5%		4.8%		(54.4%)	
The Woodlands Residential										
Single family - detached	5,124	10,581	10.7	19.9	40	79	479	532	128	134
Single family - attached	2,370	—	0.4	—	8	—	5,925	—	296	—
Total	7,494	10,581	11.1	19.9	48	79	675	532	156	134
$ Change	(3,087)		(8.8)		(31)		143		22	
% Change	(29.2%)		(44.2%)		(39.2%)		26.9%		16.4%	
Total residential land sales closed in period (a)	$ 45,467	$ 31,793	86.3	63.8	451	225				

(a) Excludes revenues closed and deferred for recognition in a previous period that met criteria for recognition in the current period. Please see the Reconciliation of MPC Land Sales Closed to GAAP

Land Sales Revenue table below which reconciles Total residential and commercial land sales closed to Total land sales revenue for the three months ended September 30, 2017 and 2016.

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Summary of Commercial MPC Land Sales Closed for the Three Months Ended September 30,

	Land Sales		Acres Sold		Price per acre	
($ in thousands)	2017	2016	2017	2016	2017	2016
Bridgeland						
No commercial land sales	$ —	$ —	—	—	$ —	$ —
Maryland Communities						
Commercial						
Medical	—	—	—	—	—	—
$ Change	—		—		—	
% Change	NM		NM		NM	
Summerlin						
Commercial						
Not-for-profit	—	—	—	—	—	—
$ Change	—		—		—	
% Change	NM		NM		NM	
The Woodlands						
No commercial land sales	—	—	—	—	—	—
Total commercial land sales closed in period (a)	$ —	$ —	—	—		

(a) Excludes revenues closed and deferred for recognition in a previous period that met criteria for recognition in the current period. Please see the Reconciliation of MPC Land Sales Closed to GAAP Land Sales Revenue table below which reconciles Total residential and commercial land sales closed to Total land sales revenue for the three months ended September 30, 2017 and 2016.

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Summary of Residential MPC Land Sales Closed for the Nine Months Ended September 30,

	Land Sales		Acres Sold		Number of Lots/Units		Price per acre		Price per lot	
($ in thousands)	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Bridgeland										
Single family - detached	$ 23,089	$ 13,557	60.4	36.2	299	201	$ 382	$ 375	$ 77	$ 67
$ Change	9,532		24.2		98		7		10	
% Change	70.3%		66.9%		48.8%		1.9%		14.9%	
Maryland Communities										
No residential land sales	—	—	—	—	—	—	—	—	—	—
Summerlin Residential										
Superpad sites	80,770	81,987	144.6	201.1	815	943	559	408	99	87
Custom lots	5,945	4,170	2.5	2.4	7	7	2,378	1,738	849	596
Total	86,715	86,157	147.1	203.5	822	950	589	423	105	91
$ Change	558		(56.4)		(128)		166		14	
% Change	0.6%		(27.7%)		(13.5%)		39.2%		15.4%	
The Woodlands Residential										
Single family - detached	18,267	14,431	38.7	26.3	160	105	472	549	114	137
Single family - detached	5,187	—	0.8	—	18	—	6,484	—	288	—
Total	23,454	14,431	39.5	26.3	178	105	594	549	132	137
$ Change	9,023		13.2		73		45		(5)	
% Change	62.5%		50.2%		69.5%		8.2%		(3.6%)	
Total residential land sales closed in period (a)	$ 133,258	$ 114,145	247.0	266.0	1,299	1,256				

(a) Excludes revenues closed and deferred for recognition in a previous period that met criteria for recognition in the current period. Please see the Reconciliation of MPC Land Sales Closed to GAAP Land Sales Revenue table below which reconciles Total residential and commercial land sales closed to Total land sales revenue for the nine months ended September 30, 2017 and 2016.

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Summary of Commercial MPC Land Sales Closed for the Nine Months Ended September 30,

	Land Sales		Acres Sold		Price per acre	
($ in thousands)	2017	2016	2017	2016	2017	2016
Bridgeland						
No commercial land sales	$ —	$ —	—	—	$ —	$ —
Maryland Communities						
Commercial						
Medical	500	—	1.0	—	500	—
$ Change	500		1.0		500	
% Change	NM		NM		NM	
Summerlin						
Commercial						
Not-for-profit	—	348	—	10.0	—	35
$ Change	(348)		(10.0)		(35)	
% Change	NM		NM		NM	
The Woodlands						
Commercial						
Medical	—	10,405	—	4.3	—	2,420
Office and other	1,441	—	1.3	—	1,108	—
Retail	2,358	—	9.1	—	259	—
Total	3,799	10,405	10.4	4.3	365	2,420
$ Change	(6,606)		6.1		(2,055)	
% Change	(63.5%)					