Howard Hughes Corp
Form 10-Q
November 09, 2015
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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, 2015

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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Yes No

The number of shares of common stock, $0.01 par value, outstanding as of November 4, 2015 was 39,714,838.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

	September 30, 2015	December 31, 2014
	(In thousands, except share amounts)	
Assets:		
Investment in real estate:		
Master Planned Community assets	$ 1,672,763	$ 1,641,063
Land	305,634	317,211
Buildings and equipment	1,478,489	1,243,979
Less: accumulated depreciation	(213,040)	(157,182)
Developments	1,205,124	914,303
Net property and equipment	4,448,970	3,959,374
Investment in Real Estate and Other Affiliates	56,191	53,686
Net investment in real estate	4,505,161	4,013,060
Cash and cash equivalents	450,647	560,451
Accounts receivable, net	32,051	28,190
Municipal Utility District receivables, net	136,196	104,394
Notes receivable, net	23,610	28,630
Deferred expenses, net	73,263	75,070
Prepaid expenses and other assets, net	323,596	310,136
Total assets	$ 5,544,524	$ 5,119,931
Liabilities:		
Mortgages, notes and loans payable	$ 2,322,296	$ 1,993,470
Deferred tax liabilities	84,214	62,205
Warrant liabilities	308,630	366,080
Uncertain tax position liability	4,823	4,653
Accounts payable and accrued expenses	489,035	466,017
Total liabilities	3,208,998	2,892,425
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, 39,714,838 shares issued and outstanding as of September 30, 2015 and 39,638,094 shares issued and outstanding as of December 31, 2014	398	396

Additional paid-in capital	2,845,021	2,838,013
Accumulated deficit	(506,096)	(606,934)
Accumulated other comprehensive loss	(7,569)	(7,712)
Total stockholders' equity	2,331,754	2,223,763
Noncontrolling interests	3,772	3,743
Total equity	2,335,526	2,227,506
Total liabilities and equity	$ 5,544,524	$ 5,119,931

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands, except per share amounts)			
Revenues:				
Master Planned Community land sales	$ 45,423	$ 59,351	$ 138,937	$ 260,186
Builder price participation	6,680	5,311	20,285	13,251
Minimum rents	37,814	24,380	109,997	66,929
Tenant recoveries	10,706	7,601	31,074	20,509
Condominium rights and unit sales	78,992	4,032	200,362	11,516
Resort and conference center revenues	11,772	8,150	35,256	27,198
Other land revenues	4,617	4,112	11,055	9,322
Other rental and property revenues	7,438	6,291	20,729	18,601
Total revenues	203,442	119,228	567,695	427,512
Expenses:				
Master Planned Community cost of sales	19,674	27,743	67,806	93,540
Master Planned Community operations	10,349	10,995	32,295	31,645
Other property operating costs	16,680	15,198	54,459	45,603
Rental property real estate taxes	6,908	4,559	19,676	12,540
Rental property maintenance costs	3,094	2,313	8,738	6,402
Condominium rights and unit cost of sales	47,573	2,026	126,747	5,788
Resort and conference center operations	8,767	8,910	26,738	22,833
Provision for doubtful accounts	1,007	119	3,082	293
Demolition costs	1,024	760	2,637	6,711
Development-related marketing costs	7,639	6,387	19,476	15,909
General and administrative	18,526	14,759	57,095	49,138
Other income, net	659	(11,409)	(1,204)	(27,468)
Depreciation and amortization	24,998	13,018	71,577	35,000
Total expenses	166,898	95,378	489,122	297,934
Operating income	36,544	23,850	78,573	129,578
Interest income	109	(1,162)	516	19,651
Interest expense	(15,212)	(12,136)	(43,143)	(28,354)
Warrant liability gain (loss)	123,640	24,690	57,450	(139,120)
Gain on sale of The Club at Carlton Woods	29,073	—	29,073	—
Increase (reduction) in tax indemnity receivable	—	5,454	—	(5,473)
	295	5,509	3,164	18,164

Equity in earnings from Real Estate and Other Affiliates				
Income (loss) before taxes	174,449	46,205	125,633	(5,554)
Provision for income taxes	18,237	590	24,795	49,895
Net income (loss)	156,212	45,615	100,838	(55,449)
Net loss (income) attributable to noncontrolling interests	12	—	—	(12)
Net income (loss) attributable to common stockholders	$ 156,224	$ 45,615	$ 100,838	$ (55,461)
Basic income (loss) per share:	$ 3.96	$ 1.16	$ 2.55	$ (1.41)
Diluted income (loss) per share:	$ 0.76	$ 0.48	$ 1.01	$ (1.41)

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Comprehensive income (loss), net of tax:				
Net income (loss)	$ 156,212	$ 45,615	$ 100,838	$ (55,449)
Other comprehensive income (loss):				
Interest rate swaps (a)	(411)	784	297	902
Capitalized swap interest (b)	(42)	(180)	(154)	(357)
Other comprehensive income	(453)	604	143	545
Comprehensive income (loss)	155,759	46,219	100,981	(54,904)
Comprehensive (income) loss attributable to noncontrolling interests	12	—	—	(12)
Comprehensive income (loss) attributable to common stockholders	$ 155,771	$ 46,219	$ 100,981	$ (54,916)

(a) Amount is shown net of deferred tax expense of $0.2 million and $0.8 million for the three and nine months ended September 30, 2015, respectively. For the three and nine months ended September 30, 2014, amounts are shown net of deferred tax benefit of $0.1 million and $0.2 million, respectively.

(b) Net of deferred tax benefit of $0.1 million for the three and nine months ended September 30, 2015, respectively. For the three and nine months ended September 30, 2014, amounts shown net of deferred tax benefit of $0.1 million and $0.2 million, respectively.

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

UNAUDITED

(In thousands, except share amounts)	Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Equity
Balance, January 1, 2014	39,576,344	$ 396	$ 2,829,813	$ (583,403)	$ (8,222)	$ 6,562	$ 2,245,146
Net income (loss)		—	—	(55,461)	—	12	(55,449)
Preferred dividend payment on behalf of REIT subsidiary		—	—	—	—	(12)	(12)
Interest rate swaps, net of tax of $135		—	—	—	902	—	902
Capitalized swap interest, net of tax of $126		—	—	—	(357)	—	(357)
Stock plan activity	61,750	—	5,940	—	—	—	5,940
Balance, September 30, 2014	39,638,094	$ 396	$ 2,835,753	$ (638,864)	$ (7,677)	$ 6,562	$ 2,196,170
Balance, January 1, 2015	39,638,094	$ 396	$ 2,838,013	$ (606,934)	$ (7,712)	$ 3,743	$ 2,227,506
Net income (loss)		—	—	100,838	—	—	100,838
Distribution to noncontrolling interest		—	—	—	—	29	29
Interest rate swaps, net of tax of $800		—	—	—	297	—	297
Capitalized swap interest, net of tax benefit of $83		—	—	—	(154)	—	(154)
Stock plan activity	76,744	2	7,008	—	—	—	7,010
Balance, September 30, 2015	39,714,838	$ 398	$ 2,845,021	$ (506,096)	$ (7,569)	$ 3,772	$ 2,335,526

See Notes to Condensed Consolidated Financial Statements.

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THE HOWARD HUGHES CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30,	
	2015	2014
	(In thousands)	
Cash Flows from Operating Activities:		
Net income (loss)	$ 100,838	$ (55,449)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation	58,257	31,330
Amortization	13,320	3,670
Amortization of deferred financing costs	4,104	2,927
Amortization of intangibles other than in-place leases	679	462
Straight-line rent amortization	(3,255)	1,113
Deferred income taxes	23,065	47,925
Restricted stock and stock option amortization	5,269	5,940
Gain on disposition of asset	(29,073)	(2,373)
Warrant liability (gain) loss	(57,450)	139,120
Reduction in tax indemnity receivable	—	5,473
Interest income related to tax indemnity	—	(18,856)
Equity in earnings from Real Estate and Other Affiliates, net of distributions	1,426	(14,666)
Provision for doubtful accounts	3,082	293
Master Planned Community land acquisitions	(6,028)	(69,930)
Master Planned Community development expenditures	(129,298)	(93,080)
Master Planned Community cost of sales	65,692	86,044
Condominium development expenditures	(137,369)	(34,358)
Condominium and other cost of sales	126,747	5,788
Percentage of completion revenue recognition from sale of condominium rights and units	(200,362)	(11,516)
Non-monetary consideration relating to land sale	—	(13,789)
Deferred rental income	37,472	—
Net changes:		
Accounts and notes receivable	(1,192)	26,188
Prepaid expenses and other assets	(9,838)	(3,436)
Condominium deposits received	52,001	125,002
Deferred expenses	(5,562)	(32,028)
Accounts payable and accrued expenses	39,065	18,055
Condominium deposits held in escrow	(52,001)	(125,002)
Condominium deposits released from escrow	132,086	—
Other, net	969	(8,888)

Cash provided by operating activities	32,644	15,959
Cash Flows from Investing Activities:		
Property and equipment expenditures	(9,505)	(6,213)
Operating property improvements	(5,856)	(3,581)
Property developments and redevelopments	(488,713)	(467,497)
Proceeds from insurance claims	—	12,901
Proceeds from dispositions	25,139	11,953
Distribution from KR Holdings, LLC	9,121	—
Investments in Real Estate and Other Affiliates, net	(635)	(3,929)
Change in restricted cash	(1,568)	(8,136)
Other	1,263	(1,484)
Cash used in investing activities	(470,754)	(465,986)
Cash Flows from Financing Activities:		
Proceeds from mortgages, notes and loans payable	370,342	414,046
Principal payments on mortgages, notes and loans payable	(40,066)	(45,443)
Deferred financing costs	(1,970)	(7,906)
Preferred dividend payment on behalf of REIT subsidiary	—	(12)
Cash provided by financing activities	328,306	360,685
Net change in cash and cash equivalents	(109,804)	(89,342)
Cash and cash equivalents at beginning of period	560,451	894,948
Cash and cash equivalents at end of period	$ 450,647	$ 805,606

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30,	
	2015	2014
	(In thousands)	
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$ 60,805	$ 49,617
Interest capitalized	35,237	34,760
Income taxes paid	2,593	1,487
Non-Cash Transactions:		
Special Improvement District bond transfers associated with land sales	2,114	7,496
Property developments and redevelopments	(15,747)	59,819
Accrued interest on construction loan borrowing	1,616	—
MPC Land contributed to Real Estate Affiliates	15,234	—
Special Improvement District bond transfers to Real Estate Affiliates	(1,518)	—
Capitalized stock compensation	2,072	—
Acquisition of 1701 Lake Robbins:		
Land	—	(1,663)
Building	—	(3,752)
Other assets and deferred expenses	—	(848)
Mortgages, notes and loans payable	—	4,600
Other liabilities	—	152

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 eliminated between consolidated subsidiaries for interim financial statements and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as issued by the Securities and Exchange Commission (the “SEC”). Such Condensed Consolidated Financial Statements do not include all of the information and disclosures required by GAAP for complete financial statements. In addition, readers of this Quarterly Report on Form 10-Q (“Quarterly Report”) should refer to The Howard Hughes Corporation’s (“HHC” or the “Company”) audited Consolidated Financial Statements which are included in the Company’s Annual Report on Form 10-K (the “Annual Report”) for the fiscal year ended December 31, 2014. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods have been included. The results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015.

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

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-03, “Interest – Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs.” This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The standard requires a retrospective application to reflect the period-specific effects of applying the new guidance. The Company will begin presenting the carrying value of its debt net of the debt issuance costs in the fourth quarter 2015. The adoption of this ASU will only impact the presentation of debt issuance costs on the Consolidated Balance Sheet.

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810) - Amendments to the Consolidation Analysis." The standard eliminates the deferral of FAS 167, per ASC 810-10-65-2(a). The standard changes whether: (1) fees paid to a decision maker or service provider represent a variable interest; (2) a limited partnership or similar entity has the characteristics of a VIE; and (3) a reporting entity is the primary beneficiary of a VIE. The effective date of the standard will be for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 for public companies, and early adoption is permitted. The Company is currently evaluating the new guidance and does not expect it to have a material impact on its Consolidated Financial Statements.

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements – Going Concern: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." This ASU requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. This ASU becomes effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of this ASU to have a material impact on the Company's Consolidated Financial Statements.

In May 2014, the FASB and the International Accounting Standards Board ("IASB") issued ASU 2014-09 "Revenues from Contracts with Customers (Topic 606)." 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. In doing so, companies will need to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The

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effective date of this standard will be for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted after December 15, 2016. Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU. The Company is currently evaluating the new guidance to determine the impact it may have on its Consolidated Financial Statements.

NOTE 3 SPONSORS AND MANAGEMENT WARRANTS

On November 9, 2010, we issued warrants to purchase 8.0 million shares of our common stock to certain of our sponsors (the "Sponsors Warrants") with an estimated initial value of approximately $69.5 million. The initial exercise price for the warrants of $50.00 per share and the number of shares of common stock underlying each warrant are subject to adjustment for future stock dividends, splits or reverse splits of our common stock or certain other events. In 2012, a sponsor exercised 1,525,272 shares, and we purchased 4,558,061 Sponsor Warrants from certain sponsors for a net cash amount of $80.5 million. As a result of these transactions, $108.6 million of additional paid in-capital was recorded in our financial statements in the year ended December 31, 2012. The Sponsors Warrants expire on November 9, 2017.

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

As of September 30, 2015, the estimated $126.3 million fair value for the Sponsors Warrants representing warrants to purchase 1,916,667 shares and the estimated $182.3 million fair value for the Management Warrants representing warrants to purchase 2,862,687 shares have been recorded as liabilities because the holders of these warrants could require us to settle such warrants in cash upon a change of control. The estimated fair values for the outstanding Sponsors Warrants and Management Warrants were $157.1 million and $209.0 million, respectively, as of December 31, 2014. 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.

Decreases and increases in the fair value of the Sponsors Warrants and the Management Warrants are recognized as either warrant liability gains or losses, respectively, in the Condensed Consolidated Statements of Operations.

NOTE 4 EARNINGS PER SHARE

Basic earnings (loss) per share ("EPS") is computed by dividing net income (loss) 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 Sponsors Warrants and Management Warrants is computed using the if converted method. Gains associated with the changes in the fair value of the Sponsors Warrants and Management Warrants are excluded from the numerator in computing diluted earnings per share because inclusion of such gains in the computation would be anti dilutive.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Information related to our EPS calculations is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands, except per share amounts)		(In thousands, except per share amounts)	
Basic EPS:				
Numerator:				
Net income (loss)	$ 156,212	$ 45,615	$ 100,838	$ (55,449)
Net loss (income) attributable to noncontrolling interests	12	—	—	(12)
Net income (loss) attributable to common stockholders	$ 156,224	$ 45,615	$ 100,838	$ (55,461)
Denominator:				
Weighted average basic common shares outstanding	39,473	39,465	39,469	39,459
Diluted EPS:				
Numerator:				
Net income (loss) attributable to common stockholders	$ 156,224	$ 45,615	$ 100,838	$ (55,461)
Less: Warrant liability gain	(123,640)	(24,690)	(57,450)	—
Adjusted net income (loss) attributable to common stockholders	$ 32,584	$ 20,925	$ 43,388	$ (55,461)
Denominator:				
Weighted average basic common shares outstanding	39,473	39,465	39,469	39,459
Restricted stock and stock options	405	405	415	—
Warrants	3,035	3,301	3,035	—
Weighted average diluted common shares outstanding	42,913	43,171	42,919	39,459
Basic income (loss) per share:	$ 3.96	$ 1.16	$ 2.55	$ (1.41)

Diluted income (loss) per share:	$ 0.76	$ 0.48	$ 1.01	$ (1.41)

The diluted EPS computation for the three and nine months ended September 30, 2015 excludes 147,538 and 124,122 stock options, respectively. The diluted EPS computations for the nine months ended September 30, 2014 excludes 1,037,740 stock options, 172,690 shares of restricted stock, 1,916,667 shares of common stock underlying the Sponsor Warrants and 2,862,687 shares of common stock underlying the Management Warrants. All such amounts are excluded from the respective diluted EPS computations because their inclusion would have been anti-dilutive.

NOTE 5 RECENT TRANSACTIONS

On September 4, 2015, the Company sold The Club at Carlton Woods, its 36-hole golf and country club in The Woodlands, for net cash proceeds of $25.1 million, and purchaser's assumption of net liabilities of $4.0 million, resulting in a pre-tax gain of $29.1 million. The property was comprised of total assets of $20.9 million and total liabilities of $24.9 million. The property was developed and operated by us as an amenity for selling residential lots in a gated community in The Woodlands. Most of the lots have been sold, and the sale of this asset will allow us to redeploy capital to our development activities.

NOTE 6 IMPAIRMENT

We review our real estate assets, including operating assets, land held for development and sale and developments in progress, for potential impairment indicators whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. GAAP requires that if impairment indicators exist and the undiscounted cash flows expected to be generated by an asset are less than its carrying amount, an impairment charge should be recorded to write down the carrying amount of such asset to fair value (or for land and properties held for sale, fair value less cost to sell). The impairment analysis does not consider the

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

timing of future cash flows and whether the asset is expected to earn an above or below market rate of return.

Our investment in each of the Real Estate 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 or nine months ended September 30, 2015 or 2014. We continually evaluate our strategic alternatives with respect to each of our properties and may revise our strategy from time to time, including our intent to hold the asset on a long-term basis or the timing of potential asset dispositions. For example, we may decide to sell property that is held for use and the sale price may be less than the carrying amount. As a result, these changes in strategy could result in impairment charges in future periods.

NOTE 7 FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	September 30, 2015				December 31, 2014			
	Fair Value Measurements Using				Fair Value Measurements Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)				(In thousands)			
Assets:								
	$ 18	$ 18	$ —	$ —	$ 75,027	$ 75,027	$ —	$ —

Cash equivalents								
Liabilities:								
Warrants	308,630	—	—	308,630	366,080	—	—	366,080
Interest rate swaps	3,651	—	3,651	—	3,144	—	3,144	—

Cash equivalents consist of registered money market mutual funds which invest in United States treasury securities 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 value approximates carrying value.

The valuation of warrants is based on an option pricing valuation model. The inputs to the model include the fair value of stock related to the warrants, exercise price of the warrants, term, expected volatility, risk-free interest rate and dividend yield and, with respect to the Management Warrants, a discount for lack of marketability.

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.

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

	2015	2014
	(In thousands)	
Balance as of January 1	$ 366,080	$ 305,560
Warrant liability (gain)/loss (a)	(57,450)	139,120
Balance as of September 30	$ 308,630	$ 444,680

(a) All gains and losses during 2015 and 2014 were unrealized.

The fair values were estimated using an option pricing model and Level 3 inputs due to the unavailability of comparable market data. Changes in the fair values of the Sponsors Warrants and the Management Warrants are recognized in earnings as a warrant liability gain or loss.

The significant unobservable inputs used in the fair value measurement of our warrants designated as Level 3 as of September 30, 2015 are as follows:

			Unobservable Inputs	
	Fair Value	Valuation Technique	Expected Volatility (a)	Marketability Discount (b)
	(In thousands)			
Warrants	$ 308,630	Option Pricing Valuation Model	31.7%	13.0% - 15.0%

(a) Based on our implied equity volatility.

(b) Represents the discount rate for lack of marketability of the Management Warrants. The discount rates ranged from 18.0%-20.0% at December 31, 2014.

Generally, an increase in expected volatility would increase the fair value of the liability, while a decrease in expected volatility would decrease the fair value of the liability, and 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.

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

		September 30, 2015		December 31, 2014	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:		(In thousands)			
Cash and cash equivalents	Level 1	$ 450,629	$ 450,629	$ 485,424	$ 485,424
Notes receivable, net (a)	Level 3	23,610	23,610	28,630	28,630
Liabilities:					
Fixed-rate debt	Level 2	$ 1,039,571	$ 1,062,435	$ 1,030,554	$ 1,050,333
Variable-rate debt	Level 2	1,282,725	1,282,725	962,916	962,916
Total mortgages, notes and loans payable		$ 2,322,296	$ 2,345,160	$ 1,993,470	$ 2,013,249

(a) Notes receivable is shown net of an allowance of $0.2 million as of September 30, 2015 and $0.5 million as of December 31, 2014.

Notes receivable are carried at net realizable value which approximates fair value. The estimated fair values are based on certain factors, such as current interest rates, terms of the note and credit worthiness of the borrower.

The fair value of fixed-rate debt in the table above, not including our Senior Notes (please refer to Note 9 – Mortgages, Notes and Loans Payable), 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 fair values of our Senior Notes, included in fixed rate debt in the table above, are based upon the last trade price closest to the end of the period presented.

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.

NOTE 8 REAL ESTATE AND OTHER AFFILIATES

In the ordinary course of business, we enter into partnerships or joint ventures primarily for the development and operations of real estate assets that are referred to as "Real Estate Affiliates". These partnerships or joint ventures are accounted for in accordance with FASB ASC 810 Consolidation.

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

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an investor that has disproportionately few voting rights. Upon the occurrence of certain events outlined in ASC 810, we reassess our initial determination of whether the partnership or joint venture is a VIE.

We perform a qualitative assessment of each VIE to determine if we are the primary beneficiary, as required by ASC 810. Under ASC 810, a company concludes that it is the primary beneficiary and consolidates the VIE if the company has both (a) the power to direct the economically significant activities of the entity and (b) the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the VIE. The company considers the contractual agreements that define the ownership structure, distribution of profits and losses, risks, responsibilities, indebtedness, voting rights and board representation of the respective parties in determining if the company is the primary beneficiary. As required by ASC 810, management's assessment of whether the company is the primary beneficiary of a VIE is continuously performed.

We account for investments in joint ventures which are not VIEs where we own a non-controlling interest and investments in joint ventures deemed to be VIEs for which we are not considered to be the primary beneficiary but have significant influence using the equity method. We use the cost method to account for investments where we do not have significant influence over the joint venture's operations and financial policies. Generally, the operating agreements with respect to our Real Estate Affiliates provide that assets, liabilities and funding obligations are shared in accordance with our ownership percentages.

Our investment in real estate and other affiliates that are reported on the equity and cost methods are as follows:

	Economic/Legal Ownership		Carrying Value		Share of Earnings/Dividends			
	September 30,	December 31,	September 30,	December 31,	Three Months Ended September 30,		Nine Months Ended Sept	
	2015	2014	2015	2014	2015	2014	2015	2014
	(In percentages)		(In thousands)		(In thousands)			
Equity Method Investments								
Master Planned Communities:								
	N/A	N/A	$ 12,052	$ —	$ —	$ —	$ —	$ —

Discovery Land Operating Assets:										
Millennium Woodlands Phase II, LLC (a) (b)	81.43	%	81.43	%	—	1,023	(177)	(98)	(1,327)	(98)
Stewart Title	50.00	%	50.00	%	3,627	3,869	163	383	659	901
Summerlin Las Vegas Baseball Club, LLC (b)	50.00	%	50.00	%	10,939	10,548	105	22	389	199
The Metropolitan Downtown Columbia (c)	50.00	%	50.00	%	4,617	4,800	140	—	(268)	—
Woodlands Sarofim	20.00	%	20.00	%	2,617	2,595	58	27	133	123
Strategic Developments:										
Circle T Ranch and Power Center	50.00	%	50.00	%	9,004	9,004	—	—	—	—
HHMK Development (b)	50.00	%	50.00	%	10	10	—	386	549	869
Millennium Woodlands Phase II, LLC (a) (b)	81.43	%	81.43	%	—	—	—	(145)	—	(280)
KR Holdings (b)	50.00	%	50.00	%	694	9,183	6	5,066	1,282	14,801
Parcel C (b)	50.00	%	50.00	%	7,030	8,737	—	—	—	—
Summerlin Apartments, LLC (b)	50.00	%	50.00	%	1,661	—	—	—	—	—
					52,251	49,769	295	5,641	1,417	16,515
Cost basis investments					3,940	3,917	—	(132)	1,747	1,649
Investment in Real Estate and Other Affiliates					$ 56,191	$ 53,686	$ 295	$ 5,509	$ 3,164	$ 18,164

N/A – Not Applicable

(a) Millennium Woodlands Phase II, LLC was placed into service in the beginning of the third quarter 2014. The investment balance is in a deficit position, which is reported in Other liabilities. We expect to recover the deficit when the property reaches stabilized occupancy.
(b) Equity method variable interest entities.
(c) The Metropolitan Downtown Columbia was placed into service in the first quarter 2015.

We are not the primary beneficiary of any of the equity method variable interest entities listed above because we do not have the power to direct activities that most significantly impact the economic performance of such joint ventures; therefore, we report our interests on the equity method. Our maximum exposure to loss as a result of these investments is limited to the aggregate carrying value of the investment as we have not provided any guarantees or otherwise made firm commitments to fund amounts on behalf of these VIEs. The aggregate carrying value of the unconsolidated VIEs was $20.3 million and $29.5 million as of

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September 30, 2015 and December 31, 2014, respectively, and was classified as Investments in Real Estate and Other Affiliates in the Condensed Consolidated Balance Sheets.

As of September 30, 2015, approximately $101.8 million of indebtedness was secured by the properties owned by our Real Estate and Other Affiliates of which our share was approximately $60.9 million based upon our economic ownership. All of this indebtedness is non-recourse to us.

The Company is the primary beneficiary of one VIE which is consolidated in the financial statements. The creditors of the consolidated VIE do not have recourse to the Company. As of September 30, 2015, the carrying values of the assets and liabilities associated with the operations of the consolidated VIE were $21.4 million and $1.0 million, respectively. As of December 31, 2014, the carrying values of the assets and liabilities associated with operations of the consolidated VIE were $21.1 million and $0.6 million, respectively. The assets of the VIE are restricted for use only by the particular VIE and are not available for our general operations.

Our recent and more significant investments in Real Estate Affiliates and the related accounting considerations are described below.

Discovery Land

During the first quarter 2015, our joint venture with Discovery Land Company (“Discovery Land”) was formed, 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, or $226,000 per acre. 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. At the time of our contribution, we determined that the entity did not meet the criterion of a VIE. Because our partner has substantive participation rights, we do not control the joint venture, and we account for it using the equity method. Discovery Land is required to fund up to a maximum of $30.0 million cash as their capital contribution and we have no further capital obligations.

After receipt of our capital contribution and a 5.0% preferred return, Discovery Land is entitled to all remaining cash distributed by the joint venture until two times its equity contribution has been repaid. Any further cash distributions are shared 50/50. Discovery Land is the manager on the project, and development began in the second quarter 2015 with the first lot closings expected to begin by the first quarter 2016.

ONE Ala Moana Condominium Project

KR Holdings is a 50/50 joint venture that was formed to develop a 206-unit luxury condominium tower at the One Ala Moana Center in Honolulu, Hawaii. The venture substantially completed construction in the fourth quarter 2014 and closed on the sale of 201 out of 206 total units. The venture used the percentage of completion method to recognize earnings. As of September 30, 2015, all of the units available for sale have been sold and closed.

Millennium Woodlands Phase II, LLC

On May 14, 2012, we entered into a joint venture, Millennium Woodlands Phase II, LLC (“Millennium Phase II”), with The Dinerstein Companies, for the construction of a new 314-unit Class A multi family complex in The Woodlands Town Center. Our partner is the managing member of Millennium Phase II. As the managing member, our partner controls, directs, manages and administers the affairs of Millennium Phase II. On July 5, 2012, Millennium Phase II was capitalized by our contribution of 4.8 acres of land valued at $15.5 million, our partner’s contribution of $3.0 million in cash and a construction loan in the amount of $37.7 million which is guaranteed by our partner. The development of Millennium Phase II further expands our multi family

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portfolio in The Woodlands Town Center. During 2014, the joint venture completed construction, and the property was placed in service and transferred into the Operating Assets segment.

Parcel C

On October 4, 2013, we entered into a joint venture agreement with a local developer, Kettler, Inc. (“Kettler”), to construct a 437-unit, Class A apartment building with 31,000 square feet of ground floor retail on Parcel C in downtown Columbia, Maryland. We contributed approximately five acres of land having an approximate book value of $4.0 million to the joint venture. Our land was valued at $23.4 million or $53,500 per constructed unit. When the venture closes on the construction loan and upon completion of certain other conditions, including obtaining completed site development and construction plans and an approved project budget, our partner will be required to contribute cash to the venture.

Summerlin Apartments, LLC

On January 24, 2014, we entered into a joint venture with a national multi-family real estate developer, The Calida Group (“Calida”), to construct, own and operate a 124-unit gated luxury apartment development in Summerlin, Nevada. 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 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, acts as the development manager, funded all pre-development activities, obtained construction financing in the first quarter 2015 and provided guarantees required by the lender. 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 (“NOI”). The venture commenced construction in February 2015 with the first units expected to become available for rent by first quarter 2016.

Summerlin Las Vegas Baseball Club, LLC

On August 6, 2012, we entered into a joint venture for the purpose of acquiring 100% of the operating assets of the Las Vegas 51s, a Triple A baseball team, which is a member of the Pacific Coast League. We own 50% of the venture and our partners jointly own the remaining 50%. Unanimous consent of the partners is required for all major decisions. As of the date the joint venture acquired the baseball team, we had funded our capital contribution of $10.5 million. Our strategy in owning an interest is to pursue a potential relocation of the team to a to be built stadium in our Summerlin master planned community. Efforts to relocate the team are ongoing and there can be no assurance that such a stadium will ultimately be built.

The Metropolitan Downtown Columbia Project

On October 27, 2011, we entered into a joint venture, Parcel D Development, LLC ("Parcel D"), with Kettler to construct a 380-unit Class A apartment building with ground floor retail space in downtown Columbia, Maryland. We, and our partner, each own 50% of the venture, and unanimous consent of the partners is required for all major decisions. On July 11, 2013, the joint venture closed a $64.1 million construction loan, which is non recourse to us, and $57.9 million is outstanding as of September 30, 2015. The loan bears interest at one-month LIBOR plus 2.40% and matures in July 2020. At loan closing, our land contribution was valued at $20.3 million, or $53,500 per unit, and Kettler contributed $13.3 million in cash, of which $7.0 million was distributed to us. Both we and Kettler made additional contributions of $3.1 million to the joint venture in accordance with the loan agreement, thus increasing our total capital account to $16.4 million. The venture substantially completed construction of The Metropolitan Downtown Columbia Project during the first quarter of 2015 and the property was reclassified into our Operating Assets segment.

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NOTE 9 MORTGAGES, NOTES AND LOANS PAYABLE

Mortgages, notes and loans payable are summarized as follows:

	September 30, 2015	December 31, 2014
	(In thousands)	
Fixed-rate debt:		
Collateralized mortgages, notes and loans payable	$ 1,022,251	$ 1,008,165
Special Improvement District bonds	17,320	22,389
Variable-rate debt:		
Collateralized mortgages, notes and loans payable (a)	1,282,725	962,916
Total mortgages, notes and loans payable	$ 2,322,296	$ 1,993,470

(a) As more fully described below, $210.4 million of variable rate debt has been swapped to a fixed rate for the term of the related debt.

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

$ In thousands	Maturity (a)	Interest Rate			Maximum Facility Amount	Carrying Value September 30, 2015	December 31, 2014
Master Planned Communities							
Bridgeland Land Loan	June 2022	5.50	%			$ 8,582	$ 15,874
Bridgeland Development Loan	July 2016	5.00	%		$ 30,000	19,600	10
Summerlin South SID Bonds - S108	December 2016	5.95	%			411	563
Summerlin South SID Bonds - S124	December 2019	5.95	%			177	236
Summerlin South SID Bonds - S128	December 2020	6.05	%			535	623
Summerlin South SID Bonds - S128C	December 2030	6.05	%			5,025	5,274
Summerlin South SID Bonds - S132	December 2020	6.00	%			1,826	2,936
Summerlin South SID Bonds - S151	June 2025	6.00	%			4,714	6,211
Summerlin West SID Bonds - S808/S810	April 2031	6.00	%			1,047	2,805
The Woodlands Master Credit Facility	August 2018	2.95	%	(b)(c)	200,000	192,663	176,663
Master Planned Communities Total						234,580	211,195
Operating Assets							
10-60 Columbia Corporate Center	May 2022	2.68	%	(c)(d)		80,000	—
70 Columbia Corporate Center	July 2019	2.45	%	(c)		20,000	20,000
Columbia Regional Building	March 2018	2.20	%	(c)	23,008	22,188	20,513
Downtown Summerlin	July 2019	2.45	%	(c)	311,800	277,944	229,153
Downtown Summerlin SID Bonds - S108	December 2016	5.95	%			235	310
Downtown Summerlin SID Bonds - S128	December 2030	6.05	%			3,350	3,431
One Hughes Landing	December 2029	4.30	%			52,000	52,000

Two Hughes Landing	September 2018	2.85	% (c)	41,230	33,205	19,992
Hughes Landing Retail	December 2018	2.15	% (c)	36,575	25,373	17,424
1701 Lake Robbins	April 2017	5.81	%		4,600	4,600
Millennium Waterway Apartments	June 2022	3.75	%		55,584	55,584
110 N. Wacker	October 2019	5.21	% (e)		27,426	29,000
9303 New Trails	December 2023	4.88	%		12,821	13,074
One Lake's Edge	November 2018	2.70	% (c)	73,525	65,548	40,787
Outlet Collection at Riverwalk	October 2018	2.95	% (c)	64,400	55,454	47,118
3831 Technology Forest Drive	March 2026	4.50	%		22,851	—
The Woodlands Resort & Conference Center	February 2019	3.70	% (c)	95,000	83,336	76,027
Ward Village	September 2016	3.36	% (c)(f)	250,000	238,716	238,716
20/25 Waterway Avenue	May 2022	4.79	%		14,168	14,330
3 Waterway Square	August 2028	3.94	%		52,000	52,000
4 Waterway Square	December 2023	4.88	%		37,547	38,289
Capital lease obligations	Various	3.60	%		57	135
Operating Assets Total					1,184,403	972,483
Strategic Developments						
1725-35 Hughes Landing Boulevard	June 2019	2.10	% (c)	143,000	81,719	47,513
Lakeland Village Center	May 2020	2.55	% (c)	14,000	—	—
Three Hughes Landing	December 2019	2.55	% (c)	65,455	14,046	—
Hughes Landing Hotel	October 2020	2.70	% (c)	37,100	10,973	—
Waiea and Anaha Condominiums	November 2019	6.95	% (c)	600,000	10,334	—
Waterway Square Hotel	August 2019	2.85	% (c)	69,300	24,200	—
Strategic Developments Total					141,272	47,513
Other Corporate Financing Arrangements	June 2018	3.00	%		19,045	19,968
Senior Notes	October 2021	6.88	%		750,000	750,000
Unamortized underwriting fees					(7,004)	(7,689)
					$ 2,322,296	$ 1,993,470

(a) Maturity date includes any extension periods that can be exercised at our option and are subject to customary extension terms.

(b) The Woodlands Credit Facility was amended and restated on July 31, 2015.

(c) The interest rate presented is based on the one month LIBOR rate, as applicable, which was 0.20% at September 30, 2015.

(d) $40.0 million of the outstanding principal balance is swapped to a 3.41% fixed rate maturity.

(e) The $27.4 million outstanding principal balance is swapped to a 5.21% fixed rate through maturity.

(f)

$143.0 million of the outstanding principal balance is swapped to a 3.81% fixed rate maturity. As of September 30, 2015 there is no undrawn availability on this facility.

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The weighted average interest rate on our mortgages, notes and loans payable, inclusive of interest rate hedges, was 4.39% and 4.61% as of September 30, 2015 and December 31, 2014, respectively. Generally, where we disclose extension options on our debt, there are financial and/or other conditions we will need to comply with in order for us to exercise such extensions.

All of the mortgage debt is secured by the individual properties listed in the table above and is non-recourse to HHC, except for:

(a) $750.0 million of Senior Notes;
(b) $311.8 million financing for the Downtown Summerlin development which has an initial maximum recourse of 35.0% of the outstanding balance, which will reduce to 15.0% upon completion of the project and 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;
(c) $64.4 million of construction financing for the Outlet Collection at Riverwalk with an initial maximum recourse of 50% of the outstanding balance, which will be reduced to 25.0% upon completion of the project and the achievement of an 11.0% debt yield and a minimum level of tenant sales per square foot for twelve months;
(d) $20.4 million of Other Corporate Financing Arrangements; and
(e) $7.0 million parent guarantee associated with the 110 N. Wacker mortgage.

The Woodlands Master Credit Facility and The Woodlands Resort & Conference Center loans are recourse to the entities that directly own The Woodlands operations. 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, but may be subject to a prepayment penalty equal to a yield-maintenance premium, defeasance, or a percentage of the loan balance. As of September 30, 2015, land, buildings and equipment and developments with a cost basis of $2.5 billion have been pledged as collateral for our mortgages, notes and loans payable.

As of September 30, 2015, we were in compliance with all of the financial covenants related to our debt agreements.

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 has an August 2016 initial maturity date with two, one–year extension options. The extension options require a reduction of the total commitment to $175.0 million for the first extension and semi-annual principal payments of $25.0 million during the second extension period. 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. As of September 30, 2015, there is no undrawn availability based on the collateral value underlying the facility.

The Bridgeland Land Loan matures in June 2022, and bears a fixed interest rate of 5.50% through June 2017 and three-month LIBOR plus 2.75% for the remaining term. Annual principal payments are required in the amount of 5.00% of the then outstanding principal balance. In addition, Bridgeland has a revolving credit facility with aggregate maximum borrowing capacity of $140.0 million. As of September 30, 2015, there is no undrawn availability on the facility. The revolving loan bears interest at the greater of 5.00% or one-month LIBOR plus 3.25%. In June 2015, we obtained a one-year extension for the revolver, which now matures on July 15, 2016. We expect to refinance this loan prior to its maturity. This loan is intended to provide working capital at Bridgeland to accelerate development efforts to meet the demand of homebuilders for finished lots in the community. The Bridgeland loans are cross-collateralized and cross-defaulted and the Bridgeland Master Planned Community serves as collateral for the loans. The loans also require that Bridgeland maintain a minimum $3.0 million cash balance and a minimum net worth of

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$250.0 million. Additionally, we are restricted from making cash distributions from Bridgeland unless the revolving credit facility has no outstanding balance and one year of real estate taxes and debt service on the term loan have been escrowed with the lender.

Operating Assets

On May 6, 2015, we closed on an $80.0 million non-recourse mortgage financing for the 10-60 Columbia Corporate Center office buildings. The loan bears interest at LIBOR plus 1.75% and has an initial maturity date of May 6, 2020, with two, one-year extension options.

On March 25, 2015, we closed on a $23.0 million non-recourse mortgage financing for 3831 Technology Forest Drive. The loan bears fixed interest at 4.50% and matures on March 24, 2026.

Strategic Developments

On October 23, 2015, we closed on a $6.7 million non-recourse construction loan for the Alden Bridge Self-Storage Facility, bearing interest at one-month LIBOR plus 2.60% with an initial maturity date of October 2019, with two one-year extension options.

Corporate

The $750.0 million in aggregate principal amount of 6.875% Senior Notes matures in 2021 (the “Senior Notes”). Interest is payable semiannually, on April 1 and October 1 of each year starting in April 2014. At any time prior to October 1, 2016, we may redeem up to 35% of the Senior Notes at a price equal to 106.875% using the proceeds from equity offerings. We may redeem all or part of the Senior Notes at any time on or after October 1, 2016 with a declining call premium thereafter to maturity. The Senior Notes contain customary terms and covenants for non investment grade senior notes and have no maintenance covenants.

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

The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges is recorded in Accumulated Other Comprehensive Income ("AOCI") and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The ineffective portion of the change in fair value of the derivatives is recognized directly in earnings. During the nine months ended September 30, 2015, the ineffective portion recorded in earnings was insignificant.

As of September 30, 2015, we had gross notional amounts of $210.4 million for interest rate swaps and a $100.0 million interest rate cap that were designated as cash flow hedges of interest rate risk. The fair value of the interest rate cap derivative was insignificant.

If the interest rate swap agreements 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

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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.

Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on our variable rate debt. Over the next 12 months, we estimate that an additional $2.4 million will be reclassified to interest expense.

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

	September 30, 2015	December 31, 2014
	(In Thousands)	
Interest Rate Swaps	$ 3,651	$ 3,144

The table below presents the effect of our derivative financial instruments on the Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended September 30,			Three Months Ended September 30,	
	2015	2014	Location of Loss	2015	2014
Cash Flow Hedges	Amount of Gain (Loss) Recognized in OCI	Amount of Gain (Loss) Recognized in OCI	Reclassified from AOCI into Earnings	Amount of Gain (Loss) Reclassified from AOCI into Earnings	Amount of Gain (Loss) Reclassified from AOCI into Earnings

	(In Thousands)			(In Thousands)	
Interest Rate Swaps	$ (877)	$ 229	Interest Expense	$ (466)	$ (555)

	Nine Months Ended September 30,			Nine Months Ended September 30,	
	2015	2014	Location of Loss	2015	2014
Cash Flow Hedges	Amount of Gain (Loss) Recognized in OCI	Amount of Gain (Loss) Recognized in OCI	Reclassified from AOCI into Earnings	Amount of Gain (Loss) Reclassified from AOCI into Earnings	Amount of Gain (Loss) Reclassified from AOCI into Earnings
	(In Thousands)			(In Thousands)	
Interest Rate Swaps	$ (979)	$ (742)	Interest Expense	$ (1,276)	$ (1,644)

NOTE 11 INCOME TAXES

Two of our subsidiaries are involved in a dispute with the IRS relating to years in which those subsidiaries were owned by General Growth Properties ("GGP"), and in connection therewith, GGP provided us with an indemnity against certain potential tax liabilities. Pursuant to the Tax Matters Agreement, GGP had indemnified us from and against 93.75% of any and all losses, claims, damages, liabilities and reasonable expenses to which we become subject (the "Tax Indemnity"), in each case solely to the extent directly attributable to certain taxes related to sales of certain assets in our Master Planned Communities segment prior to March 31, 2010 ("MPC Taxes"), in an amount up to $303.8 million, plus interest and penalties related to these amounts (the "Indemnity Cap") so long as GGP controlled the action in the United States Tax Court (the "Tax Court") related to the dispute with the IRS.

On May 6, 2011, GGP filed Tax Court petitions on behalf of its former REIT subsidiaries seeking a redetermination of federal income tax for the years 2007 and 2008. The petitions sought to overturn determinations by the IRS that the taxpayers were liable

for combined deficiencies totaling $144.1 million. The case was heard by the Tax Court in November 2012 and filed its ruling in favor of the IRS on June 2, 2014.

In December 2014, we entered into a tax indemnity and mutual release agreement with GGP (the "Settlement Agreement") pursuant to which, in consideration of the full satisfaction of GGP's obligation for reimbursement of taxes and interest related to certain assets in our Master Planned Communities segment prior to March 31, 2010, GGP (i) made a cash payment to us in the amount of $138.0 million and (ii) conveyed to us fee simple interest in six office properties and related parking garages located in Columbia, Maryland, known as 10-60 Columbia Corporate Center, for an agreed upon total value of $130.0 million. On December 15, 2014, the Company paid the MPC Taxes and filed an appeal of the decision to the Fifth Circuit Court of Appeals. The appeal sought to overturn the lower court decision and allow the Company to continue to use its current method of tax accounting for the sale of assets in the Company's Master Planned Communities Segment. Oral arguments were heard in the appellate court on September 2, 2015 and the court affirmed the Tax Court ruling on October 27, 2015. Unless the Company seeks a further appeal on this adverse ruling, we will no longer use the completed contract method of tax accounting at our Summerlin Master Planned Community. All taxes and interest due related to this decision were paid when the appeal was filed. This ruling will accelerate the use of our tax attributes and change the timing of future tax payments.

Unrecognized tax benefits pursuant to uncertain tax positions were $184.2 million as of September 30, 2015 and December 31, 2014, none of which would impact our effective tax rate. This amount is not reduced for either amounts reclassified under ASU 2013-11, or payments made to the IRS pursuant to the appeal filed with the Fifth Circuit Court of Appeals. A significant amount of the unrecognized tax benefits is related to the appeal of the Tax Court decision and based on the unfavorable ruling if no further appeal is sought, will be adjusted in our financial statements for the fourth quarter 2015.

We have significant permanent differences, primarily from warrant liability gains and losses, interest income on the tax indemnity receivable 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 10.5% and 19.7% for the three and nine months ended September 30, 2015 compared to 1.3% and (896.5)% for the three and nine months ended September 30, 2014. The changes in the tax rates were primarily attributable to changes in the warrant liability, valuation allowance and unrecognized tax benefits.

We file a consolidated corporate tax return which, through December 31, 2014, includes all of our subsidiaries with the exception of Victoria Ward, Limited ("Ward"). Ward elected to be taxed as a REIT commencing with the taxable

year beginning January 1, 2002 and ending with the taxable year ending December 31, 2014. Beginning on January 1, 2015, Ward will be included in our consolidated tax return.

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 Form 10-K for the year ended December 31, 2014.

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Stock Options

The following table summarizes our stock option plan:

	Stock Options	Weighted Average Exercise Price
Stock Options outstanding at January 1, 2015	1,046,490	$ 72.61
Granted	91,000	140.49
Forfeited	(73,250)	104.88
Stock Options outstanding at September 30, 2015	1,064,240	$ 76.28

For the three and nine months ended September 30, 2015, stock option expense was $0.6 million and $1.5 million, respectively. For the three and nine months ended September 30, 2014, stock option expense was $1.1 million and $3.1 million, respectively.

Restricted Stock

The following table summarizes restricted stock activity:

	Restricted Stock	Weighted Average Grant Date Fair Value
Restricted stock outstanding at January 1, 2015	172,690	$ 92.02
Granted	80,913	121.59
Vested	(7,546)	147.56

Forfeited	(4,169)		101.33
Restricted Stock outstanding at September 30, 2015	241,888	$	100.02

For the three and nine months ended September 30, 2015, compensation expense related to restricted stock awards was $1.3 million and $3.4 million, respectively. For the three and nine months ended September 30, 2014, compensation expense related to restricted stock awards was $1.1 million and $2.9 million, respectively.

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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.

	September 30, 2015	December 31, 2014
	(In thousands)	
Condominium receivables	$ 95,521	—
Condominium deposits	71,507	$ 151,592
Special Improvement District receivable	30,843	33,318
In-place leases	24,225	32,715
Below-market ground leases	19,409	19,663
Above-market tenant leases	3,806	4,656
Equipment, net of accumulated depreciation of $3.5 million and $2.4 million, respectively	19,150	20,284
Tenant incentives and other receivables	23,240	14,264
Security and escrow deposits	12,556	9,829
Prepaid expenses	9,997	9,196
Federal income tax receivable	8,268	8,629
Intangibles	3,880	3,593
Uncertain tax position asset	443	383
Other	751	2,014
	$ 323,596	$ 310,136

The $13.5 million net increase primarily relates to a $95.5 million increase in condominium receivables, which represents revenue recognized in excess of buyer deposits received for our Waiea and Anaha projects, partially offset

by a net $80.1 million decrease in condominium deposits at Ward Village due to utilization of deposits for construction costs. Tenant incentives and other receivables increased by $9.0 million primarily due to construction progress on ExxonMobil tenant improvements at our 1725-35 Hughes Landing development project. The $8.5 million decrease related to in-place leases is attributable to the normal amortization of these intangibles primarily for the 10-60 Columbia Corporate Center assets acquired in December 2014.

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Accounts Payable and Accrued Expenses

The following table summarizes the significant components of accounts payable and accrued expenses.

	September 30, 2015	December 31, 2014
	(In thousands)	
Construction payables	$ 184,966	$ 170,935
Deferred income	101,390	65,675
Condominium deposit liability	29,718	82,150
Tenant and other deposits	31,688	12,756
Accounts payable and accrued expenses	34,318	34,154
Accrued interest	28,282	14,791
Accrued payroll and other employee liabilities	22,856	25,838
Accrued real estate taxes	14,830	9,903
Interest rate swaps	3,651	3,144
Above-market ground leases	2,153	2,272
Membership deposits	—	21,023
Other	35,183	23,376
	$ 489,035	$ 466,017

Accounts payable and accrued expenses increased by $23.0 million. This net increase reflects increases of $35.7 million of deferred income related to deferred rental income on our ExxonMobil lease in The Woodlands and two commercial land sales in our Bridgeland MPC, $18.9 million in tenant and other deposits primarily due to tenant improvements at our 1725-35 Hughes Landing project, $13.5 million of accrued interest on the Senior Notes, $14.0 million in construction payables primarily due to continued development activities at Ward Village, 1725-35 Hughes Landing Boulevard, South Street Seaport, Waterway Hotel, Hughes Landing Hotel and Three Hughes Landing, and $11.8 million in Other accrued items. These increases are partially offset by a decrease of $52.4 million in the condominium deposit liability for the two towers at Ward Village due to the revenue recognized during the period, and a $21.0 million decrease in membership deposits resulting from the sale of The Club at Carlton Woods.

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NOTE 14 ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) (“AOCI”)

The following table summarizes AOCI for the period indicated:

Changes in Accumulated Other Comprehensive Income (Loss) by Component (a)

Gains and (Losses) on Cash Flow Hedges

(In Thousands)

	For the Three Months Ended September 30, 2015
Balance as of June 30, 2015	$ (7,116)
Other comprehensive income (loss) before reclassifications	(919)
Amounts reclassified from Accumulated Other Comprehensive Income (Loss)	466
Net current-period other comprehensive income (loss)	(453)
Balance as of September 30, 2015	$ (7,569)

	For the Nine Months Ended September 30, 2015

Balance as of January 1, 2015	$	(7,712)
Other comprehensive income (loss) before reclassifications		(1,133)
Amounts reclassified from Accumulated Other Comprehensive Income (Loss)		1,276
Net current-period other comprehensive income (loss)		143
Balance as of September 30, 2015	$	(7,569)

(a) All amounts are net of tax.

The following table summarizes the amounts reclassified out of AOCI for the period indicated:

Reclassifications out of Accumulated Other Comprehensive Income (Loss)

(In Thousands)

Accumulated Other Comprehensive Income (Loss) Components	Amounts reclassified from Accumulated Other Comprehensive Income (Loss) For the Three Months Ended September 30, 2015	For the Nine Months Ended September 30, 2015	Affected line item in the Statement of Operations
Gains and losses on cash flow hedges			
Interest rate swap contracts	$ 746	$ 2,046	Interest expense
	(280)	(770)	Provision for income taxes
Total reclassifications for the period	$ 466	$ 1,276	Net of tax

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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 and surety bonds totaling $77.0 million and $53.7 million as of September 30, 2015 and December 31, 2014, respectively. These letters of credit and bonds were issued primarily in connection with insurance requirements, special real estate assessments and construction obligations.

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 rent of $1.2 million starting July 1, 2013 with an expiration of December 30, 2072, including 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 the fair market value or the then base rent. In addition to the annual base rent of $1.2 million, we are required to make annual payments of $210,000 as additional rent through the term of the lease. The additional rent escalates annually at the Consumer Price Index. We are entitled to a total rent credit of $1.5 million, to be taken monthly over a 30-month period. Simultaneously with the execution of the lease, we executed a completion guaranty for the redevelopment of Pier 17. The completion guaranty requires us to perform certain obligations under the lease, including the commencement of construction by October 1, 2013 with a scheduled completion date in 2017.

In the fourth quarter 2012, the historic area of South Street Seaport suffered damage due to flooding as a result of Superstorm Sandy. Reconstruction efforts are ongoing and the property is only partially operating. We have received $47.9 million in insurance proceeds through September 30, 2015 related to our claim and recognized Other income of $0.3 million for the nine months ended September 30, 2015 for the amounts received during that period. We are in litigation with several of the insurance carriers and we are seeking recoveries greater than what the insurance companies have paid to date. There can be no assurance that we will recover any additional insurance proceeds.

Please refer to Note 11 – Income Taxes for additional contingencies related to our uncertain tax positions.

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, and multi-family properties, The Woodlands Resort & Conference Center and other real estate investments. The Club at Carlton Woods was also included in Operating Assets until its sale on September 4, 2015. These assets are currently generating revenues, and we believe there is an opportunity to redevelop, reposition, or sell certain of these assets to improve segment performance.

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

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Revenue recognition for contracted individual units in a condominium project are accounted for under the percentage of completion method when the following criteria are met: a) construction is beyond a preliminary stage; b) buyer is unable to require a refund of its deposit, except for non delivery of the unit; c) sufficient units are sold to assure that it will not revert to a rental property; d) sales prices are collectible; and e) aggregate sales proceeds and costs can be reasonably estimated. Those units that do not meet the criteria are accounted for using the full accrual or deposit method which defers revenue recognition until the unit is closed.

Revenue recognized on the percentage-of-completion method is calculated based upon the ratio of project costs incurred to date compared to total estimated project cost. Total estimated project costs include direct costs such as the carrying value of our land, site planning, architectural, construction costs, financing costs and indirect cost allocations for certain infrastructure and amenity costs which benefit the project based upon the relative fair value of the land prior to development. Changes in estimated project costs impact the amount of revenue and profit recognized on a percentage of completion basis during the period in which they are determined and future periods.

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The assets included in each segment as of September 30, 2015, are contained in the following chart:

Master Planned Communities	Operating Assets		Strategic Developments	
	Retail	Office	Under Construction	Other
• Bridgeland	Columbia Regional Building	10-70 Columbia Corporate Center	Anaha Condominiums	Alameda Plaza
• Maryland	Cottonwood Square	Columbia Office Properties	Three Hughes Landing	ONE Ala Moana (e)
• Summerlin (a)	Creekside Village Green (c)	One Hughes Landing	1725-35 Hughes Landing Boulevard	Alden Bridge Self-Storage
• The Woodlands	Downtown Summerlin	Two Hughes Landing		AllenTowne
• The Woodlands Hills (b)	Hughes Landing Retail (c)	2201 Lake Woodlands Drive	Hughes Landing Hotel (Embassy Suites)	Bridges at Mint Hill
	1701 Lake Robbins	9303 New Trails		Century Plaza Mall
	Landmark Mall	110 N. Wacker	Lakeland Village Center	Circle T Ranch and Power Center (d)
	Outlet Collection at Riverwalk	3831 Technology Forest Drive	Summerlin Apartments, LLC (d)	
	Park West	3 Waterway Square	Waiea Condominiums	Cottonwood Mall
	South Street Seaport (under construction)	4 Waterway Square	Waterway Square Hotel (Westin)	The Outlet Collection at Elk Grove (g)
	Ward Village	1400 Woodloch Forest		80% Interest in Fashion Show Air Rights
	20/25 Waterway Avenue			Kendall Town Center
	Waterway Garage Retail			Lakemoor (Volo) Land
				Maui Ranch Land
	Other			Parcel C (d)

Golf Courses at TPC Summerlin and TPC Las Vegas (participation interest)
Kewalo Basin Harbor

Stewart Title of Montgomery County, TX (d)
Summerlin Hospital Medical

Seaport District Assemblage
Ward Block M
Ward Gateway Towers