

AMREIT
Form 10-Q
August 14, 2008

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 June 30, 2008

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

For the transition period from _____ to _____

Commission File Number: 0-28378

(Name of registrant as specified its charter)

TEXAS
(State or Other Jurisdiction of Incorporation or
Organization)

76-0410050
(I.R.S. Employer Identification No.)

8 GREENWAY PLAZA, SUITE 1000
HOUSTON, TEXAS
(Address of Principal Executive Offices)

77046
(Zip Code)

713-850-1400
(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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO "

Indicate by check mark 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 " Smaller reporting company x
(Do not check if a 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 x

Edgar Filing: AMREIT - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| Class | Outstanding as of August 12, 2008 |
|--|--|
| Class A Common Stock, \$0.01 par value | 6,634,489 shares |
| Class C Common Stock, \$0.01 par value | 4,150,088 shares |
| Class D Common Stock, \$0.01 par value | 10,982,002 shares |

Table of Contents

| Item No. | | Form 10-Q Report Page |
|-----------------------|--|-----------------------|
| <u>PART I</u> | | |
| 1 | <u>Financial Statements</u> | 1 |
| | <u>Description of Business and Nature of Operations</u> | 5 |
| | <u>Summary of Significant Accounting Policies</u> | 5 |
| | <u>Deferred Compensation</u> | 7 |
| | <u>Investments in Merchant Development Funds and Other Affiliates</u> | 9 |
| | <u>Acquired Lease Intangibles</u> | 11 |
| | <u>Notes Payable</u> | 11 |
| | <u>Concentrations</u> | 12 |
| | <u>Shareholders' Equity and Minority Interest</u> | 12 |
| | <u>Related Party Transactions</u> | 13 |
| | <u>Real Estate Acquisitions and Dispositions</u> | 13 |
| | <u>Commitments</u> | 13 |
| | <u>Subsequent Events</u> | 13 |
| | <u>Operating Segments</u> | 13 |
| 2 | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 18 |
| 3 | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 21 |
| 4 | <u>Controls and Procedures</u> | 21 |
| <u>PART II</u> | | |
| 1 | <u>Legal Proceedings</u> | 21 |
| 1A | <u>Risk Factors</u> | 21 |
| 2 | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 21 |
| 3 | <u>Defaults Upon Senior Securities</u> | 21 |
| 4 | <u>Submission of Matters to a Vote of Security Holders</u> | 21 |
| 5 | <u>Other Information</u> | 22 |
| 6 | <u>Exhibits</u> | 22 |

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

AmREIT AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
June 30, 2008 and December 31, 2007
(in thousands, except share data)

| | June 30, 2008 | December 31, 2007 |
|--|-------------------|-------------------------|
| ASSETS | (unaudited) | |
| Real estate investments at cost: | | |
| Land | \$ 127,551 | \$ 130,563 |
| Buildings | 135,124 | 141,045 |
| Tenant improvements | 9,543 | 10,105 |
| | 272,218 | 281,713 |
| Less accumulated depreciation and amortization | (17,369) | (15,626) |
| | 254,849 | 266,087 |
| Real estate held for sale and investment in direct financing leases held for sale, net | 32,871 | 22,438 |
| Net investment in direct financing leases held for investment | 2,063 | 2,058 |
| Intangible lease cost, net | 11,226 | 13,096 |
| Investment in merchant development funds and other affiliates | 6,720 | 10,514 |
| Net real estate investments | 307,729 | 314,193 |
| Cash and cash equivalents | 205 | 1,221 |
| Tenant receivables, net | 4,132 | 4,398 |
| Accounts receivable, net | 2,570 | 1,251 |
| Accounts receivable - related party | 3,944 | 5,386 |
| Notes receivable - related party | 9,393 | 10,442 |
| Deferred costs | 2,284 | 2,472 |
| Other assets | 5,189 | 4,394 |
| TOTAL ASSETS | \$ 335,446 | \$ 343,757 |

| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
|---|-------------------|-------------------|
| Liabilities: | | |
| Notes payable | \$ 175,556 | \$ 168,560 |
| Notes payable, held for sale | 12,570 | 12,811 |
| Accounts payable - related party | 367 | 49 |
| Accounts payable and other liabilities | 5,446 | 7,650 |
| Below market leases, net | 2,378 | 3,401 |
| Security deposits | 705 | 674 |
| TOTAL LIABILITIES | 197,022 | 193,145 |
| Minority interest | 1,220 | 1,179 |
| Shareholders' equity: | | |
| Preferred shares, \$.01 par value, 10,000,000 shares authorized, none issued | - | - |
| Class A common shares, \$.01 par value, 50,000,000 shares authorized, 6,634,489 and 6,626,559 shares issued, respectively | 66 | 66 |
| Class C common shares, \$.01 par value, 4,400,000 shares authorized, 4,149,094 and 4,143,971 shares issued and outstanding, respectively | 42 | 41 |
| Class D common shares, \$.01 par value, 17,000,000 shares authorized, 11,036,170 and 11,045,763 shares issued and outstanding, respectively | 110 | 110 |
| Capital in excess of par value | 185,571 | 185,165 |
| Accumulated distributions in excess of earnings | (39,527) | (33,365) |
| Cost of treasury shares, 1,229,253 and 337,308 Class A common shares, respectively | (9,058) | (2,584) |
| TOTAL SHAREHOLDERS' EQUITY | 137,204 | 149,433 |
| TOTAL LIABILITIES AND SHAREHOLDERS' | \$ 335,446 | \$ 343,757 |

EQUITY

See Notes to Consolidated Financial Statements.

~1~

Table of Contents

AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and six months ended June 30, 2008 and 2007
(unaudited)
(in thousands, except per share data)

| | Three months ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|---------------|---------------------------|---------------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues: | | | | |
| Rental income from operating leases | \$ 8,142 | \$ 7,504 | \$ 15,628 | \$ 14,396 |
| Earned income from direct financing leases | 60 | 61 | 120 | 120 |
| Real estate fee income | 115 | 160 | 285 | 854 |
| Real estate fee income - related party | 1,311 | 349 | 2,743 | 1,062 |
| Construction revenues | 698 | 695 | 1,130 | 792 |
| Construction revenues - related party | 1,650 | 219 | 2,554 | 1,095 |
| Securities commission income - related party | 424 | 1,484 | 949 | 2,477 |
| Asset management fee income - related party | 377 | 312 | 753 | 596 |
| Total revenues | 12,777 | 10,784 | 24,162 | 21,392 |
| Expenses: | | | | |
| General and administrative | 2,288 | 1,818 | 4,706 | 3,976 |
| Property expense | 2,456 | 2,006 | 4,425 | 3,731 |
| Construction costs | 2,221 | 868 | 3,342 | 1,729 |
| Legal and professional | 432 | 470 | 876 | 763 |
| Real estate commissions | 5 | 26 | 42 | 447 |
| Securities commissions | 355 | 1,245 | 840 | 2,074 |
| Depreciation and amortization | 2,606 | 1,925 | 4,505 | 3,834 |
| Total expenses | 10,363 | 8,358 | 18,736 | 16,554 |
| Operating income | 2,414 | 2,426 | 5,426 | 4,838 |
| Other income (expense): | | | | |
| Interest and other income - related party | 229 | 250 | 503 | 500 |
| Loss from merchant development funds and other affiliates | (246) | (15) | (389) | (27) |

Edgar Filing: AMREIT - Form 10-Q

| | | | | |
|--|------------|------------|------------|------------|
| Income tax benefit for taxable REIT subsidiary | 200 | 224 | 276 | 374 |
| Interest expense | (2,371) | (2,086) | (4,802) | (4,176) |
| Income before discontinued operations | 226 | 799 | 1,014 | 1,509 |
| Income (loss) from discontinued operations, net of taxes | (891) | 302 | (682) | 595 |
| Income (loss) from discontinued operations | (891) | 302 | (682) | 595 |
| Net income (loss) | (665) | 1,101 | 332 | 2,104 |
| Distributions paid to class B, C and D shareholders | (2,504) | (2,711) | (5,002) | (5,416) |
| Net loss available to class A shareholders | \$ (3,169) | \$ (1,610) | \$ (4,670) | \$ (3,312) |
| Net loss per class A common share - basic and diluted | | | | |
| Loss before discontinued operations | \$ (0.39) | \$ (0.30) | \$ (0.67) | \$ (0.61) |
| Income (loss) from discontinued operations | \$ (0.15) | \$ 0.05 | \$ (0.11) | \$ 0.09 |
| Net loss | \$ (0.54) | \$ (0.25) | \$ (0.78) | \$ (0.52) |
| Weighted average class A common shares used to compute net loss per share, basic and diluted | 5,775 | 6,411 | 5,995 | 6,366 |

See Notes to Consolidated Financial Statements.

Table of Contents

AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands, except share data)

| | Six Months Ended June 30, | |
|---|---------------------------|----------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 332 | \$ 2,104 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Investment in real estate acquired for resale | (2,739) | - |
| Proceeds from sales of real estate acquired for resale | - | 1,399 |
| Impairment charge | 1,332 | |
| Tenant receivable write-off | 648 | - |
| Loss from merchant development funds and other affiliates | 390 | 27 |
| Cash receipts related to deferred related party fees | (323) | - |
| Depreciation and amortization | 3,791 | 3,865 |
| Amortization of deferred compensation | 224 | 353 |
| Minority interest in income of consolidated joint ventures | 227 | 74 |
| Distributions from merchant development funds and other affiliates | 19 | 234 |
| Decrease in tenant receivables | 266 | 356 |
| Decrease in accounts receivable | (319) | 325 |
| (Increase) decrease in accounts receivable - related party | 1,442 | (122) |
| Cash receipts from direct financing leases more than income recognized | 102 | 23 |
| Increase in other assets | (831) | (1,116) |
| Decrease in accounts payable and other liabilities | (1,617) | (3,856) |

Edgar Filing: AMREIT - Form 10-Q

| | | |
|---|----------|----------|
| Decrease in accounts payable-related party | (269) | - |
| Increase in security deposits | 31 | 11 |
| Net cash provided by operating activities | 2,706 | 3,677 |
| Cash flows from investing activities: | | |
| Improvements to real estate | (758) | (1,602) |
| Acquisition of investment properties | - | (9,558) |
| Loans to affiliates | (4,108) | (2,444) |
| Payments from affiliates | 5,157 | 5,772 |
| Investment in receivable | (1,711) | - |
| Additions to furniture, fixtures and equipment | (91) | (40) |
| Proceeds from sale of investment in other affiliates to related party | 9,068 | - |
| Investment in merchant development funds and other affiliates | (5,490) | (1,001) |
| Distributions from merchant development funds and other affiliates | 130 | 110 |
| Increase in preacquisition costs | 89 | 14 |
| Net cash provided by (used in) investing activities | 2,286 | (8,749) |
| Cash flows from financing activities: | | |
| Proceeds from notes payable | 31,462 | 59,994 |
| Payments of notes payable | (24,588) | (46,785) |
| Increase in deferred costs | (18) | (264) |
| Purchase of treasury shares | (6,172) | (15) |
| Issuance of common shares | 81 | - |
| Retirement of common shares | (3,229) | (2,953) |
| Issuance costs | (34) | (6) |
| Common dividends paid | (3,431) | (3,909) |
| Distributions to minority interests | (79) | (49) |
| Net cash provided by (used in) financing activities | (6,008) | 6,013 |
| Net increase (decrease) in cash and cash equivalents | (1,016) | 941 |
| Cash and cash equivalents, beginning of period | 1,221 | 3,415 |
| | \$ 205 | \$ 4,356 |

Cash and cash equivalents,
end of period

Supplemental schedule of
cash flow information:

Cash paid during the year
for:

| | | | | |
|--------------|----|-------|----|-------|
| Interest | \$ | 5,409 | \$ | 4,728 |
| Income taxes | | 380 | | 341 |

Supplemental schedule of noncash investing and and financing activities

During 2008 and 2007, 0 and 41,000 class B common shares, respectively were converted to class A common shares. Additionally, during 2008 and 2007, we issued class C common and D common shares with a value of \$3.1 million satisfaction of dividends through the dividend reinvestment program.

In 2007, we issued 131,000 restricted shares to employees and trust managers as part of their compensation arrangements. The restricted shares vest over a four and three year period, respectively. We recorded \$1.1 million in deferred compensation related to the issuance of the restricted shares.

See Notes to Consolidated Financial Statements.

Table of Contents

AmREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the six months ended June 30, 2008
(unaudited)
(in thousands)

| | Common Shares Amount | Capital in excess of par value | Accumulated distributions in excess of earnings | Cost of treasury shares | Total |
|--|----------------------------|--------------------------------------|--|-------------------------------|------------|
| Balance at December 31, 2007 | \$ 217 | \$ 185,165 | \$ (33,365) | \$ (2,584) | \$ 149,433 |
| Net income | - | - | 332 | - | 332 |
| Deferred compensation issuance of restricted shares, Class A | | 302 | - | (302) | - |
| Issuance of common shares, Class A | - | 47 | - | - | 47 |
| Repurchase of common shares, Class A | - | - | - | (6,172) | (6,172) |
| Amortization of deferred compensation | - | 224 | - | - | 224 |
| Issuance of common shares, Class C | 2 | 857 | - | - | 859 |
| Retirement of common shares, Class C | (1) | (808) | - | - | (809) |
| Issuance of common shares, Class D | 2 | 2,202 | - | - | 2,204 |
| Retirement of common shares, Class D | (2) | (2,418) | - | - | (2,420) |
| Distributions | - | - | (6,494) | - | (6,494) |
| Balance at June 30, 2008 | \$ 218 | \$ 185,571 | \$ (39,527) | \$ (9,058) | \$ 137,204 |

See Notes to Consolidated Financial Statements.

Table of Contents

AmREIT AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008
(unaudited)

1. DESCRIPTION OF BUSINESS AND NATURE OF OPERATIONS

We are an established real estate company that has elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes. Our business model is similar to an institutional advisory company that is judged by its investor partners on the returns we are able to deliver to reach specified long-term results. Our primary objective is to build long-term shareholder value and continue to build and enhance the net asset value (“NAV”) of us and our advised funds.

We seek to create value and drive net operating income (“NOI”) growth on the properties owned in our institutional-grade portfolio of Irreplaceable Corners™ and those owned by a series of closed-end, merchant development funds. We also seek to support an advisory business that raises capital through an extensive independent broker-dealer channel as well as through institutional joint venture partners.

Our direct predecessor, American Asset Advisers Trust, Inc. (“ATI”), was formed as a Maryland corporation in 1993. Prior to 1998, ATI was externally advised by American Asset Advisors Corp. which was formed in 1985. In June 1998, ATI merged with its advisor and changed its name to AmREIT, Inc. In December 2002, AmREIT, Inc. reorganized as a Texas real estate investment trust and became AmREIT.

Our class A common shares are traded on the American Stock Exchange under the symbol “AMY.” Our offices are located at 8 Greenway Plaza, Suite 1000 Houston, Texas 77046. Our telephone number is 713.850.1400 and we maintain an internet site at www.amreit.com.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

Our financial records are maintained on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when incurred. The consolidated financial statements include our accounts as well as the accounts of any wholly- or majority-owned subsidiaries in which we have a controlling financial interest. Investments in joint ventures and partnerships where we have the ability to exercise significant influence but do not exercise financial and operating control, are accounted for using the equity method, unless such entities qualify as variable interest entities, and thus are considered for consolidation under applicable accounting literature related to consolidation. All significant inter-company accounts and transactions have been eliminated in consolidation.

The consolidated financial statements included in this report are unaudited; however, amounts presented in the consolidated balance sheet as of December 31, 2007 are derived from our audited financial statements at that date. In our opinion, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted of normal recurring items.

REVENUE RECOGNITION

We lease space to tenants under agreements with varying terms. The majority of the leases are accounted for as operating leases with revenue being recognized on a straight-line basis over the terms of the individual leases. Accrued rents are included in tenant receivables. Revenue from tenant reimbursements of taxes, maintenance expenses and insurance is recognized in the period the related expense is recorded. Additionally, certain of the lease agreements contain provisions that grant additional rents based on tenants' sales volumes (contingent or percentage rent). Percentage rents are recognized when the tenants achieve the specified targets as defined in their lease agreements. We recognize lease termination fees in the period that the lease is terminated and collection of the fees is reasonably assured. During the six months ended June 30, 2008 and 2007, we recognized \$0 and \$153,000, respectively, in lease termination fees, which are included in rental income from operating leases. The terms of certain leases require that the building/improvement portion of the lease be accounted for under the direct financing method which treats the building as if we had sold it to the lessee and entered into a long-term financing arrangement with such lessee. This accounting method is appropriate when the lessee has all of the benefits and risks of property ownership that they otherwise would if they owned the building versus leasing it from us.

We have been engaged to provide various real estate services, including development, construction, construction management, property management, leasing and brokerage. The fees for these services are recognized as services are provided and are generally calculated as a percentage of revenues earned or to be earned or of property cost, as appropriate. Revenues from fixed-price construction contracts are recognized on the percentage-of-completion method, measured by the physical completion of the structure. Revenues from cost-plus-percentage-fee contracts are recognized on the basis of costs incurred during the period plus the percentage fee earned on those costs. Construction management contracts are recognized only to the extent of the fee revenue.

Construction contract costs include all direct material and labor costs and any indirect costs related to contract performance. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from any contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Any profit incentives are included in revenues when their realization is reasonably assured. An amount equal to contract costs attributable to any claims is included in revenues when realization is probable and the amount can be reliably estimated.

Unbilled construction receivables represent reimbursable costs and amounts earned under contracts in progress as of the date of our balance sheet. Such amounts become billable according to contract terms, which usually consider the passage of time, achievement of certain milestones or completion of the project. Advance billings represent billings to or collections from clients on contracts in advance of revenues earned thereon. Unbilled construction receivables are generally billed and collected within the twelve months following the date of our balance sheet, and advance billings are generally earned within the twelve months following the date of our balance sheet. As of June 30, 2008, \$75,000 of unbilled receivables has been included in "Accounts receivable" and \$3,000 of unbilled receivables due from related parties has been included in "Accounts receivable – related party." As of December 31, 2007, \$4,000 of unbilled receivables has been included in "Accounts receivable" and \$85,000 of unbilled receivables due from related parties has been included in "Accounts receivable – related party." We had advance billings of \$6,000 as of June 30, 2008 and December 31, 2007.

Securities commission income is recognized as units of our merchant development funds are sold through our wholly-owned subsidiary, AmREIT Securities Company. Securities commission income is earned as the services are performed and pursuant to the corresponding prospectus or private offering memorandum. Generally, it includes a selling commission of between 6.5% and 7.5%, a dealer-manager fee of between 2.5% and 3.25% and offering and organizational costs of 1.0% to 1.50%. The selling commission is then paid to the unaffiliated selling broker-dealer and reflected as securities commission expense.

Table of Contents

REAL ESTATE INVESTMENTS

Development Properties – Land, buildings and improvements are recorded at cost. Expenditures related to the development of real estate are carried at cost which includes capitalized carrying charges, acquisition costs and development costs. Carrying charges, primarily interest, real estate taxes and loan acquisition costs, and direct and indirect development costs related to buildings under construction, are capitalized as part of construction in progress. The capitalization of such costs ceases at the earlier of one year from the date of completion of major construction or when the property, or any completed portion, becomes available for occupancy. We capitalize acquisition costs as incurred. Such costs are expensed if and when the acquisition becomes no longer probable. During the six months ended June 30, 2008 and 2007 we capitalized \$29,000 and \$162,000, respectively, in interest on properties under development.

Acquired Properties and Acquired Lease Intangibles – We account for real estate acquisitions pursuant to Statement of Financial Accounting Standards No. 141, Business Combinations (“SFAS No. 141”). Accordingly, we allocate the purchase price of the acquired properties to land, building and improvements, identifiable intangible assets and to the acquired liabilities based on their respective fair values. Identifiable intangibles include amounts allocated to acquire out-of-market leases, the value of in-place leases and customer relationship value, if any. We determine fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as-if-vacant property value include an estimate of carrying costs during the expected lease-up periods considering market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and estimates of lost rentals at market rates during the expected lease-up periods, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses. Intangibles related to out-of-market leases and in-place lease value are recorded as acquired lease intangibles and are amortized as an adjustment to rental revenue or amortization expense, as appropriate, over the remaining terms of the underlying leases. Premiums or discounts on acquired out-of-market debt are amortized to interest expense over the remaining term of such debt.

Depreciation — Depreciation is computed using the straight-line method over an estimated composite useful life of up to 50 years for buildings, up to 20 years for site improvements and over the term of lease for tenant improvements. Leasehold estate properties, where we own the building and improvements but not the related ground, are amortized over the life of the lease.

Properties Held for Sale — Properties are classified as held for sale if management has decided to market the property for immediate sale in its present condition with the belief that the sale will be completed within one year. Operating properties held for sale are carried at the lower of cost or fair value less cost to sell. Depreciation and amortization are suspended during the held for sale period. As of June 30, 2008 we owned 29 properties with a carrying value of \$32.9 million that were classified as real estate held for sale. As of December 31, 2007 we owned 19 properties with a carrying value of \$22.4 million that were classified as real estate held for sale.

Our properties generally have operations and cash flows that can be clearly distinguished from the rest of our operations. The operations and gains on sales reported in discontinued operations represent those properties that have been sold or are held for sale and for which operations and cash flows have been clearly distinguished. The operations of these properties have been eliminated from ongoing operations, and we will not have continuing involvement after disposition. Prior period operating activity related to such properties has been reclassified as discontinued operations in the accompanying statements of operations, effective on the date the decision to sell is made.

Impairment – We review our properties for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. We determine whether an impairment in value occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the residual value of the property, with the carrying value of the individual property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the asset exceeds its fair value. An impairment charge of \$1.3 million was recognized for the six months ended June 30, 2008 related to four properties that represent non-core real estate assets. We are holding these assets for sale as of June 30, 2008, one of which was sold in July 2008. No impairment charges were recognized for the six months ended June 30, 2007.

RECEIVABLES AND ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

Tenant receivables — Included in tenant receivables are base rents, tenant reimbursements and receivables attributable to recording rents on a straight-line basis. An allowance for the uncollectible portion of accrued rents and accounts receivable is determined based upon customer credit-worthiness (including expected recovery of our claim with respect to any tenants in bankruptcy), historical bad debt levels, and current economic trends. As of June 30, 2008 and December 31, 2007, we had an allowance for uncollectible accounts of \$600,000 and \$157,000, respectively, related to our tenant receivables. During the second quarter of 2008, we increased the allowance by \$470,000 in bad debts associated primarily with a couple of major tenants, one of which declared bankruptcy during the second quarter and another which vacated their space during the second quarter.

Accounts receivable – Included in accounts receivable are amounts due from clients of our construction services business and various other receivables. As of June 30, 2008 and December 31, 2007, we had an allowance for uncollectible accounts of \$411,000 and \$264,000, respectively, related to our accounts receivable. During the second quarter of 2008, we increased the allowance by \$178,000 in bad debts associated with two construction projects.

Also included in accounts receivable as of June 30, 2008 is a \$1.8 million receivable from the City of Pearland, Texas. We acquired this receivable in June 2008 in conjunction with the acquisition of Shadow Creek Ranch shopping center by our affiliated funds in February 2008. The receivable is to be funded by 1/3 of the 1.5% sales tax that the City of Pearland collects from the shopping center.

Notes receivable – related party – Included in related party notes receivable are loans made to our affiliated merchant development funds as part of our treasury management function whereby we place excess cash in short-term bridge loans for these affiliates related to the acquisition or development of properties. We typically provide such financing to our affiliates as a way of efficiently deploying our excess cash and earning a higher return than we would otherwise earn in other short term investments or overnight funds. In most cases, the funds have a construction lender in place, and we step in and provide financing on the same terms as the third party lender. In so doing, we are able to access these funds as needed by having our affiliate then draw down on their construction loans. These loans are unsecured, bear interest at the prime rate (5.00% at June 30, 2008) and are due upon demand.

Table of Contents

DEFERRED COSTS

Deferred costs include deferred leasing costs and deferred loan costs, net of amortization. Deferred loan costs are incurred in obtaining financing and are amortized using a method that approximates the effective interest method to interest expense over the term of the debt agreements. Deferred leasing costs consist of external commissions associated with leasing our properties and are amortized to expense over the lease term. Accumulated amortization related to deferred loan costs as of June 30, 2008 and December 31, 2007 totaled \$793,000 and \$627,000, respectively. Accumulated amortization related to deferred leasing costs as of June 30, 2008 and December 31, 2007 totaled \$550,000 and \$450,000, respectively.

DEFERRED COMPENSATION

Our deferred compensation and long term incentive plan is designed to attract and retain the services of our trust managers and employees that we consider essential to our long-term growth and success. As such, it is designed to provide them with the opportunity to own shares, in the form of restricted shares, in us, and provide key employees the opportunity to participate in the success of our affiliated actively managed merchant development funds through the economic participation in our general partner companies. All long term compensation awards are designed to vest over a period of three to seven years and promote retention of our team.

Restricted Share Issuances - Deferred compensation includes grants of restricted shares to our trust managers and employees as a form of long-term compensation. The share grants vest over a period of three to seven years. We determine the fair value of the restricted shares as the number of shares awarded multiplied by the closing price per share of our class A common shares on the grant date. We amortize such fair value ratably over the vesting periods of the respective awards. The following table presents restricted share activity during the six months ended June 30, 2008.

| | Non-vested Shares | Weighted Average grant date fair value |
|---------------------|----------------------|--|
| Beginning of period | 410,830 | \$ 7.67 |
| Granted | - | - |
| Vested | (52,588) | 7.73 |
| Forfeited | (39,829) | 7.90 |
| End of period | 318,413 | 7.63 |

There were no restricted shares issued during the six months ended June 30, 2008. During the six months ended June 30, 2007 the weighted-average grant date fair value of shares issued under our deferred compensation and long term incentive plan was \$8.51 per share. The total fair value of shares vested during the six months ended June 30, 2008 and 2007 was \$407,000 and \$390,000 respectively. Total compensation cost recognized related to restricted shares during the six months ended June 30, 2008 and 2007 was \$224,000 and \$353,000, respectively. As of June 30, 2008, total unrecognized compensation cost related to restricted shares was \$2.4 million, and the weighted average period over which we expect this cost to be recognized is 3.56 years.

General Partner Profit Participation Interests - We have assigned up to 45% of the economic interest in certain of our merchant development funds to certain of our key employees. This economic interest is received, as, if and when we receive economic benefit from our profit participation, after certain preferred returns have been paid to the partnership's limited partners. This assignment of economic interest generally vests over a period of five to seven years. This allows us to align the interest of our employees with the interest of our shareholders. Because any future profits and earnings from the merchant development funds cannot be reasonably predicted or estimated, and any employee benefit is contingent upon the benefit received by the general partner of the merchant development funds, we recognize expense associated with the assignment of these economic interests as we recognize the corresponding income from the associated merchant development funds. No portion of the economic interest in the merchant development funds that have provided profit participation to us to date have been assigned to employees. Therefore, no compensation expense has been recorded to date. See Note 3 below for a discussion of the potential sale of assets from one our merchant development funds, AAA CTL Notes, Ltd.

Tax-Deferred Retirement Plan (401k) - We maintain a defined contribution 401k retirement plan for our employees. This plan is available for all employees immediately upon employment. The plan allows for contributions to be either invested in an array of large, mid and small cap mutual funds or directly into class A common shares. Employee contributions invested in our shares are limited to 50% of the employee's contributions. We match 50% of the employee's contribution, up to a maximum employee contribution of 4%. None of the employer contribution can be matched in our shares.

Share Options - We are authorized to grant options of our class A common shares as either incentive or non-qualified share options, up to an aggregate of 6.0% of the total voting shares outstanding. As of June 30, 2008 and December 31, 2007, none of these options have been granted.

INCOME TAXES

We account for federal and state income taxes under the asset and liability method.

Federal – We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, and are, therefore, not subject to Federal income taxes to the extent of dividends paid, provided we meets all conditions specified by the Internal Revenue Code for retaining our REIT status, including the requirement that at least 90% of our REIT taxable income be distributed to shareholders.

Our real estate development and operating business, AmREIT Realty Investment Corporation and subsidiaries (“ARIC”), is a fully integrated and wholly-owned business consisting of brokers and real estate professionals that provide development, acquisition, brokerage, leasing, construction, asset and property management services to our publicly traded portfolio and merchant development funds as well as to third parties. ARIC and our wholly-owned corporations that serve as the general partners of our merchant development funds are treated for Federal income tax purposes as taxable REIT subsidiaries (collectively, the “Taxable REIT Subsidiaries”).

State – In May 2006, the State of Texas adopted House Bill 3, which modified the state's franchise tax structure, replacing the previous tax based on capital or earned surplus with one based on margin (often referred to as the “Texas Margin Tax”) effective with franchise tax reports filed on or after January 1, 2008. The Texas Margin Tax is computed by applying the applicable tax rate (1% for us) to the profit margin, which, generally, will be determined for us as total revenue less a 30% standard deduction. Although House Bill 3 states that the Texas Margin Tax is not an income tax, SFAS No. 109, Accounting for Income Taxes, applies to the Texas Margin Tax. We have recorded a margin tax provision of \$145,000 and \$124,000 for the Texas Margin Tax for the six months ended June 30, 2008 and 2007, respectively.

EARNINGS PER SHARE

Edgar Filing: AMREIT - Form 10-Q

Basic earnings per share has been computed by dividing net loss available to class A common shareholders by the weighted average number of class A common shares outstanding. Diluted earnings per share has been computed by dividing net income (as adjusted as appropriate) by the weighted average number of common shares outstanding plus the weighted average number of dilutive potential common shares. Diluted earnings per share information is not applicable due to the anti-dilutive nature of the class C and class D common shares which represent 23.0 million and 20.4 million potential common shares for the three months ended June 30, 2008 and 2007, respectively.

The following table presents information necessary to calculate basic and diluted earnings per class A share for the six months ended June 30, as indicated:

| | Three months ended | | Six months ended | |
|---|--------------------|----------|------------------|----------|
| | June 30 | | June 30 | |
| | 2008 | 2007 | 2008 | 2007 |
| Loss to class A common shareholders* | \$ 3,169 | \$ 1,610 | \$ 4,670 | \$ 3,312 |
| Weighted average class A common shares outstanding* | 5,775 | 6,411 | 5,995 | 6,366 |
| Basic and diluted loss per share | (0.54) | (0.25) | (0.78) | (0.52) |

* In thousands

~7~

Table of Contents

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Our consolidated financial instruments consist primarily of cash, cash equivalents, tenant receivables, accounts receivable, notes receivable, accounts payable and other liabilities and notes payable. The carrying value of cash, cash equivalents, tenant receivables, accounts receivable, notes receivable, accounts payable, and other liabilities are representative of their respective fair values due to the short-term maturity of these instruments. Our revolving line of credit has market-based terms, including a variable interest rate. Accordingly, the carrying value of the line of credit is representative of its fair value.

As of June 30, 2008, the carrying value of our debt obligations associated with assets held for investment was \$175.6 million, \$137.6 million of which represented fixed rate obligations with an estimated fair value of \$139.3 million. As of December 31, 2007, the carrying value of our debt obligations associated with assets held for investment was \$168.6 million, \$138.1 million of which represented fixed rate obligations with an estimated fair value of \$139.1 million.

As of June 30, 2008, the carrying value of our debt obligations associated with assets held for sale was \$12.6 million, all of which represented fixed rate obligations with an estimated fair value of \$13.3 million. As of December 31, 2007, the carrying value of our debt obligations associated with assets held for sale was \$12.8 million, all of which represented fixed rate obligations with an estimated fair value of \$13.6 million.

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

As of June 30, 2008, we are an investor in, and the primary beneficiary of, one entity that qualifies as a variable interest entity pursuant to FIN 46R. This entity was established to develop, own, manage, and hold property for investment and comprises \$6.1 million of our total consolidated assets at period end. This entity, which we hold a 50% interest in, had no debt outstanding at period end and had revenues of \$250,000 for the six months ended June 30, 2008.

NEW ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of financial instruments according to a fair value hierarchy. Additionally, companies are required to provide certain disclosures regarding instruments within the hierarchy, including a reconciliation of the beginning and ending balances for each major category of assets and liabilities. SFAS No. 157 is effective for our fiscal year beginning January 1, 2008. The adoption of SFAS No. 157 did not have a material effect on our results of operations or financial position.

Edgar Filing: AMREIT - Form 10-Q

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (“SFAS No. 159”). SFAS No. 159 expands opportunities to use fair value measurement in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We did not measure any eligible financial assets and liabilities at fair value under the provisions of SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), Business Combinations (“SFAS No. 141R”). SFAS No. 141R will change the accounting for business combinations. Under FAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We currently capitalize acquisition costs as part of the basis of the asset acquired. Upon effectiveness of SFAS No. 141R we will expense acquisition costs as incurred.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51 (“SFAS No. 160”). SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS No. 160 shall be applied prospectively. We are currently evaluating the potential impact of the adoption of SFAS No. 160 on our consolidated financial statements.

DISCONTINUED OPERATIONS

The following is a summary of our discontinued operations for the three and six months ended June 30, 2008 and 2007 (in thousands, except for per share data):

| | Three months ended | | Six months ended | |
|---|--------------------|--------|------------------|--------|
| | June 30 | | June 30 | |
| | 2008 | 2007 | 2008 | 2007 |
| Rental revenue | \$ 428 | \$ 273 | \$ 686 | \$ 487 |
| Earned income from direct financing leases | 443 | 447 | 887 | 895 |
| Total revenues | 871 | 720 | 1,573 | 1,382 |
| Property expense | 29 | 33 | 125 | 30 |
| Other general and administrative | (6) | 13 | (1) | 14 |
| Federal income tax expense (benefit) | (171) | 9 | (157) | 19 |
| Legal and professional | 18 | 12 | 44 | 16 |
| Depreciation and amortization | 35 | 43 | 67 | 78 |
| Minority interest | 198 | 34 | 229 | 75 |
| Impairment charge | 1,332 | - | 1,332 | - |
| Interest expense | 327 | 274 | 616 | 555 |
| Total expenses | 1,762 | 418 | 2,255 | 787 |
| Income (loss) from discontinued operations | (891) | 302 | (682) | 595 |
| Basic and diluted income from discontinued operations | | | | |

| | | | | | | | | |
|--------------------------|----|--------|----|------|----|--------|----|------|
| per class A common share | \$ | (0.15) | \$ | 0.05 | \$ | (0.11) | \$ | 0.09 |
|--------------------------|----|--------|----|------|----|--------|----|------|

Included in discontinued operations is the operating activity related to 29 of our properties that are held for sale. Our AAA CTL portfolio comprises of 17 of these properties. These 17 properties were treated as investments in direct financing leases for financial reporting purposes. See Note 3 for further discussion of AAA CTL.

STOCK ISSUANCE COSTS

Issuance costs incurred in the raising of capital through the sale of common shares are treated as a reduction of shareholders' equity.

CASH AND CASH EQUIVALENTS

For purposes of the consolidated statements of cash flows, we consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of demand deposits at commercial banks and money market funds.

RECLASSIFICATIONS

Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the presentation used in the current period consolidated financial statements. Such reclassifications had no effect on net income (loss) or shareholders' equity as previously reported.

~8~

Table of Contents

3. INVESTMENTS IN MERCHANT DEVELOPMENT FUNDS AND OTHER AFFILIATES

AAA CTL Notes, Ltd.

AAA CTL Notes I Corporation (“AAA Corp”), our wholly-owned subsidiary, invested as a general partner and limited partner in AAA CTL Notes, Ltd. (“AAA”). AAA is a majority-owned subsidiary through which we purchased 15 IHOP Corp. (“IHOP”) leasehold estate properties and two IHOP fee simple properties. We have consolidated AAA in our financial statements. Certain members of our management team have been assigned a 51% aggregate interest in the income and cash flow of AAA’s general partner. Net sales proceeds from the liquidation of AAA will be allocated to the limited partners and to the general partner pursuant to the limited partnership agreement of AAA.

During the third quarter of 2007, we decided to market the AAA assets for sale. Accordingly, they have been reflected as assets held for sale in the accompanying balance sheet and statement of operations.

Merchant Development Funds

As of June 30, 2008, we owned, through wholly-owned subsidiaries, interests in six limited partnerships which are accounted for under the equity method as we exercise significant influence over, but do not control, the investee. In each of the partnerships, the limited partners have the right, with or without cause, to remove and replace the general partner by a vote of the limited partners owning a majority of the outstanding units. These merchant development funds were formed to develop, own, manage and add value to properties with an average holding period of two to four years. Our interests in these merchant development funds range from 2.1% to 10.5%. See Note 8 regarding transactions we have entered into with our merchant development funds.

AmREIT Opportunity Fund (“AOF”) — AmREIT Opportunity Corporation (“AOC”), our wholly-owned subsidiary, invested \$250,000 as a limited partner and \$1,000 as a general partner in AOF. We currently own a 10.5% limited partner interest in AOF. Liquidation of AOF commenced in July 2002, and, as of June 30, 2008, AOF has an interest in one property. As the general partner, AOC receives a promoted interest in cash flow and any profits after certain preferred returns are achieved for its limited partners.

AmREIT Income & Growth Fund, Ltd. (“AIG”) — AmREIT Income & Growth Corporation (“AIGC”), our wholly-owned subsidiary, invested \$200,000 as a limited partner and \$1,000 as a general partner in AIG. We currently own an approximate 2.0% limited partner interest in AIG. Certain members of our management team have been assigned a 49% aggregate interest in the income and cash flow of AIGC. Pursuant to the AIG limited partnership agreement, net sales proceeds from its liquidation (expected in 2008) will be allocated to the limited partners, and to the general partner, AIGC, as, if and when the annual return thresholds have been achieved by the limited partners.

AmREIT Monthly Income & Growth Fund (“MIG”) — AmREIT Monthly Income & Growth Corporation, our wholly-owned subsidiary, invested \$200,000 as a limited partner and \$1,000 as a general partner in MIG. We currently own an approximate 1.3% limited partner interest in MIG.

AmREIT Monthly Income & Growth Fund II (“MIG II”) — AmREIT Monthly Income & Growth II Corporation, our wholly-owned subsidiary, invested \$400,000 as a limited partner and \$1,000 as a general partner in MIG II. We currently own an approximate 1.6% limited partner interest in MIG II.

AmREIT Monthly Income & Growth Fund III (“MIG III”) — AmREIT Monthly Income & Growth III Corporation (“MIGC III”), our wholly-owned subsidiary, invested \$800,000 as a limited partner and \$1,000 as a general partner in MIG III. MIG III began raising money in June 2005. The offering was closed in October 2006, and the capital raised was approximately \$71 million. Our \$800,000 investment represents a 1.1% limited partner interest in MIG III. Certain members of our management team have been assigned a 28.5% general partner’s share of aggregate interest

in the income and cash flow of MIGC III. Pursuant to the MIG III limited partnership agreement, net sales proceeds from its liquidation (expected in 2012) will be allocated to the limited partners, and to the general partner (MIGC III) as, if and when the annual return thresholds have been achieved by the limited partners.

AmREIT Monthly Income & Growth Fund IV (“MIG IV”) — AmREIT Monthly Income & Growth IV Corporation (“MIGC IV”), our wholly-owned subsidiary, invested \$800,000 as a limited partner and \$1,000 as a general partner in MIG IV. MIG IV began raising money in November 2006. The offering was closed March 2008, and the capital raised was approximately \$50 million. Our \$800,000 investment represents a 1.6% limited partner interest in MIG IV. Certain members of our management team have been assigned a 28.5% general partner’s share of aggregate interest in the income and cash flow of MIGC IV. Pursuant to the MIG IV limited partnership agreement, net sales proceeds from its liquidation (expected in 2013) will be allocated to the limited partners, and to the general partner (MIGC IV) as, if and when the annual return thresholds have been achieved by the limited partners.

REITPlus, Inc. (“REITPlus”) — In November 2007, a registration statement relating to REITPlus, Inc., a \$550 million non-traded REIT offering that is advised by one of our wholly-owned subsidiaries, was declared effective by the SEC, allowing REITPlus to begin offering its common stock through our securities operation’s broker-dealer network. REITPlus conducts substantially all of its operations through REITPlus Operating Partnership, LP (“REITPlus OP”) which will own substantially all of the properties acquired on REITPlus’s behalf. On May 16, 2007, we purchased 100 shares of common stock of REITPlus for total cash consideration of \$1,000 and were admitted as the initial shareholder. Additionally, on May 16, 2007, we made an initial limited partner contribution of \$1 million to REITPlus OP. We expect our limited partnership interest at completion of the offering to be less than 1%.

Our wholly-owned subsidiary serves as the advisor to REITPlus and will therefore earn recurring fees such as asset management and property management fees, and transactional fees such as acquisition fees, development fees, financing coordination fees, and real estate sales commissions. We will also participate in a 15% promoted interest, payable upon REITPlus’ liquidation, listing of its shares on a national securities exchange, or the termination or non-renewal of the advisory agreement with our subsidiary (other than for cause) after the REITPlus stockholders receive or are deemed to have received, their invested capital plus a 7% preferred return. In our capacity as the parent company of the advisor to REITPlus, we have paid organization and offering costs of \$1.6 million on its behalf. We have recorded these costs as a receivable in the accompanying financial statements. Such costs will be reimbursed to us subject to limitations on reimbursements set forth in the advisory agreement.

Table of Contents

Merchant Development Funds - Financial Information

The following table sets forth certain financial information as of June 30, 2008 for the AIG, MIG, MIG II, MIG III and MIG IV merchant development funds (AOF is not included as it is currently in liquidation) and REITPlus:

| Merchant Development Fund | Capital under Mgmt. | LP Interest | GP Interest | Scheduled Liquidation | Sharing Ratios(1) | | | | | | | |
|---------------------------|---------------------|--------------|-------------|-----------------------|-------------------|---------------|---------------|------|------|-----|------|--------------|
| | | | | | LP | GP | LP Preference | | | | | |
| AIG | \$3 million | 2.0% | 1.0% | 2008 | 99% | 1% | 8% | | | | | |
| | | | | | 90% | 10% | 10% | | | | | |
| | | | | | 80% | 20% | 12% | | | | | |
| | | | | | 70% | 30% | 15% | | | | | |
| | | | | | 0% | 100% | 40% Catch Up | | | | | |
| | | | | | 60% | 40% | Thereafter | | | | | |
| MIG | \$15 million | 1.3% | 1.0% | 2010 | 99% | 1% | 8% | | | | | |
| | | | | | 90% | 10% | 10% | | | | | |
| | | | | | 80% | 20% | 12% | | | | | |
| | | | | | 0% | 100% | 40% Catch Up | | | | | |
| | | | | | 60% | 40% | Thereafter | | | | | |
| MIG II | \$25 million | 1.6% | 1.0% | 2011 | 99% | 1% | 8% | | | | | |
| | | | | | 85% | 15% | 12% | | | | | |
| | | | | | 0% | 100% | 40% Catch Up | | | | | |
| | | | | | 60% | 40% | Thereafter | | | | | |
| | | | | | MIG III | \$71 million | 1.1% | 1.0% | 2012 | 99% | 1% | 10% |
| 0% | 100% | 40% Catch Up | | | | | | | | | | |
| 60% | 40% | Thereafter | | | | | | | | | | |
| MIG IV | \$50 million | 1.6% | 1.0% | 2013 | | | | | | 99% | 1% | 8.5% |
| | | | | | | | | | | 0% | 100% | 40% Catch Up |
| | | | | | 60% | 40% | Thereafter | | | | | |
| | | | | | REITPlus (2) | \$3.8 million | NA | NA | 2014 | 99% | 1% | (Note 3) |
| | | | | | | | | | | 85% | 15% | |

(1) Illustrating the Sharing Ratios and LP Preference provisions using AIG as an example, the LPs share in 99% of the cash distributions until they receive an 8% preferred return. The LPs share in 90% of the cash distributions until they receive a 10% preferred return and so on.

(2) REITPlus commenced receiving capital in the second quarter of 2008.

(3) We will be entitled to distributions from REITPlus with respect to our \$1 million investment to the same extent as stockholders who purchase shares in the public offering. For a description of our subsidiary's promoted interest in REITPlus, please see the second paragraph under "REITPlus, Inc." above in the Section 3.

Other Affiliates

Other than the merchant development funds, we have an investment in three entities that are accounted for under the equity method since we exercise significant influence over such entities.

AmREIT Woodlake, L.P. - In 2007, we invested \$3.4 million in AmREIT Woodlake, LP, ("Woodlake") for a 30% limited partner interest in the partnership. Woodlake was formed in 2007 to acquire, lease and manage Woodlake Square, a shopping center located on the west side of Houston, Texas at the intersection of Westheimer and Gessner. In June 2008, we sold two-thirds (20%) of our interest in Woodlake to MIG IV. Pursuant to the purchase agreement, the property was sold at its carrying value, resulting in no gain or loss to us. At June 30, 2008, we hold a remaining 10% interest in Woodlake Square which will be purchased at its carrying value by REITPlus once REITPlus has the capital required to make such acquisition.

AmREIT Westheimer Gessner, L.P. - In 2007, we invested \$3.8 million in AmREIT Westheimer Gessner, LP, for a 30% limited partner interest in the partnership. AmREIT Westheimer Gessner, LP was formed in 2007 to acquire, lease and manage Borders Shopping Center, a shopping center located on the west side of Houston, Texas at the intersection of Westheimer and Gessner. In June 2008, we sold two-thirds (20%) of our interest in Borders Shopping Center to MIG IV. Pursuant to the purchase agreement, the property was sold at its carrying value, resulting in no gain or loss to us. At June 30, 2008, we hold a 10% interest in Borders Shopping Center which will be purchased at its carrying value by REITPlus once REITPlus has the capital required to make such acquisition.

AmREIT SPF Shadow Creek, L.P. - In the first quarter of 2008, we invested \$5.1 million in AmREIT SPF Shadow Creek, LP, for a 10% limited partner interest in the partnership. AmREIT SPF Shadow Creek, LP was formed in 2008 to acquire, lease and manage Shadow Creek Ranch, a shopping center located in Pearland, Texas at the intersection of Highway 288 and FM 518. During the second quarter of 2008, we sold 76% (7.6%) of our interest in Shadow Creek Ranch to REITPlus. Pursuant to the purchase agreement, the property was sold at its carrying value, resulting in no gain or loss. At June 30, 2008, we hold a 2.4% interest in Shadow Creek which will be purchased at its carrying value by REITPlus once REITPlus has the capital required to make such acquisition.

~10~

Table of Contents

4. ACQUIRED LEASE INTANGIBLES

In accordance with SFAS No. 141, we have identified and recorded the value of intangibles at the property acquisition date. Such intangibles include the value of in-place leases and out-of-market leases. These assets are amortized over the leases' remaining terms. The amortization of above-market leases is recorded as a reduction of rental income and the amortization of in-place leases is recorded to amortization expense. The amortization expense related to in-place leases was \$1.6 million and \$1.3 million during the six months ended June 30, 2008 and June 30, 2007, respectively. The amortization of above-market leases, which was recorded as a reduction of rental income, was \$175,000 and \$203,000 during the six months ended June 30, 2008 and June 30, 2007, respectively.

In-place and above-market lease amounts and their respective accumulated amortization at June 30, 2008 and December 31, 2007 are as follows (in thousands):

| | June 30, 2008 | | December 31, 2007 | |
|----------------------------|-----------------|---------------------|-------------------|---------------------|
| | In-Place leases | Above-market leases | In-Place leases | Above-market leases |
| Cost | \$ 18,210 | \$ 2,025 | \$ 19,052 | \$ 2,025 |
| Accumulated amortization | (7,763) | (1,246) | (6,910) | (1,071) |
| Intangible lease cost, net | \$ 10,447 | \$ 779 | \$ 12,142 | \$ 954 |

Acquired lease intangible liabilities (below-market leases) of \$2.4 million and \$3.4 as of June 30, 2008 and December 31, 2007, respectively, are net of previously accreted minimum rent of \$1.7 million and \$1.6 million at June 30, 2008 and December 31, 2007, respectively. Below-market leases are accreted over the leases' remaining terms. The accretion of below-market leases, which was recorded as an increase to rental income, was \$1.0 million and \$244,000 during the six months ended June 30, 2008 and June 30, 2007, respectively.

5. NOTES PAYABLE

Our outstanding debt at June 30, 2008 and December 31, 2007 consists of the following (in thousands):

| | June 30, 2008 | December 31, 2007 |
|--|------------------|----------------------|
| Notes Payable, Held for Investment | | |
| Fixed rate mortgage loans | \$ 137,580 | \$ 138,121 |
| Variable-rate unsecured line of credit | 37,976 | 30,439 |
| Total | \$ 175,556 | \$ 168,560 |
| Notes Payable, Held for Sale | | |
| Fixed rate mortgage loans | \$ 12,570 | \$ 12,811 |
| Total | \$ 12,570 | \$ 12,811 |

We have an unsecured credit facility in place which is being used to provide funds for the acquisition of properties and working capital. The credit facility matures in October 2009 and provides that we may borrow up to \$70 million subject to the value of unencumbered assets. Effective October 2007, we renewed our credit facility on terms and conditions substantially the same as the previous facility. The credit facility contains covenants which, among other restrictions, require us to maintain a minimum net worth, a maximum leverage ratio, maximum tenant concentration ratios, specified interest coverage and fixed charge coverage ratios and allow the lender to approve all distributions. For the quarter ended June 30, 2008, we violated two covenants per the terms of the credit facility. Our lender has waived both events of non-compliance as of June 30, 2008. Given the nature of these covenants, we expect we will be out of compliance for the remainder of the year, and that our lender will grant us waivers for those events of non-compliance although no assurance can be given that these waivers will be granted. We were in compliance with all other covenants as of June 30, 2008. The credit facility's annual interest rate varies depending upon our debt to asset ratio, from LIBOR plus a spread of 1.0% to LIBOR plus a spread of 1.85%. As of June 30, 2008, the interest rate was LIBOR plus 1.00%. As of June 30, 2008, there was a balance outstanding of \$38.0 million under our credit facility. We have approximately \$30 million available under our credit facility, subject to the covenants above. We have \$1.0 million in letters of credit outstanding related to various properties. These letters of credit reduce our availability under our credit facility.

As of June 30, 2008, the weighted average interest rate on our fixed-rate debt was 5.78%, and the weighted average remaining life of such debt was 6.24 years. We added no fixed-rate debt during the six months ended June 30, 2008. We added fixed-rate debt of \$19.9 million during 2007.

As of June 30, 2008, scheduled principal repayments on notes payable and the credit facility were as follows (in thousands):

| Scheduled Payments by Year | Associated with Assets Held for Investment | | | Associated with Assets Held for Sale | | |
|----------------------------------|---|-------------------------|-------------------|---|-------------------------|-------------------|
| | Scheduled Principal Payments | Term-Loan Maturities | Total Payments | Scheduled Principal Payments | Term-Loan Maturities | Total Payments |
| 2008 | \$ 437 | 13,410 | 13,847 | \$ 238 | - | 238 |
| 2009 | 38,894 | - | 38,894 | 530 | - | 530 |
| 2010 | 982 | - | 982 | 573 | - | 573 |
| 2011 | 987 | 3,075 | 4,062 | 620 | - | 620 |
| 2012 | 979 | 25,353 | 26,332 | 328 | 10,281 | 10,609 |
| Thereafter | 2,019 | 88,900 | 90,919 | - | - | - |
| Unamortized debt premiums | - | 520 | 520 | - | - | - |
| Total | \$ 44,298 | \$ 131,258 | \$ 175,556 | \$ 2,289 | \$ 10,281 | \$ 12,570 |

Table of Contents

6. CONCENTRATIONS

As of June 30, 2008, one property individually accounted for more than 10% of our consolidated total assets – Uptown Park in Houston, Texas, which accounted for 15% of total assets. Consistent with our strategy of investing in areas that we know well, 17 of our properties are located in the Houston metropolitan area. These Houston properties represent 66% of our base rental income for the six months ended June 30, 2008. Houston is Texas’ largest city and the fourth largest city in the United States.

Following are the base rents generated by our top tenants for the periods ended June 30 2008 and 2007 (\$ in thousands):

| Tenant | Three months ended | | Six months ended | |
|-------------------|--------------------|----------|------------------|----------|
| | June 30, | | June 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| IHOP Corporation* | \$ 618 | \$ 562 | \$ 1,117 | \$ 1,124 |
| Kroger | 529 | 529 | 1,058 | 1,058 |
| Grotto | 289 | 148 | 465 | 336 |
| CVS | 231 | 218 | 461 | 437 |
| Hard Rock Cafe | 111 | 110 | 221 | 219 |
| TGI Fridays | 109 | 105 | 217 | 201 |
| Champps Americana | 106 | 102 | 211 | 205 |
| Golden Corral | 105 | 91 | 203 | 182 |
| Linens 'N Things | 101 | 101 | 201 | 201 |
| Paesanos | 89 | 89 | 178 | 180 |
| | \$ 2,288 | \$ 2,055 | \$ 4,332 | \$ 4,143 |

* A significant portion of IHOP Corporation revenues are related to our AAA assets which are qualified as held for sale as described in Note 3. The activity related to these assets held for sale is reflected as “Earned Income from DFL” in the Discontinued Operations section of Note 1.

7. SHAREHOLDERS’ EQUITY AND MINORITY INTEREST

Class A Common Shares — Our class A common shares are listed on the American Stock Exchange (“AMEX”) and traded under the symbol “AMY.” As of June 30, 2008, there were 5,405,236 of our class A common shares outstanding, net of 1,229,253 shares held in treasury. Our payment of any future dividends to our class A common shareholders is dependent upon applicable legal and contractual restrictions, including the provisions of the class C common shares, as well as our earnings and financial needs.

Class B Common Shares — As of June 30, 2008 none of the class B common shares were outstanding. In December 2007, we completed a tender offer for approximately 48% of our class B common shares in which we repurchased

Edgar Filing: AMREIT - Form 10-Q

998,000 shares at \$9.25 per share for a total purchase price of \$9.2 million. We redeemed the remaining 1 million outstanding shares during December 2007 at \$10.18 per share for \$10.4 million in cash.

Class C Common Shares — The class C common shares are not listed on an exchange and there is currently no available trading market for the class C common shares. As of June 30, 2008, there were 4,149,094 of our class C common shares outstanding. The class C common shares have voting rights, together with all classes of common shares, as one class of shares. The class C common shares were issued at \$10.00 per share. The class C common shares receive a fixed 7.0% preferred annual dividend, paid in monthly installments, and are convertible into the class A common shares after a 7-year lock out period based on 110% of invested capital, at the holder's option. The class C common shares are convertible beginning in August 2010. We have the right to force conversion of the class C common shares into class A shares on a one-for-one basis or to redeem the shares at a cash redemption price of \$11.00 per share at the holder's option. Currently, there is a class C dividend reinvestment program that allows investors to reinvest their dividends into additional class C common shares. These reinvested shares are also convertible into the class A common shares after the 7-year lock out period and receive the 10% conversion premium upon conversion.

Class D Common Shares — The class D common shares are not listed on an exchange and there is currently no available trading market for the class D common shares. As of June 30, 2008, there were 11,036,170 of our class D common shares outstanding. The class D common shares have voting rights, together with all classes of common shares, as one class of shares. The class D common shares were issued at \$10.00 per share. The class D common shares receive a fixed 6.5% annual dividend, paid in monthly installments, subject to payment of dividends then payable to class B and class C common shares. The class D common shares are convertible into the class A common shares at a 7.7% premium on original capital after a 7-year lock out period, at the holder's option. The class D common shares are convertible beginning in June 2011. We have the right to force conversion of the class D common shares into class A shares at the 7.7% conversion premium or to redeem the shares at a cash price of \$10.00. In either case, the conversion premium will be pro rated based on the number of years the shares are outstanding. Currently, there is a class D dividend reinvestment program that allows investors to reinvest their dividends into additional class D common shares. These reinvested shares are also convertible into the class A common shares after the 7-year lock out period and receive the 7.7% conversion premium upon conversion.

Minority Interest — Minority interest represents a third party interest in entities that we consolidate as a result of our controlling financial interest in such investees. The minority interest is attributable to a third party interest in AAA (which is held for sale as of June 30, 2008 as discussed in Note 3.)

Share Repurchase Program

In June 2007, our Board of Trust Managers authorized a \$5.0 million common share repurchase program as part of our ongoing investment strategy, allowing us to purchase our common shares of beneficial interest. In May of 2008, the Board of Trust Managers extended our common share repurchase program by an additional \$5.0 million for a maximum buyback amount of \$10 million. Share repurchases may be made in the open market or in privately negotiated transactions at the discretion of management and as market conditions warrant. We anticipate funding the repurchase of shares primarily through the proceeds received from general corporate funds as well as through the use of our credit facility.

Repurchases of our common shares of beneficial interest for the six months ended June 30, 2008 are as follows:

| Period | (a) Total Number of Shares | (b) Average Price Paid | (c) Total Number of Shares Purchased As Part of | (d) Maximum Dollar Value of Shares that May Yet be |
|--------|----------------------------------|------------------------------|---|--|
| | | | | |

Edgar Filing: AMREIT - Form 10-Q

| | Purchased | per Share | Publicly Announced Program | Purchased Under the Program |
|--------------------------------------|-----------|-----------|----------------------------------|-----------------------------------|
| January 1, 2008 to March 31, 2008 | 156,490 | \$ 6.99 | 156,490 | \$ 2,618,707 |
| April 1, 2008 to June 30, 2008 | 695,800 | \$ 7.28 | 695,800 | \$ 2,560,990 |

~12~

Table of Contents

8. RELATED PARTY TRANSACTIONS

See Note 3 regarding investments in merchant development funds and other affiliates and Note 2 regarding related party notes receivable.

We earn real estate fee income by providing property acquisition, leasing, asset management, property management, financing, coordination, real estate disposition, construction and construction management services to our merchant development funds and other affiliates. The companies that serve as the general partner for the funds are wholly-owned by us. Real estate fee income of \$2.7 million and \$1.1 million was paid by our merchant development funds and other affiliates to us for the six months ended June 30, 2008 and 2007, respectively. Additionally, construction revenues of \$2.6 million and \$1.1 million were earned from the merchant development funds during the six months ended June 30, 2008 and 2007, respectively. We earn asset management fees from the funds for facilitating the deployment of capital and for performing other management oversight services. Asset management fees of \$753,000 and \$596,000 were paid by the funds to us for the six months ended June 30, 2008 and 2007, respectively. Additionally, during the six months ended June 30, 2008 and 2007 we were reimbursed by the merchant development funds \$422,000 and \$294,000, respectively, for reimbursements of administrative costs and for organization and offering costs incurred on behalf of those funds.

As a sponsor of real estate investment opportunities to the Financial Industry Regulatory Authority (“FINRA”) financial planning broker-dealer community, we maintain an indirect 1% general partner interest in the investment funds that we sponsor. The limited partnership funds are typically structured such that the limited partners receive 99% of the available cash flow until 100% of their original invested capital has been returned and a preferred return has been met. Once this has happened, then the general partner begins sharing in the available cash flow at various promoted levels. We also may assign a portion of this general partner interest in these investment funds to our employees as long term, contingent compensation. We believe that this assignment will align the interest of management with that of the shareholders, while at the same time allowing for a competitive compensation structure in order to attract and retain key management positions without increasing the overhead burden.

9. REAL ESTATE ACQUISITIONS AND DISPOSITIONS

During the six months ended June 30, 2008, we acquired a 1.4-acre parcel of land in San Antonio, Texas that is currently under development for a national drugstore tenant with whom we have an executed long-term lease.

In May 2007, we acquired a 2-acre parcel of land in Champaign, Illinois that was acquired for resale and is currently under development for a national tenant that is in the rental equipment business. In February 2007, we acquired The Woodlands Mall Ring Road property, which represents 66,000 square feet of gross leaseable area in Houston, Texas. The property is ground-leased to five tenants, including Bank of America, Circuit City and Landry’s Seafood. Additionally, during 2007, we sold one property acquired for resale for \$1.4 million which approximated our cost.

10. COMMITMENTS

In March 2004, we signed a new lease agreement for our office facilities which expires August 31, 2009. In addition, we lease various office equipment for daily activities. Rental expense for the six months ended June 30, 2008 and 2007 was \$198,000 and \$133,000, respectively.

Additionally, we have committed \$713,000 of nonrefundable earnest money on a contract for the acquisition of receivables that would be funded by a tax municipality from its issuance of public bonds.

11. SUBSEQUENT EVENTS

On July 10, 2008 we sold one of our non-core single tenant assets that is classified as held for sale as of June 30, 2008. The sales price was equal to the property's carrying value on the date of sale.

12. OPERATING SEGMENTS

The operating segments presented are the segments of AmREIT for which separate financial information is available, and revenue and operating performance is evaluated regularly by senior management in deciding how to allocate resources and in assessing performance.

The portfolio segment consists of our portfolio of single and multi-tenant shopping center projects. This segment consists of 51 properties located in 15 states. Expenses for this segment include depreciation, interest, minority interest, legal cost directly related to the portfolio of properties and property level expenses. Our consolidated assets are substantially all in this segment. Additionally, substantially all of the increase in total assets during the three months ended June 30, 2008 occurred within the portfolio segment.

Our real estate development and operating business is a fully integrated and wholly-owned business consisting of brokers and real estate professionals that provide development, acquisition, brokerage, leasing, construction, and asset and property management services to our publicly traded portfolio and merchant development funds as well as to third parties. Our securities operations consist of FINRA registered securities broker-dealer business that, through the internal securities group, raises capital from the independent financial planning marketplace. The merchant development funds sell limited partnership interests and non-listed REIT securities to retail investors, in which we invest as both the general partner and as a limited partner; in the case of the limited partnerships, and as a stockholder in the REIT or a limited partner in the REIT's operating partnership (see Note 3). These merchant development funds were formed to develop, own, manage, and add value to properties with an average holding period of two to four years with respect to the limited partnerships, and an extended term consistent with REIT status for REITPlus.

~13~

Table of Contents

| For the three months ended June 30, 2008 (in thousands) | Asset Advisory | | | | Total |
|--|----------------|---------------------------|-----------------|----------------------------------|-----------------|
| | Portfolio | Real Estate Operations | Securities | Merchant Development Funds | |
| Rental income | \$ 8,202 | \$ - | \$ - | \$ - | \$ 8,202 |
| Real estate fee income | | 1,395 | 31 | - | 1,426 |
| Construction revenues | - | 2,348 | - | - | 2,348 |
| Securities commission income | - | - | 424 | - | 424 |
| Asset management fee income | - | - | - | 377 | 377 |
| Total revenue | 8,202 | 3,743 | 455 | 377 | 12,777 |
| General and administrative | 453 | 1,387 | 420 | 28 | 2,288 |
| Property expense | 2,464 | (8) | | - | 2,456 |
| Construction costs | - | 2,221 | - | - | 2,221 |
| Legal and professional | 342 | 50 | 40 | | 432 |
| Real estate commissions | - | 5 | - | - | 5 |
| Securities commissions | - | 21 | 334 | - | 355 |
| Depreciation and amortization | 2,606 | - | - | - | 2,606 |
| Total expenses | 5,865 | 3,676 | 794 | 28 | 10,363 |
| Interest expense | (2,144) | 54 | (95) | (186) | (2,371) |
| Other income/ (expense) | 13 | 82 | 183 | (95) | 183 |
| Income (loss) from discontinued operations | 135 | (1,026) | - | - | (891) |
| Net income (loss) | \$ 341 | \$ (823) | \$ (251) | \$ 68 | \$ (665) |

Table of Contents

| For the three months ended June 30, 2007 (in thousands) | Portfolio | Real Estate Operations | Securities | Asset Advisory Merchant Development Funds | Total |
|--|-----------------|---------------------------|-----------------|--|-----------------|
| Rental income | \$ 7,565 | \$ - | \$ - | \$ - | \$ 7,565 |
| Real estate fee income | - | 509 | - | - | 509 |
| Construction revenues | - | 914 | - | - | 914 |
| Securities commission income | - | - | 1,484 | - | 1,484 |
| Asset management fee income | - | - | - | 312 | 312 |
| Total revenue | 7,565 | 1,423 | 1,484 | 312 | 10,784 |
| General and administrative | 197 | 1,235 | 361 | 25 | 1,818 |
| Property expense | 1,970 | 36 | - | - | 2,006 |
| Construction costs | - | 868 | - | - | 868 |
| Legal and professional | 337 | 83 | 50 | - | 470 |
| Real estate commissions | - | 26 | - | - | 26 |
| Securities commissions | - | - | 1,245 | - | 1,245 |
| Depreciation and amortization | 1,925 | - | - | - | 1,925 |
| Total expenses | 4,429 | 2,248 | 1,656 | 25 | 8,358 |
| Interest expense | (1,939) | (139) | (8) | - | (2,086) |
| Other income/ (expense) | 20 | 463 | (21) | (3) | 459 |
| Income (loss) from discontinued operations | 291 | 11 | - | - | 302 |
| Net income (loss) | \$ 1,508 | \$ (490) | \$ (201) | \$ 284 | \$ 1,101 |

~15~

Table of Contents

| For the six months ended June 30, 2008 (in thousands) | Asset Advisory | | | | Total |
|--|-----------------|---------------------------|-----------------|----------------------------------|---------------|
| | Portfolio | Real Estate Operations | Securities | Merchant Development Funds | |
| Rental income | \$ 15,748 | \$ - | \$ - | \$ - | \$ 15,748 |
| Real estate fee income | | 2,928 | 100 | - | 3,028 |
| Construction revenues | - | 3,684 | - | - | 3,684 |
| Securities commission income | - | - | 949 | - | 949 |
| Asset management fee income | - | - | - | 753 | 753 |
| Total revenue | 15,748 | 6,612 | 1,049 | 753 | 24,162 |
| General and administrative | 761 | 2,952 | 926 | 67 | 4,706 |
| Property expense | 4,414 | 11 | - | - | 4,425 |
| Construction costs | - | 3,342 | - | - | 3,342 |
| Legal and professional | 662 | 86 | 128 | - | 876 |
| Real estate commissions | - | 42 | - | - | 42 |
| Securities commissions | - | 23 | 817 | - | 840 |
| Depreciation and amortization | 4,505 | - | - | - | 4,505 |
| Total expenses | 10,342 | 6,456 | 1,871 | 67 | 18,736 |
| Interest expense | (4,297) | 27 | (240) | (292) | (4,802) |
| Other income/ (expense) | 233 | 26 | 354 | (223) | 390 |
| Income (loss) from discontinued operations | 325 | (1,007) | - | - | (682) |
| Net income (loss) | \$ 1,667 | \$ (798) | \$ (708) | \$ 171 | \$ 332 |

Table of Contents

| For the six months ended June 30, 2007 (in thousands) | Asset Advisory | | | | Total |
|--|-----------------|---------------------------|-----------------|----------------------------------|-----------------|
| | Portfolio | Real Estate Operations | Securities | Merchant Development Funds | |
| Rental income | \$ 14,516 | \$ - | \$ - | \$ - | \$ 14,516 |
| Real estate fee income | - | 1,916 | - | - | 1,916 |
| Construction revenues | - | 1,887 | - | - | 1,887 |
| Securities commission income | - | - | 2,477 | - | 2,477 |
| Asset management fee income | - | - | - | 596 | 596 |
| Total revenue | 14,516 | 3,803 | 2,477 | 596 | 21,392 |
| General and administrative | 590 | 2,449 | 850 | 87 | 3,976 |
| Property expense | 3,658 | 73 | - | - | 3,731 |
| Construction costs | - | 1,729 | - | - | 1,729 |
| Legal and professional | 571 | 130 | 62 | - | 763 |
| Real estate commissions | - | 447 | - | - | 447 |
| Securities commissions | - | - | 2,074 | - | 2,074 |
| Depreciation and amortization | 3,834 | - | - | - | 3,834 |
| Total expenses | 8,653 | 4,828 | 2,986 | 87 | 16,554 |
| Interest expense | (3,901) | (264) | (11) | - | (4,176) |
| Other income/ (expense) | 271 | 585 | 96 | (105) | 847 |
| Income (loss) from discontinued operations | 583 | 12 | - | - | 595 |
| Net income (loss) | \$ 2,816 | \$ (692) | \$ (424) | \$ 404 | \$ 2,104 |

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The use of the words “we,” “us” or “our” refers to AmREIT and our subsidiaries, except where the context otherwise requires.

FORWARD-LOOKING STATEMENTS

Certain information presented in this Form 10-Q constitutes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Although we believe that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, our actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference include the following: changes in general economic conditions, changes in real estate market conditions, continued availability of proceeds from our debt or equity capital, our ability to locate suitable tenants for our properties, the ability of tenants to make payments under their respective leases, timing of acquisitions, development starts and sales of properties and the ability to meet development schedules. Any forward-looking statement speaks only as of the date on which it was made, and the Company undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operation results over time.

The following discussion should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this report, as well as our 2007 consolidated financial statements and notes thereto included in our filing on Form 10-K for the year ended December 31, 2007. Historical results and trends which might appear should not be taken as indicative of future operations.

EXECUTIVE OVERVIEW

We are an established real estate company that has elected to be taxed as a real estate investment trust (“REIT”) for federal income tax purposes. Our business model is similar to an institutional advisory company that is judged by its investor partners on the returns we are able to deliver to reach specified long-term results. Our primary objective is to build long-term shareholder value and continue to build and enhance the net asset value (“NAV”) of us and our advised funds.

We seek to create value and drive net operating income (“NOI”) growth on the properties owned in our institutional-grade portfolio of Irreplaceable Corners™ and those owned by a series of closed-end, merchant development funds. We also seek to support a growing advisory business that raises capital through an extensive independent broker-dealer channel as well as through institutional joint venture partners.

The institutional-grade portfolio of Irreplaceable Corners – premier retail properties in high-traffic, highly-populated areas – are held for long-term value and to provide a foundation to our funds from operations (“FFO”) through a steady stream of rental income. Our advisory business has a 24-year track record of delivering returns to its investor partners through a series of closed-end, merchant development funds, resulting in recurring income from assets under management and in transactional income through profit participation interests and real estate fees, including acquisition, development and leasing fees.

The recurring-income nature of the institutional-grade portfolio of Irreplaceable Corners and the advisory business can be complemented by the added growth potential of our real estate development and operating business. This model seeks to provide value through offering an array of services to our tenants and to the properties owned in both the

institutional-grade portfolio of Irreplaceable Corners and those owned by the closed-end, merchant development funds as well as to third parties.

When we listed on the AMEX in July 2002, our total assets had a book value of \$48 million and equity under management within our advisory business totaled \$15 million. As of June 30, 2008:

- We owned a real estate portfolio consisting of 51 properties located in 15 states that had a net book value of \$336 million;
- We directly managed, through our five actively managed merchant development funds, a total of \$168 million in contributed capital; and
- We had over 1.4 million square feet of retail centers in various stages of development, re-development or in the pipeline for both our advisory business and for third parties.

Portfolio of Irreplaceable Corners

Our portfolio consists primarily of premier retail properties typically located on “Main and Main” intersections in high-traffic, highly populated affluent areas. Because of their location and exposure as central gathering places, we believe these centers attract well established tenants and can withstand the test of time, providing our shareholders a steady rental income stream.

As of June 30, 2008, we owned a real estate portfolio consisting of 51 properties located in 15 states. A majority of our properties are located in densely populated, suburban communities in and around Houston, Dallas and San Antonio. Within these broad markets, we target locations that we believe have the best demographics and highest long term value. We refer to these properties as Irreplaceable Corners. Our criteria for an Irreplaceable Corner includes: high barriers to entry (typically infill locations in established communities without significant raw land available for development), significant population within a three mile radius (typically in excess of 100,000 people), a location on the hard corner of an intersection guided by a traffic signal, ideal average household income in the surrounding community in excess of \$80,000 per year, strong visibility and significant traffic counts passing by the location (typically in excess of 30,000 cars per day). We believe that centers with these characteristics will provide for consistent leasing demand and rents that increase at or above the rate of inflation. Additionally, these areas have barriers to entry for competitors seeking to develop new properties due to the lack of available land. We take a very hands-on approach to ownership, and directly manage the operations and leasing at all of our wholly owned properties.

We expect that single-tenant, credit leased properties will continue to experience cap rate pressure during 2008 due to the low interest rate environment and increased buyer demand. Therefore, we will continue to divest of properties which no longer meet our core criteria, and, to the extent that we can do so accretively, replace them with high quality grocery-anchored, lifestyle, and multi-tenant shopping centers or the development of single-tenant properties located on Irreplaceable Corners. Each potential acquisition is subjected to a rigorous due diligence process that includes site inspections, financial underwriting, credit analysis and market and demographic studies. Therefore, there can be no assurance that we will ultimately purchase any or all of these projects. Our acquisitions program is sensitive to changes in interest rates. As of June 30, 2008, 78% of our outstanding debt had a long-term fixed interest rate with an average term of 6.2 years. Our philosophy continues to be matching long-term leases with long-term debt structures while keeping our debt to total assets ratio less than 55%.

Advisory Business

The primary goal of our advisory business is to grow assets under management, primarily through the Independent Broker-dealer Network (“IBD”) and through institutional joint venture relationships. Through these assets under management, we are able to generate current recurring fee income, long term profit participation, and transactional revenues for real estate services provided such as acquisition, development and leasing. We break this business down into two components, our securities operations and our merchant development funds. In an effort to vertically integrate our business model and better control the inflows of capital into our advisory business, we have a wholly-

owned Financial Industry Regulatory Agency (FINRA) registered broker-dealer, AmREIT Securities Company (“ASC”). For the past 24 years, we have been raising capital for our merchant development funds and building relationships in the financial planning and broker-dealer community, earning fees and sharing in profits from those activities. Historically, our advisory group has raised capital in two ways: first, directly for us through non-traded classes of common shares, and second, for our actively managed merchant development funds.

The advisory business invests in and actively manages seven merchant development partnership funds, which were formed to develop, own, manage, and add value to properties with an average holding period of two to four years, and REITPlus, Inc., a non-listed REIT that will acquire properties to be held for an extended period consistent with its intention to qualify as a REIT. We invest in the limited partnerships we manage as both the general partner and as a limited partner, and in REITPlus we have invested as a limited partner in its operating partnership. Our advisory business sells interests in these funds to retail investors. We, as the general partner or advisor, manage the funds and, in return, receive management fees as well as potentially significant profit participation interests. However, we strive to create a structure that aligns the interests of our shareholders with those of the investors in our managed funds. In this spirit, the funds are structured so that the general partner does not receive a significant profit until after the limited partners in the funds have received or are deemed to have received their targeted return, which links our success to that of the investors in our managed funds.

Real Estate Development and Operating Group

Our real estate development and operating business, “ARIC”, is a fully integrated and wholly-owned business consisting of brokers and real estate professionals that provide development, acquisitions, brokerage, leasing, construction, general contracting, asset and property management services to our portfolio of properties, to our advisory business, and to third parties. This operating subsidiary, which is a taxable REIT subsidiary, is transaction-oriented, is very active in the real estate market and has the potential to generate significant earnings on an annual basis. This business can provide significant long-term growth; however due to its transactional nature, its quarter to quarter results will fluctuate, and therefore its contributions to our earnings will be volatile.

Table of Contents

Liquidity and Capital Resources

At June 30, 2008 and December 31, 2007, our cash and cash equivalents totaled \$205,000 and \$1.2 million, respectively. Cash flows provided by (used in) operating activities, investing activities and financing activities for the six months ended June 30, are as follows (in thousands):

| | 2008 | 2007 |
|----------------------|------------|------------|
| Operating activities | \$ 2,706 | \$ 3,677 |
| Investing activities | \$ 2,286 | \$ (8,749) |
| Financing activities | \$ (6,008) | \$ 6,013 |

Cash flows from operating activities and financing activities have been the principal sources of capital to fund our ongoing operations and dividends. Our cash on hand, internally-generated cash flow, borrowings under our existing credit facilities, issuance of equity securities, as well as the placement of secured debt and other equity alternatives, are expected to provide the necessary capital to maintain and operate our properties as well as execute our growth strategies.

Additionally, as part of our investment strategy, we constantly evaluate our property portfolio, systematically selling off any non-core or underperforming assets and replacing them with Irreplaceable Corners and other core assets. We anticipate that we will continue to increase our operating cash flow by selling any underperforming assets and deploying the capital generated into high-quality income-producing retail real estate assets.

Cash provided by operating activities as reported in the consolidated statements of cash flows decreased by approximately \$971,000 for the six months ended June 30, 2008 period when compared to the comparable prior year period. During the 2008 period, we had a \$4.1 million reduction in cash flows from our activities related to real estate that we acquire for resale. During the 2008 period, we purchased one property for \$2.7 million versus the 2007 period wherein we generated \$1.4 million in proceeds from the sale of one property. This reduction in cash flows was partially offset by a \$3.2 million increase in working capital cash flows. This increase in working capital cash flow was driven primarily by a \$1.2 million reduction in cash outflows during the six months ended June 30, 2008 period compared to the comparable prior year period related to the timing of our property tax payments. Additionally, we had a \$1.6 million increase in working capital cash flow related to improved collections on our related party receivables during the 2008 period.

Cash provided by investing activities as reported in the consolidated statements of cash flows increased by approximately \$11.0 million for the six months ended June 30, 2008 period when compared to the comparable prior year period. This increase is attributable to a \$9.6 million decrease in property acquisitions during the six months ended June 30, 2008, coupled with a net increase of \$4.6 million in cash flows attributable to our investments in affiliates. These increases were partially offset by a \$1.8 million investment in receivables purchased in conjunction with the acquisition of the Shadow Creek Ranch shopping Center by our affiliated funds as well as an additional \$1.7 million in loans made to affiliates as part of our treasury management function. We made no property acquisitions during the first quarter of 2008. However, in February 2007, we acquired The Woodlands Mall Ring Road property, which represents 66,000 square feet of gross leaseable area in Houston, Texas. The property has been ground-leased to five tenants, including NationsBank, Circuit City and Landry's Seafood. With respect to investments made in affiliates, we made a \$5.0 million investment during the first quarter of 2008 in Shadow Creek Ranch Shopping Center through a joint venture with an institutional partner. Shadow Creek Ranch Shopping Center is a 616,372

square foot grocery-anchored shopping center located in Pearland, Texas. During 2008, we sold a portion of that investment at cost to one of our affiliates, REITPlus, for \$3.9 million. We expect to sell the remaining \$1.1 million investment in Shadow Creek Ranch to REITPlus during the third quarter of 2008. Additionally during 2008, we sold to MIG IV for \$5.2 million a 20% interest in Woodlake Square and Westheimer Gessner which we acquired in 2007. Our \$1.8 million investment in the receivable is to be funded by 33% of all sales tax revenues generated by the shopping center. We have received the first two payments under this arrangement and expect to be fully funded by July 2012. With respect to loans to affiliates, we have the ability as part of our treasury management function to place excess cash in short term bridge loans for our merchant development funds for the purpose of acquiring or developing properties. We typically provide such financing to our affiliates as a way of efficiently deploying our excess cash and earning a higher return than we would in other short term investments or overnight funds. In most cases, the funds have a construction lender in place, and we simply step in as the lender and provide financing on the same terms as the third party lender. In so doing, we are able to access these funds as needed by having our affiliate then draw down on their construction loans. These loans are unsecured, bear a market rate of interest and are due upon demand.

Additionally, with respect to cash flows used in investing activities, we have committed \$713,000 of nonrefundable earnest money on a contract for the acquisition of receivables that would be funded by a tax municipality from their issuance of public bonds. The acquisition is scheduled to close in the third quarter of 2008.

Cash flows provided by financing activities decreased \$12.0 million from \$6.0 million during the six months ended June 30, 2007 to \$6.0 million in cash used in financing activities during the 2008 period. This decrease was primarily the result of a \$6.3 million reduction in net proceeds from notes payable during the 2008 period when compared to the 2007 period. During 2008, our proceeds from notes payable have been limited to draw downs on our line of credit for the purpose of property investment and working capital needs. In order to manage our leverage during 2008, we have paid down a net \$6.9 million of our notes payable with cash on hand as cash flows provided by operating and investing activities. This reduction in proceeds was coupled with an increase in treasury share repurchases of \$6.2 million pursuant to our approved share repurchase program.

We have an unsecured credit facility in place which is being used to provide funds for the acquisition of properties and working capital. The credit facility matures in October 2009 and provides that we may borrow up to \$70 million subject to the value of unencumbered assets. Effective October 2007, we renewed our credit facility on terms which provided us with an increased borrowing base at reduced borrowing costs. All other conditions remained substantially the same as the previous facility. The credit facility contains covenants which, among other restrictions, require us to maintain a minimum net worth, a maximum leverage ratio, maximum tenant concentration ratios, specified interest coverage and fixed charge coverage ratios and allow the lender to approve all distributions. For the quarter ended June 30, 2008, we violated two covenants per the terms of the credit facility. Our lender has waived both events of non-compliance as of June 30, 2008. Given the nature of these covenants, we expect we will be out of compliance for the remainder of the year, and that our lender will grant us waivers for those events of non-compliance although no assurance can be given that these waivers will not be granted. We were in compliance with all other covenants as of June 30, 2008. The credit facility's annual interest rate varies depending upon our debt to asset ratio, from LIBOR plus a spread of 1.0% to LIBOR plus a spread of 1.85%. As of June 30, 2008, the interest rate was LIBOR plus 1.00%. As of June 30, 2008, there was \$38.0 million outstanding on the credit facility. As of June 30, 2008, we have approximately \$30.0 million available under our line of credit, subject to the covenant provisions discussed above. In addition to the credit facility, we utilize various permanent mortgage financing and other debt instruments.

During the six months ended June 30, 2008, we declared dividends to our shareholders of \$6.5 million, compared with \$7.0 million in the six months ended June 30, 2007. The class A, C and D shareholders receive monthly dividends and the class B shareholders receive quarterly dividends. All dividends are declared on a quarterly basis. The dividends by class are as follows (in thousands):

Edgar Filing: AMREIT - Form 10-Q

| | Class A | Class B | Class C | Class D |
|---------------------|---------|-----------|---------|----------|
| 2008 Second Quarter | \$ 719 | \$ - | \$ 723 | \$ 1,781 |
| First Quarter | \$ 773 | \$ - | \$ 723 | \$ 1,775 |
| 2007 Fourth Quarter | \$ 785 | \$ 1,097* | \$ 721 | \$ 1,783 |
| Third Quarter | \$ 793 | \$ 191 | \$ 720 | \$ 1,783 |
| Second Quarter | \$ 796 | \$ 192 | \$ 726 | \$ 1,791 |
| First Quarter | \$ 785 | \$ 194 | \$ 725 | \$ 1,786 |

*- Includes a \$933,000 redemption premium associated with the redemption of the remaining class B shares in December 2007.

Until we acquire properties, we use our funds to pay down outstanding debt under the credit facility. Thereafter, any excess cash is provided first to our affiliates in the form of short-term bridge financing for development or acquisition of properties and then is invested in short-term investments or overnight funds. This investment strategy allows us to manage our interest costs and provides us with the liquidity to acquire properties at such time as those suitable for acquisition are located.

Inflation has had very little effect on our income from operations. We expect that increases in store sales revenues due to inflation, as well as increases in the Consumer Price Index, may contribute to capital appreciation of our properties. These factors, however, also may have an adverse impact on the operating margins of the tenants of the properties.

In June 2007, our Board of Trust Managers authorized a common share repurchase program as part of our ongoing investment strategy. Under the terms of the program, we may purchase up to a maximum value of \$5 million of our class A common shares of beneficial interest. In May of 2008, the Board of Trust Managers extended our common share repurchase program to a maximum value of \$10 million. Share repurchases may be made in the open market or in privately negotiated transactions at the discretion of management and as market conditions warrant. We anticipate funding the repurchase of shares primarily through the proceeds received from general corporate funds as well as through the use of our credit facility.

Repurchases of our common shares of beneficial interest for the six months ended June 30, 2008 are as follows:

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased As Part of Publicly Announced Program | (d) Maximum Dollar Value of Shares that May Yet be Purchased Under the Program |
|-----------------------------------|--|---|--|--|
| January 1, 2008 to March 31, 2008 | 156,490 | \$ 6.99 | 156,490 | \$ 2,618,707 |
| April 1, 2008 to June 30, 2008 | 695,800 | \$ 7.28 | 695,800 | \$ 2,560,990 |

Table of Contents

Results of Operations

Comparison of the three months ended June 30, 2008 to the three months ended June 30, 2007

Revenues

Total revenues increased by \$2.0 million, or 18%, for the three months ended June 30, 2008 as compared to the comparable prior year period (\$12.8 million in 2008 versus \$10.8 million in 2007). This increase was primarily attributable to an increase in rental income, construction revenues and real estate fees, offset by a decrease in securities commission income.

Rental income increased by \$638,000, or 7%, for the three months ended June 30, 2008 compared to the comparable prior year period. The increase was primarily due to an increase in amortization of below market leases due to accelerated amortization related to a tenant that terminated their lease during the quarter.

Construction revenues, which were generated by AmREIT Construction Company (“ACC”), were \$2.3 million for the three months ended June 30, 2008, compared to \$914,000 for the comparable prior year period. Such revenues have been recognized under the percentage-of-completion method of accounting. This increase in revenues is primarily attributable to an increase in related party work.

Real estate fee income increased approximately \$917,000, or 180%, for the three months ended June 30, 2008 as compared to the prior year period primarily as a result of an increase in acquisition fees earned on property transactions within our merchant development funds.

Securities commission revenue decreased by \$1.1 million, or 71%, for the three months ended June 30, 2008 as compared to the prior year period. This decrease in commission revenue was driven by a decrease in capital-raising activities of our advisory/sponsorship business. During the second quarter of 2008, we raised \$3.8 million in capital for one of our merchant development funds, REITPlus, Inc (“REIT Plus”) as compared to \$13.3 million in capital that we raised for AmREIT Monthly Income and Growth Fund IV, LP (MIG IV) during the second quarter of 2007. This decrease in commission income was partially offset by a corresponding decrease in commission expense paid to other third party broker-dealer firms. As we raise capital for our affiliated merchant development partnerships, we earn a securities commission of approximately 11% of the money raised. These commission revenues are then offset by commission payments to non-affiliated broker-dealers of between 8% and 9%.

Expenses

Total operating expenses increased by \$2.0 million, or 24%, for the three months ended June 30, 2008 as compared to the prior year period. This increase was primarily attributable to increases in general and administrative expense, construction costs and depreciation, which were offset by a decrease in securities commissions.

General and administrative expense increased by \$470,000, or 26%, for the three months ended June 30, 2008 as compared to the prior year period. During the 2007 quarter, our general and administrative costs were reduced due to a true up related to the reimbursement by our merchant development funds for certain costs that we incurred in distributing the limited partner units of those funds.

ACC recognized \$2.2 million in construction costs during 2008, compared to \$868,000 in 2007. This increase in construction costs is consistent with the increase in revenues described above.

Depreciation expense increased by \$681,000, or 35%, for the three months ended June 30, 2008 as compared to the prior year period. This increase was primarily attributable to accelerated depreciation related to a tenant that terminated their lease during the quarter.

Securities commission expense decreased by \$890,000, or 72%, for the three months ended June 30, 2008 as compared to the prior year period. This decrease is attributable to decreased capital-raising activity through ASC during 2008 as discussed in "Revenues" above.

Other

Interest expense increased by \$285,000, or 14%, for the three months ended June 30, 2008 as compared to the prior year period. The increase in interest expense is primarily attributable to draw-downs on our credit facility after the second quarter of 2007 related to the tender of the class B common shares and our investment in Borders, Woodlake Square and Shadow Creek Ranch.

Loss from merchant development funds and other affiliates increased by \$231,000, for the three months ended June 30, 2008 as compared to the prior year period. The increase is mainly due to \$97,000 of losses that we recognized related to our 30% limited partner interest in AmREIT Woodlake, LP.

Income (loss) from discontinued operations decreased by \$1.2 million for the three months ended June 30, 2008. The decrease is primarily attributed to \$926,000 of impairment charges, net of tax, that were recognized during the quarter.

Comparison of the six months ended June 30, 2008 to the six months ended June 30, 2007

Revenues

Total revenues increased by \$2.8 million, or 13%, for the six months ended June 30, 2008 as compared to the comparable prior year period (\$24.2 million in 2008 versus \$21.4 million in 2007). This increase was primarily attributable to an increase in rental income, construction revenues and real estate fees, offset by a decrease in securities commission income.

Rental income increased by \$1.2 million, or 9%, for the six months ended June 30, 2008 compared to the comparable prior year period. The increase was primarily due to an increase in amortization of below market leases due to accelerated amortization related to a tenant that terminated their lease during the quarter. An increase in occupancy and an increase in tenant reimbursements of taxes, maintenance expenses and insurance also contributed to the increase in rental income.

Construction revenues, which were generated by AmREIT Construction Company ("ACC"), were \$3.7 million for the six months ended June 30, 2008, compared to \$1.9 million for the comparable prior year period. Such revenues have been recognized under the percentage-of-completion method of accounting. This increase in revenues is primarily attributable to an increase in related party work.

Real estate fee income increased approximately \$1.1 million, or 58%, for the six months ended June 30, 2008 as compared to the prior year period primarily as a result of an increase in acquisition fees earned on property transactions within our merchant development funds.

Securities commission revenue decreased by \$1.5 million, or 62%, in for the six months ended June 30, 2008 as compared to the prior year period. This decrease in commission revenue was driven by a decrease in capital-raising activities of our advisory/sponsorship business. During the six months ended June 30, 2008, we raised \$8.6 million in capital for two of our merchant development funds, REITPlus, Inc ("REIT Plus") and AmREIT Monthly Income and Growth Fund IV, LP (MIG IV) as compared to \$21.9 million in capital that we raised for MIG IV during the six months ended June 30, 2007. This decrease in commission income was partially offset by a corresponding decrease in commission expense paid to other third party broker-dealer firms. As we raise capital for our affiliated merchant development partnerships, we earn a securities commission of approximately 11% of the money raised. These commission revenues are then offset by commission payments to non-affiliated broker-dealers of between 8% and 9%.

Expenses

Total operating expenses increased by \$2.2 million, or 13%, for the six months ended June 30, 2008 as compared to the prior year period. This increase was primarily attributable to increases in construction costs, general and administrative expenses and depreciation, which were offset by a decrease in securities commissions.

ACC recognized \$3.3 million in construction costs during 2008, compared to \$1.7 million in 2007. This increase in construction costs is consistent with the increase in revenues described above.

General and administrative expense increased by \$730,000, or 18%, for the six months ended June 30, 2008 as compared to the prior year period. During the 2007 quarter, our general and administrative costs were reduced due to the reimbursement by our merchant development funds for certain costs that we incurred in distributing the limited partner units of those funds.

Depreciation expense increased by \$671,000, or 17%, for the six months ended June 30, 2008 as compared to the prior year period. This increase was primarily attributable to accelerated depreciation related to a tenant that terminated their lease during 2008.

Securities commission expense decreased by \$1.2 million, or 60%, in for the six months ended June 30, 2008 as compared to the prior year period. This decrease is attributable to decreased capital-raising activity through ASC during 2008 as discussed in "Revenues" above.

Other

Interest expense increased by \$626,000, or 15%, for the six months ended June 30, 2008 as compared to the prior year period. The increase in interest expense is primarily attributable to draw-downs on our credit facility after the second quarter of 2007 related to the tender of the class B common shares and our investment in Borders, Woodlake Square and Shadow Creek Ranch.

Loss from merchant development funds and other affiliates increased by \$362,000, for the six months ended June 30, 2008 as compared to the prior year period. The increase is mainly due to \$193,000 of losses that we recognized related to our 30% limited partner interest in AmREIT Woodlake, LP.

Income (loss) from discontinued operations decreased by \$1.3 million, for the six months ended June 30, 2008 as compared to the prior year period. The decrease is primarily attributed to \$926,000 of impairment charges, net of tax, that were recognized during the year.

Table of Contents

Funds From Operations

We consider funds from operations (“FFO”), a non-GAAP measure, to be an appropriate measure of the operating performance of an equity REIT. The National Association of Real Estate Investment Trusts (“NAREIT”) defines FFO as net income (loss) computed in accordance with GAAP, excluding gains or losses from sales of property, plus real estate related depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. In addition, NAREIT recommends that extraordinary items not be considered in arriving at FFO. We calculate our FFO in accordance with this definition. Most industry analysts and equity REITs, including us, consider FFO to be an appropriate supplemental measure of operating performance because, by excluding gains or losses on dispositions and excluding depreciation, FFO is a helpful tool that can assist in the comparison of the operating performance of a company’s real estate between periods, or as compared to different companies. Management uses FFO as a supplemental measure to conduct and evaluate our business because there are certain limitations associated with using GAAP net income by itself as the primary measure of our operating performance. Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, management believes that the presentation of operating results for real estate companies that uses historical cost accounting is insufficient by itself. There can be no assurance that FFO presented by us is comparable to similarly titled measures of other REITs. FFO should not be considered as an alternative to net income or other measurements under GAAP as an indicator of our operating performance or to cash flows from operating, investing or financing activities as a measure of liquidity.

Below is the calculation of FFO and the reconciliation to net income, which we believe is the most comparable GAAP financial measure to FFO, in thousands:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Income - before discontinued operations | \$ 226 | \$ 799 | \$ 1,014 | \$ 1,509 |
| Income - from discontinued operations | (891) | 302 | (682) | 595 |
| Plus depreciation of real estate assets - from operations | 2,618 | 1,928 | 4,531 | 3,836 |
| Plus depreciation of real estate assets - from discontinued operations | 35 | 43 | 67 | 78 |
| Adjustments for nonconsolidated affiliates | 270 | 19 | 564 | 36 |
| Less class B, C & D distributions | (2,504) | (2,711) | (5,002) | (5,416) |
| Total Funds From Operations available to | \$ (246) | \$ 380 | \$ 492 | \$ 638 |

class A shareholders

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The information called for by this item is provided elsewhere herein and in “Item 7A. Quantitative and Qualitative Disclosures about Market Risk” in AmREIT’s Annual Report on Form 10-K for the year ended December 31, 2007. There have been no material changes in market risk from the information provided under Item 7A in AmREIT’s Annual Report on Form 10-K for the year ended December 31, 2007.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) as of June 30, 2008. Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of June 30, 2008.

Changes in Internal Controls

There has been no change to our internal control over financial reporting during the quarter ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are not a party to any material pending legal proceedings.

Item 1A. Risk Factors.

in addition to the other information set forth in this report, you should carefully consider the factors discussed in “Item 1A. Risk Factors” in our Annual Report on Form 10-k for the year ended December 31, 2007, as filed with the SEC, for a full discussion of risk factors which could materially affect our business financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In June 2007, our Board of Trust Managers authorized our common share repurchase program as part of our ongoing investment strategy. Under the terms of the program, we may purchase up to a maximum value of \$5 million of our class A common shares of beneficial interest. In May of 2008, the Board of Trust Managers extended our common share repurchase program to a maximum value of \$10 million. Share repurchases may be made in the open market or in privately negotiated transactions at the discretion of management and as market conditions warrant.

During the three months ended June 30, 2008, we repurchased common shares of beneficial interest as follows:

| Period | (a) | (b) | (c) | (d) |
|--------|-----|-----|-----|-----|
|--------|-----|-----|-----|-----|

Edgar Filing: AMREIT - Form 10-Q

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased As Part of Publicly Announced Program | Maximum Dollar Value of Shares that May Yet be Purchased Under the Program (1) |
|---------------------------------|----------------------------------|------------------------------|--|--|
| April 1, 2008 to April 30, 2008 | 322,600 | \$7.50 | 322,600 | \$199,414 |
| May 1, 2008 to May 31, 2008 | 10,800 | \$7.25 | 10,800 | \$5,121,116 |
| June 1, 2008 to June 30, 2008 | 362,400 | \$7.06 | 362,400 | \$2,560,990 |

(1) A description of the maximum number of shares that may be purchased under our share repurchase program is included in the narrative preceding this table.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

AmREIT held its Annual Meeting of Shareholders on June 3, 2008. For more information on the following proposal, see our proxy statement dated April 17, 2008, the relevant portions of which are incorporated herein by reference.

The shareholders elected each of the five nominees to the Board of Trust Managers for a one-year term:

| TRUST MANAGER | FOR | WITHHELD |
|---------------------------|------------|-----------|
| H. Kerr Taylor | 9,961,587 | 2,765,891 |
| Robert S. Cartwright, Jr. | 9,959,932 | 2,767,546 |
| G. Steven Dawson | 9,954,968 | 2,772,510 |
| H.L. Rush, Jr. | 9,971,352 | 2,756,126 |
| Philip Taggart | 9,977,515 | 2,749,963 |
| Total | 24,121,328 | 6,087,747 |

Table of Contents

Item 5. Other Information.

None.

Item 6. Exhibits.

Ex 3.1 - Amended and Restated Declaration of Trust (included as Exhibit 3.1 of the Exhibits to the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002, and incorporated herein by reference).

Ex. 3.2 - By-Laws, dated December 22, 2002 (included as Exhibit 3.1 of the Exhibits to the Company's Annual Report on Form 10-KSB for the year ended December 31, 2002, and incorporated herein by reference).

Ex. 3.2.1- Amendment No. 1 to By-laws, dated May 1, 2008 (included as Exhibit 3.1 of the Exhibits to the Company's Current Report on Form 8-K, filed on May 7, 2008, and incorporated herein by reference).

Ex 10.1 Revolving Credit Agreement, dated effective as of October 30, 2007 by and between AmREIT as borrower and Wells Fargo Bank, (included as Exhibit 10.4 of the Exhibits to the Company's Annual Report on Form 10-K for the year ended December 31, 2007, and incorporated herein by reference).

Ex 31.1 - Certification pursuant to Rule 13a-14(a) of Chief Financial Officer dated August 8, 2008 (filed herewith).

Ex 31.2 - Certification pursuant to Rule 13a-14(a) of Chief Financial Officer dated August 8, 2008 (filed herewith).

Ex 32.1 - Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

Ex 32.2 - Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

~22~

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf on the 14th of August, 2008 by the undersigned, there unto duly authorized.

AmREIT

/s/ H. Kerr Taylor
H. Kerr Taylor, President and Chief Executive
Officer

/s/ Chad C. Braun
Chad C. Braun, Executive Vice President and
Chief Financial Officer

~23~

Table of Contents

EXHIBIT 31.1

SARBANES-OXLEY SECTION 302(a) CERTIFICATION

I, H. Kerr Taylor, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AmREIT;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the consolidated financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of trust managers (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

By: /s/ H. Kerr Taylor, President and Chief
Executive Officer

Table of Contents

EXHIBIT 31.2

SARBANES-OXLEY SECTION 302(a) CERTIFICATION

I, Chad C. Braun, certify that:

1. I have reviewed this quarterly report on Form 10-Q of AmREIT;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the consolidated financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of trust managers (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2008

By: /s/ Chad C. Braun, Chief Financial Officer

Table of Contents

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AmREIT (the “Company”) on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, H. Kerr Taylor, President and Chief Executive Officer, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge,:

1. The Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2008

By: /s/ H. Kerr Taylor, President and Chief
Executive Officer

Table of Contents

EXHIBIT 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AmREIT (the “Company”) on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Chad C. Braun, Executive Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2008

By: /s/ Chad C. Braun, Executive Vice
President and Chief Financial Officer

