

FORM 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

For the quarterly period ended September 30, 2003

OR

☐ 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: 000-49986

AMERICA FIRST APARTMENT INVESTORS, INC.
(Exact name of registrant as specified in its charter)

Maryland	47-0858301
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

Suite 400, 1004 Farnam Street, Omaha, Nebraska	68102
(Address of principal executive offices)	(Zip Code)

(402) 444-1630
(Registrant's telephone number, including area code)

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

YES ☒ NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

YES NO ☒

As of November 7, 2003, there were 5,074,897 outstanding shares of the registrant's common stock.

AMERICA FIRST APARTMENT INVESTORS, INC.

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Part I. Financial Information

Item 1. Financial Statements

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

	Sept. 30, 2003 (Unaudited)	Dec. 31, 2002
Assets		
Cash and cash equivalents		
Unrestricted	\$ 10,877,553	\$ 8,419,537
Restricted	5,360,568	4,246,248
Investment in real estate, net of accumulated depreciation	116,134,611	119,490,678
Investment in corporate equity securities, at fair value	1,907,424	1,668,755
Other assets	2,089,953	3,028,676
	<u>\$ 136,370,109</u>	<u>\$ 136,853,894</u>
Liabilities		
Accounts payable and accrued expenses	\$ 4,386,384	\$ 5,262,964
Bonds and mortgage notes payable	82,356,031	82,913,439
Dividends or distribution payable	1,268,724	1,268,451
	<u>88,011,139</u>	<u>89,444,854</u>
Equity (See Note 1)		
Stockholders' Equity		
Common stock, \$.01 par value; 500,000,000 shares authorized, 5,074,897 issued and outstanding	50,749	-
Additional paid in capital	47,406,636	-
Retained earnings	672,598	-
Accumulated other comprehensive income (loss)	228,987	(9,682)
General Partner	-	97,380
Beneficial Unit Certificate holders (\$9.42 per BUC in 2002)	-	47,321,342
	<u>48,358,970</u>	<u>47,409,040</u>
	<u>\$ 136,370,109</u>	<u>\$ 136,853,894</u>

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

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)

	For the Three Months Ended Sept. 30, 2003	For the Three Months Ended Sept. 30, 2002	For the Nine Months Ended Sept. 30, 2003	For the Nine Months Ended Sept. 30, 2002
Income				
Rental income	\$ 5,987,787	\$ 6,229,128	\$ 18,154,156	\$ 18,804,975
Interest and dividend income	63,650	90,704	200,794	234,661
Gain on interest rate swap agreements	8,489	9,425	25,813	13,500
Gain on Jefferson Place subordinate note	-	-	4,444,452	-
	<u>6,059,926</u>	<u>6,329,257</u>	<u>22,825,215</u>	<u>19,053,136</u>
Expenses				
Real estate operating expenses	3,462,195	3,455,886	9,737,168	9,894,674
Depreciation expense	1,242,591	1,251,058	3,753,696	3,717,621
Interest expense	1,055,867	1,099,193	3,220,975	3,260,020
Amortization of debt financing costs	71,888	69,810	215,370	209,923
General and administrative expenses	440,884	446,657	1,419,483	1,355,075
	<u>6,273,425</u>	<u>6,322,604</u>	<u>18,346,692</u>	<u>18,437,313</u>
Net income (loss)	(213,499)	6,653	4,478,523	615,823
Other comprehensive income (loss)				
Unrealized gains on securities				
Net unrealized holding gains arising during the period	178,821	28,946	238,669	44,678
	<u>178,821</u>	<u>28,946</u>	<u>238,669</u>	<u>44,678</u>
Net comprehensive income (loss)	\$ <u>(34,678)</u>	\$ <u>35,599</u>	\$ <u>4,717,192</u>	\$ <u>660,501</u>
Net income (loss) allocated to:				
General Partner		\$ 12,577		\$ 43,334
BUC holders		<u>(5,924)</u>		<u>572,489</u>
		<u>\$ 6,653</u>		<u>\$ 615,823</u>
Net income (loss), basic, per share (per BUC in 2002)	\$ <u>(0.04)</u>	\$ <u>0.00</u>	\$ <u>0.88</u>	\$ <u>0.11</u>
Net income (loss), diluted, per share (per BUC in 2002)	\$ <u>(0.04)</u>	\$ <u>0.00</u>	\$ <u>0.88</u>	\$ <u>0.11</u>
Dividends (distributions in 2002) declared and paid per common share (per BUC in 2002)	\$ <u>0.25</u>	\$ <u>0.25</u>	\$ <u>0.75</u>	\$ <u>0.75</u>

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

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
(UNAUDITED)

	General Partner	Beneficial Unit Certificate holders	Common Stock Shares	Common Stock Amount	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2002	\$ 97,380	\$ 47,321,342	-	\$ -	\$ -	\$ -	\$ (9,682)	\$ 47,409,040
Issuance of shares of the Company in exchange for BUCs and the General Partner interest of the Partnership	(97,380)	(47,321,342)	5,073,805	50,738	47,367,984	-	-	-
Acquisition of shares of the Company	-	-	100	1	1,199	-	-	1,200
Issuance of common stock	-	-	992	10	9,990	-	-	10,000
Net income	-	-	-	-	-	4,478,523	-	4,478,523
Stock options issued	-	-	-	-	27,463	-	-	27,463
Change in net unrealized holding gains	-	-	-	-	-	-	238,669	238,669
Dividends	-	-	-	-	-	(3,805,925)	-	(3,805,925)
Balance at September 30, 2003	<u>\$ -</u>	<u>\$ -</u>	<u>5,074,897</u>	<u>\$ 50,749</u>	<u>\$ 47,406,636</u>	<u>\$ 672,598</u>	<u>\$ 228,987</u>	<u>\$ 48,358,970</u>

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

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended Sept. 30, 2003	For the Nine Months Ended Sept. 30, 2002
Cash flows from operating activities		
Net income	\$ 4,478,523	\$ 615,823
Adjustments to reconcile net income to net cash provided by operating activities		
Gain on interest rate swap agreements	(25,813)	(13,500)
Gain on Jefferson Place subordinate note	(4,444,452)	-
Depreciation	3,753,696	3,717,621
Non-cash stock compensation expense	37,463	-
Amortization of debt financing costs	215,370	209,923
Transfers to restricted cash	(1,114,320)	(899,381)
Decrease in other assets	749,166	46,884
Increase in accounts payable and accrued expenses	1,211,609	209,802
Net cash provided by operating activities	<u>4,861,242</u>	<u>3,887,172</u>
Cash flows from investing activities		
Real estate capital improvements	(397,629)	(490,611)
Net proceeds from repayment of Jefferson Place subordinate note	2,356,263	-
Purchase of corporate equity securities	<u>-</u>	<u>(1,478,090)</u>
Net cash provided by (used in) investing activities	<u>1,958,634</u>	<u>(1,968,701)</u>
Cash flows from financing activities		
Distributions paid	(3,805,652)	(3,741,931)
Principal payments on bonds and mortgage notes payable	(557,408)	(525,060)
Debt financing costs paid	-	(37,535)
Acquisition of shares of the Company	<u>1,200</u>	<u>-</u>
Net cash used in financing activities	<u>(4,361,860)</u>	<u>(4,304,526)</u>
Net increase (decrease) in cash and cash equivalents	2,458,016	(2,386,055)
Cash and cash equivalents at beginning of period	8,419,537	10,947,957
Cash and cash equivalents at end of period	<u>\$ 10,877,553</u>	<u>\$ 8,561,902</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 2,834,977</u>	<u>\$ 3,369,654</u>

Supplemental disclosure of non-cash investing and financing activities:

On January 1, 2003, the Company merged with America First Apartment Investors, L.P. In connection with such Merger, the Company issued 5,073,805 shares of stock in exchange for the limited partner and general partner interests of the Partnership.

In May 2003, the Company issued 992 shares of its common stock having a value of \$10,000 as Director compensation.

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

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003
(UNAUDITED)

1. Organization and Basis of Presentation

America First Apartment Investors, Inc. (the "Company") was formed on March 29, 2002 under the Maryland General Corporation Law for the purpose of owning and operating multifamily apartment complexes. The Company may also invest in mortgages and mortgage-backed securities or securities issued by other REITs or real estate companies. The Company commenced its business operations upon the completion of the Merger of America First Apartment Investors, L.P. (the "Partnership") with and into the Company. Upon consummation of the Merger, which became effective January 1, 2003, the Company assumed all of the assets, liabilities and business operations of the Partnership. As of September 30, 2003, the Company owns and operates 15 multifamily apartment complexes containing a total of 3,335 rental units and one commercial property.

The Company was capitalized through the issuance of 100 shares of its common stock, par value \$.01 per share, at a price of \$12.00 per share to an affiliate of the Partnership. As a result of the Merger, each outstanding Beneficial Unit Certificate ("BUC") of the Partnership was converted into one share of common stock, \$.01 par value, of the Company, for a total of 5,023,067 shares of the common stock the Company issued to BUC holders. In addition, 50,738 shares of common stock of the Company were issued to America First Capital Associates LP Four in exchange for its general partner interest of the Partnership. Accordingly, the Company began business operations, as the successor-in-interest to the Partnership, on January 1, 2003. Effective January 2, 2003, the common stock of the Company was listed on NASDAQ under the symbol APRO. The transaction was accounted for as a reverse merger whereby the Partnership is the accounting acquirer, and all assets and liabilities were carried over at the Partnership's carrying value. The accompanying financial results as of December 31, 2002 and for all periods presented prior to the Merger are those of the Partnership.

The accompanying interim unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted according to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. The consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's and Partnership's Annual Reports on Form 10-K for the year ended December 31, 2002. Certain amounts from prior periods have been reclassified to conform to the current period presentation. In the opinion of management, all normal and recurring adjustments necessary to present fairly the financial position at September 30, 2003, and the results of operations for all periods presented have been made. The results of operations for the three and nine month periods ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation. The preparation of financial statements in conformity with GAAP 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company has elected to be treated as a Real Estate Investment Trust ("REIT") for tax purposes. As a REIT, the Company will generally not be subject to federal income taxes on distributed income. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a

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requirement to distribute at least 90% of the REIT's ordinary taxable income to shareholders. It is the Company's current intention to adhere to these requirements and maintain its REIT status.

2. Restricted Cash

Restricted cash and cash equivalents, which is legally restricted to use, is comprised of resident security deposits, required maintenance reserves and escrowed funds.

3. Segment Reporting

The Company defines each of its multifamily apartment properties as an individual operating segment. It has also determined that all multifamily properties have similar economic characteristics and also meet the other criteria which permit the multifamily properties to be aggregated into one reportable segment, that being the acquiring, holding, operating and selling of multifamily apartment properties. The Company's chief operating decision-makers assess and measure segment operating results based on a performance measure referred to as net operating income at the individual operating segment. Net operating income for each multifamily apartment property represents its net rental revenues less its real estate operating expenses. The Company's commercial property is defined as a separate individual operating segment, but is not separately reportable.

The net income, revenues and net operating income for the Company's multifamily apartment properties segment for the three and nine month periods ending September 30, 2003 and 2002 are summarized as follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(UNAUDITED)

	For the Three Months Ended Sept. 30, 2003	For the Three Months Ended Sept. 30, 2002	For the Nine Months Ended Sept. 30, 2003	For the Nine Months Ended Sept. 30, 2002
Multifamily real estate segment revenues	\$ 5,820,046	\$ 6,049,231	\$ 17,651,582	\$ 18,201,832
Reconciling items:				
Rental and interest income from commercial property	167,742	179,897	502,574	603,143
Gain on subordinate note	-	-	4,444,452	-
Interest and dividend income	72,138	100,129	226,607	248,161
Consolidated revenues	<u>\$ 6,059,926</u>	<u>\$ 6,329,257</u>	<u>\$ 22,825,215</u>	<u>\$ 19,053,136</u>
Consolidated net income (loss)	\$ (213,498)	\$ 6,653	\$ 4,478,523	\$ 615,823
Reconciling items:				
General and administrative expenses	440,884	446,657	1,419,483	1,355,075
Commercial property net (income) loss	(12,493)	(7,729)	(2,314)	(94,406)
Interest and dividend income	(72,138)	(100,129)	(226,607)	(248,161)
Gain on subordinate note	-	-	(4,444,452)	-
Net income from multifamily real estate segment	<u>\$ 142,755</u>	<u>\$ 345,452</u>	<u>\$ 1,224,633</u>	<u>\$ 1,628,331</u>
Reconciling items:				
Depreciation	1,192,529	1,189,798	3,568,929	3,545,812
Amortization of debt financing costs	60,639	58,561	182,357	176,175
Interest expense	994,837	1,037,994	3,038,100	3,076,390
Net operating income from multifamily real estate segment	<u>\$ 2,390,760</u>	<u>\$ 2,631,805</u>	<u>\$ 8,014,019</u>	<u>\$ 8,426,708</u>

The Company does not derive any of its consolidated revenues from foreign countries and does not have any major customers that individually account for 10% or more of the Company's consolidated revenues.

4. Transactions with Related Parties

The Company has entered into an Advisory Agreement with America First Apartment Advisory Corporation (the "Advisor") to manage the day to day operations and provide other management services to the Company. The Company will pay fees to the Advisor for these services and will reimburse the Advisor and its affiliates for certain allowable expenses it incurs on behalf of the Company. This agreement went into effect on the date of the Merger, January 1, 2003, and includes the following provisions: (i) the Advisor will administer the day-to-day operations of the Company; (ii) the Advisor will act as the authorized agent on behalf of the Company in connection with the identification, evaluation, purchase, financing, operation and disposition of all real estate assets; (iii) the Advisor will provide the executive and administrative personnel and services required for the operation of the Company; (iv) the Advisor will maintain the financial records and perform the financial reporting of the Company and (v) the Advisor will monitor and provide information to the Board of Directors on an on-going basis.

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES
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In connection with the above services, the Company pays an administration fee to the Advisor. This fee is in an amount equal to: (i) 0.60% per annum of the first \$250,000,000 of the sum of the original principal amount of bonds and the gross purchase price of real estate assets acquired by the Partnership and (ii) 0.50% per annum of such sum in excess of \$250,000,000; provided that the administrative fee will be 0.60% on such assets in any calendar year where Funds from Operations ("FFO") exceeds \$1.60 per common share. Such fee was \$220,757 and \$662,272 for the three and nine month periods ending September 30, 2003, respectively.

The Advisor is also entitled to a property acquisition fee in connection with the identification, evaluation and acquisition of real estate assets in the amount of 1.25% of the gross purchase price paid by the Company for such real estate assets.

An affiliate of the Advisor provides property management services for the multifamily properties owned by the Company. The fees for services provided represent the lower of: (i) costs incurred in managing the property, or (ii) customary fees for such services determined on a competitive basis. Such fees were \$240,218 and \$729,787 for the three and nine month periods ended September 30, 2003, respectively.

5. Stock Option Plan

The Company adopted a Stock Option Plan (the "Plan") on April 1, 2002 to permit awards of equity based compensation to those providing services to the Company. The Plan is administered by the Compensation Committee of the Board of Directors. The Plan allows for the granting of options to purchase an aggregate of up to 750,000 shares of the Company's common stock. The Plan authorizes the Board of Directors and its Compensation Committee to grant Incentive Stock Options ("ISOs"), as defined under section 422 of the IRS Code, non-qualified stock options ("NQSOS"), and dividend equivalent rights ("DERs") to eligible persons. The exercise price for options granted under the Plan shall not be less than the fair market value of the Company's common stock on the date of the grant. Options granted under the Plan expire 10 years from the respective grant dates of the options.

No equity-based awards were granted under the Plan in 2002. On February 4, 2003, NQSOS to acquire a total of 40,000 shares of common stock were granted to the Company's four non-employee Directors, at an exercise price of \$8.73. The options vest 25% on the grant date and 25% on each of the next three anniversaries of the grant date. On the same date, a total of 40,000 DERs were granted to the Company's four non-employee directors, which vest 25% on the grant date and 25% on each of the next three anniversaries of the grant date.

Stock option activity for the period ended September 30, 2003 is summarized as follows:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance at December 31, 2002	-	-
Granted	40,000	\$ 8.73
Cancelled	-	-
Balance at September 30, 2003	<u>40,000</u>	<u>\$ 8.73</u>
Options exercisable at September 30, 2003	<u>10,000</u>	<u>\$ 8.73</u>

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At September 30, 2003, all outstanding options have an exercise price of \$8.73 and a remaining contractual life of 9.3 years. The Company accounts for its stock options using the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". Under SFAS 123, the Company records compensation expense based upon the estimated fair value of its granted options, over their vesting period. The per share estimated fair value of the options granted on their grant date during the nine months ended September 30, 2003 was \$2.19. The estimated fair value of the Company's options is determined using the Black-Scholes option-pricing model with the following assumptions: a risk free interest rate of 3.24%, an expected remaining contractual life of 5.0 years and an expected volatility rate of 20%. Compensation expense for stock options was \$5,492 and \$34,786 for the three and nine month periods ended September 30, 2003, respectively. Payments on the DERs for options not exercised are charged to earnings when declared and were \$2,500 and \$7,500 for the three and nine month periods ended September 30, 2003, respectively.

6. Per Share Data

The following table presents information necessary to calculate basic and diluted earnings per share for the period indicated. There were no differences between basic and diluted earnings per share calculations for the nine months ended September 30, 2003.

Net income attributable to common shares - basic	\$	4,478,523
Expense attributable to DER's		<u>7,500</u>
Net income attributable to common shares - diluted	\$	<u><u>4,486,023</u></u>
Weighted average common shares - basic		5,074,070
Dilutive options		<u>10,000</u>
Weighted average common shares - diluted		<u><u>5,084,070</u></u>
Net income per common share:		
Basic	\$	<u>0.88</u>
Diluted	\$	<u><u>0.88</u></u>

7. Gain on Jefferson Place Subordinate Note

On June 26, 2003, the Jefferson Place Apartments were sold and the Company recorded a gain of \$4,444,452 on the repayment of its subordinate note due from Jefferson Place Apartments. The total gain is comprised of \$2,709,040 of cash proceeds from the sale less \$352,777 of written off receivables for a net cash gain of \$2,356,263. The Company also recorded a \$2,088,189 non-cash gain representing the reversal of a loss reserve. The subordinate note due from Jefferson Place Apartments had an original principal value of \$3,500,000, a net book value of \$0, and was received by the predecessor partnership in 1997 in connection with the re-issuance of the formerly owned Jefferson Place tax-exempt bonds. The subordinate note represented unpaid tax-exempt interest and principal. Therefore, the gain is not subject to Federal income taxes. In connection with the 1997 re-issuance, the predecessor partnership also pledged as collateral its Retreat Apartments and recorded a loss reserve of \$2,088,189 for the guarantee. The loss reserve represented management's best estimate of the potential guarantee loss based upon the estimated fair values of the respective properties at the inception of the

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guarantee and was reversed on June 26, 2003, when the Company was relieved of its guarantee via the sale of Jefferson Place.

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

The following discussion of the Company's results of operations for the three and nine month periods ended September 30, 2003 should be read in conjunction with all of the consolidated financial statements and notes thereto included in Item 1 of this report as well as the Company and Partnership's Annual Reports on Form 10-K for the year ended December 31, 2002.

General

America First Apartment Investors, Inc. (the "Company") was formed on March 29, 2002 under the Maryland General Corporation Law for the purpose of owning and operating multifamily apartment complexes, investing in mortgages and mortgage backed securities, and securities issued by other REITs or real estate companies. The Company commenced its business operations upon the completion of the Merger of America First Apartment Investors, L.P. (the "Partnership") with and into the Company. Upon consummation of the Merger, which became effective January 1, 2003, the Company assumed all of the assets, liabilities and business operations of the Partnership. As of September 30, 2003, the Company owns and operates 15 multifamily apartment complexes containing a total of 3,335 rental units and one commercial property. There were no real estate asset acquisitions or dispositions during the first nine months of 2003.

The following table sets forth certain information regarding the Company's investment in real estate at September 30, 2003:

AMERICA FIRST APARTMENT INVESTORS, INC. AND SUBSIDIARIES

Property Name	Location	Number of Units	Number of Units Occupied	Percentage of Units Occupied at Sept. 30, 2003	Economic Occupancy ⁽¹⁾
Jackson Park Place	Fresno, CA	296	288	97%	96%
Covey at Fox Valley	Aurora, IL	216	190	88%	79%
The Park at Fifty Eight	Chattanooga, TN	196	161	82%	67%
Shelby Heights	Bristol, TN	100	95	95%	94%
Coral Point	Mesa, AZ	336	304	90%	69%
Park at Countryside	Port Orange, FL	120	117	98%	91%
The Retreat	Atlanta, GA	226	223	99%	74%
Park Trace Apartments	Norcross, GA	260	251	97%	79%
Littlestone at Village Green	Gallatin, TN	200	185	93%	81%
St. Andrews at Westwood Apts	Orlando, FL	259	243	94%	82%
The Hunt Apartments	Oklahoma City, OK	216	206	95%	94%
Greenbriar Apartments	Tulsa, OK	120	110	92%	80%
Oakwell Farms Apartments	Nashville, TN	414	348	84%	78%
Oakhurst Apartments	Ocala, FL	214	202	94%	89%
Belvedere Apartments	Naples, FL	162	142	88%	82%
		<u>3,335</u>	<u>3,065</u>	<u>92%</u>	<u>82%</u>
The Exchange at Palm Bay	Palm Bay, FL	<u>72,002</u> ⁽²⁾	<u>65,920</u> ⁽²⁾	<u>92%</u>	<u>NA</u>

⁽¹⁾ Economic occupancy is presented for the nine months ended September 30, 2003, and is defined as the net rental income received during the period divided by the maximum amount of rental income that would be derived from each property if 100% occupied at current lease rental rates. This statistic is reflective of vacancy losses, rental concessions, delinquent rents, and non-revenue units such as model units and employee units.

⁽²⁾ Represents square feet.

Critical Accounting Policies

The Company's critical accounting policies are the same as those described in the Partnership's Form 10-K for the year ending December 31, 2002, with the addition of a policy for the accounting of the Company's stock based compensation.

The Company accounts for its stock options using the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". Under SFAS 123, the Company records compensation expense based upon the fair value of its granted options, over their vesting period. The fair value of the Company's options is determined using the Black-Scholes option-pricing model. The Black-Scholes model includes assumptions regarding dividend yields, expected volatility, expected lives and risk-free interest rates.

Results of Operations

The financial results of the Company reflect the effects of the current weak multi-family housing market due to three primary factors: (i) recessionary conditions that have significantly weakened rental rates; (ii) record low

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interest rates that are making home ownership more affordable to both existing and prospective tenants; and (iii) increased costs to operate real estate. In response to these conditions, management will continue to focus on the attraction and retention of quality tenants, and on the effective cost management of operating expenses.

The following provides a more detailed discussion of the Company's financial results for the three and nine month periods ended September 30, 2003. Prior year information is that of the Partnership.

Three Months Ended September 30, 2003 Compared to the Three Months Ended September 30, 2002

Rental income decreased \$241,341 or 4% for the three months ended September 30, 2003 compared to the same period in 2002. This decrease is attributable to an overall decline in the economic occupancy of the properties. The average economic occupancy was 79% for the three months ended September 30, 2003, compared to 84% for the three months ended September 30, 2002. This decline reflects the continuing need in many markets to provide rental concessions in order to attract and retain tenants.

Interest and dividend income decreased \$27,054, or 30%, for the quarter ended September 30, 2003 compared to the same period in 2002. Dividend income increased \$3,000 for the quarter ended September 30, 2003 compared to the quarter ended September 30, 2002 due to purchases of additional corporate equity securities during the last two quarters of 2002. This increase was offset by a decrease in interest income caused by a decrease in the average interest rate earned on cash and cash equivalents. The average annualized interest rate earned on cash and cash equivalents was 1.04% for the third quarter of 2003, compared to 1.77% for the third quarter of 2002.

The Company recorded a valuation gain of \$8,489 on its interest rate swap agreements in the third quarter of 2003, compared to a valuation gain of \$9,425 during the same period in 2002.

Real estate operating expenses increased \$6,309 for the three months ended September 30, 2003 compared to the three months ended September 30, 2002. Certain operating expenses such as advertising and referral fees have increased due to market competition; however most of the increase is offset by declines in other operating and maintenance expenses.

Depreciation expense for the third quarter of 2003 was consistent with the same period in 2002 due to having no acquisitions or dispositions of real estate properties and making limited capital improvements to existing properties during the periods under comparison.

Interest expense decreased \$43,326 or 4% for the quarter ended September 30, 2003 compared to the same period in 2002. This is primarily due to a decrease in the interest rate on the Company's variable-rate debt. Approximately 13% of the Company's bonds and mortgage notes payable bear interest at variable rates at September 30, 2003. The average variable rate was 1.45% for the three months ended September 30, 2003, compared to 1.94% for the three months ended September 30, 2002.

Amortization of debt financing costs for the three months ended September 30, 2003 is consistent when compared to the same period in 2002.

General and administrative expenses decreased \$5,773 or 1% and remained relatively flat for the quarter ended September 30, 2003 compared to the third quarter 2002.

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Nine Months Ended September 30, 2003 Compared to the Nine Months Ended September 30, 2002

Rental income decreased \$650,819 or 3% for the nine months ended September 30, 2003 compared to the same period in 2002. This decrease is attributable to an overall decline in the economic occupancy of the properties. The average economic occupancy was 81% for the nine months ended September 30, 2003, compared to 85% for the nine months ended September 30, 2002. This decline reflects the continuing need in many markets to provide rental concessions in order to attract and retain tenants.

Interest and dividend income decreased \$33,867, or 14%, for the nine months ended September 30, 2003 compared to the same period in 2002. Dividend income increased \$60,944 for the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002 due to purchases of additional corporate equity securities during the final two quarters of 2002. This increase was offset by a decrease in interest income caused by a decrease in the average interest rate earned on cash and cash equivalents. The average annualized interest rate earned on cash and cash equivalents was 1.21% for the first nine months of 2003, compared to 1.83% for the same period of 2002.

The Company recorded a valuation gain of \$25,813 on its interest rate swap agreements in the first nine months of 2003, compared to a valuation gain of \$13,500 during the same period in 2002. The increase in the gain is attributable to a decrease in the average rates on which the estimated fair value of the swap agreements is calculated.

On June 26, 2003, the Jefferson Place Apartments were sold and the Company recorded a gain of \$4,444,452 on the repayment of its subordinate note due from Jefferson Place Apartments. The total gain is comprised of \$2,709,040 of cash proceeds from the sale less \$352,777 of written off receivables for a net cash gain of \$2,356,263. The Company also recorded a \$2,088,189 non-cash gain representing the reversal of a loss reserve. The subordinate note due from Jefferson Place Apartments had an original principal value of \$3,500,000, a net book value of \$0, and was received by the predecessor partnership in 1997 in connection with the re-issuance of the formerly owned Jefferson Place tax-exempt bonds. The subordinate note represented unpaid tax-exempt interest and principal. Therefore, the gain is not subject to Federal income taxes. In connection with the 1997 re-issuance, the predecessor partnership also pledged as collateral its Retreat Apartments and recorded a loss reserve of \$2,088,189 for the guarantee. The loss reserve represented management's best estimate of the potential guarantee loss based upon the estimated fair values of the respective properties at the inception of the guarantee and was reversed on June 26, 2003, when the Company was relieved of its guarantee via the sale of Jefferson Place. No such gain was recorded during the nine months ended September 30, 2002.

Real estate operating expenses decreased \$157,506 or 2% for the nine months ended September 30, 2003 compared to the nine months ended September 30, 2002. This decrease is attributable to the decline in apartment occupancy and the effective management and containment of operating expenses.

Depreciation expense for the first nine months of 2003 increased \$36,073 or 1% over the same period in 2002. This increase is due to capital improvements made to existing properties. There were no acquisitions or dispositions of real estate properties during the periods under comparison.

Interest expense decreased \$39,045 or 1% for the nine months ended September 30, 2003. This is primarily due to a slight decrease in the interest rate on the Company's variable-rate debt. Approximately 13% of the Company's bonds and mortgage notes payable bear interest at variable rates at September 30, 2003. The average variable rate was 1.61% for the nine months ended September 30, 2003, compared to 1.93% for the nine months ended September 30, 2002.

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Amortization of debt financing costs for the nine months ended September 30, 2003 is consistent when compared to the same period in 2002.

General and administrative expenses increased \$64,411 or less than 5% for the nine months ended September 30, 2003 compared to the same period in 2002. This increase is attributable to increases in compensation expenses, insurance expense and legal expenses.

Funds from Operations

The Company's funds from operations ("FFO") decreased \$228,619 or 18% to \$1,029,092 for the third quarter of 2003, compared to \$1,257,711 for the same period in 2002. This is primarily due decreased rental revenues resulting from lower economic occupancy.

FFO increased \$3,898,775 or 90% to \$8,232,219 for the first nine months of 2003, compared to \$4,333,444 for the same period in 2002. This is primarily due to the gain on the subordinate note from Jefferson Place Apartments of \$4,444,452. Excluding this gain, FFO would have decreased \$545,677 between the two periods, primarily due to decreased rental revenues resulting from lower economic occupancy.

The Company computes FFO in accordance with standards established by the National Association of Real Estate Investment Trusts ("NAREIT") which define FFO as net income (loss) computed in accordance with GAAP, excluding gains (or losses) from sales of properties, plus real estate related depreciation and amortization (excluding amortization of deferred financing costs) and after comparable adjustments for an entity's portion of these items related to unconsolidated entities and joint ventures. The following table sets forth a reconciliation of the Company's net income as determined under GAAP and its FFO for the three and nine month periods ended September 30, 2003 and 2002.

	For the Three Months Ended Sept. 30, 2003	For the Three Months Ended Sept. 30, 2002	For the Nine Months Ended Sept. 30, 2003	For the Nine Months Ended Sept. 30, 2002
Net income (loss)	\$ (213,499)	\$ 6,653	\$ 4,478,523	\$ 615,823
Depreciation	<u>1,242,591</u>	<u>1,251,058</u>	<u>3,753,696</u>	<u>3,717,621</u>
Funds From Operations	<u>\$ 1,029,092</u>	<u>\$ 1,257,711</u>	<u>\$ 8,232,219</u>	<u>\$ 4,333,444</u>

The Company's capitalization policy for its real estate capital improvements has a significant effect on its FFO. Real estate costs that are accounted for as expenses are a deduction in FFO. Alternatively, real estate costs that are capitalized are not an expense that is deducted from FFO, but are depreciated and the related depreciation expense is added to FFO. The Company's capitalization policy is to treat most recurring capital improvements, such as appliances, vinyl flooring and carpet as expenses, and this may cause the Company's reported FFO to be lower than peer companies that capitalize recurring improvements of these types..

The Company considers FFO to be a key measure of its performance as it adds back the Company's significant non-cash expense of depreciation. Although the Company considers FFO to be a key measure of its operating performance, FFO should not be considered as an alternative to GAAP net income as an indication of the Company's financial performance. In addition, FFO does not represent cash generated from operating activities determined by GAAP and should not be considered as an alternative thereto as a measure of the Company's

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liquidity or as an indicator of the funds available to the Company to meet its cash needs. The Company's FFO may include funds that are unavailable for discretionary use due to requirements to conserve funds for capital expenditures, property acquisitions and other commitments and uncertainties. FFO reported by the Company may not be comparable to FFO reported by other entities that do not calculate FFO in accordance with the NAREIT definition or which interpret the NAREIT definition differently than the Company.

Liquidity and Capital Resources

Cash provided by operating activities for the nine months ended September 30, 2003 increased \$974,070 compared to the same period a year earlier primarily due to timing differences in the payment of payables. Cash provided by investing activities increased \$3,927,335 for the first three quarters of 2003 compared to the same period in 2002 primarily due to net proceeds received on the repayment of the Jefferson Place subordinate note and by the increased purchase of corporate equity securities in 2002. Net cash used in financing activities for the nine months ended September 30, 2003 is consistent with the prior year and consists of dividend distributions and principal payments on bonds and mortgage notes payable.

The Company's short-term liquidity needs include the payment of operating expenses, current debt service requirements and dividend distributions to shareholders. The Company anticipates that its strong cash position and cash provided by operating and investing activities will be sufficient to meet its anticipated short-term liquidity requirements, including regular dividend distributions to shareholders and maintaining the condition of its properties. The Company currently does not anticipate entering into short-term and long-term debt arrangements for purposes of paying expenses and making dividend distributions. However, the Company has the authority to enter into such arrangements.

The following table sets forth information regarding dividend distributions to shareholders for the nine months ended September 30, 2003 and cash distributions to BUC holders prior to the Merger during the periods shown:

	For the Nine Months Ended Sept. 30, 2003	For the Nine Months Ended Sept. 30, 2002
Dividends per share to shareholders/ Distributions per BUC	\$ <u>0.75</u>	\$ <u>0.75</u>

At September 30, 2003, the Company had debt obligations under twelve financing arrangements with an aggregate principal balance outstanding of approximately \$82,360,000. Such debt obligations consisted of ten tax-exempt mortgage bonds with an aggregate principal balance outstanding of approximately \$64,900,000 and two mortgage notes payable with a combined principal amount outstanding of approximately \$17,460,000. Six of the debt obligations which total approximately \$35,800,000 require monthly, semiannual or annual payments of principal and interest while six bonds with an aggregate principal amount of approximately \$46,560,000 require only semiannual payments of interest. Maturity dates range from September 2005 to March 2022. Approximately 87% of the Company's financing arrangements are fixed-rate obligations bearing a weighted average interest rate of 5.65% per annum at September 30, 2003. The remaining 13% of the financing arrangements are variable-rate obligations that had a weighted average interest rate of 1.61% for the nine months ended September 30, 2003. Each financing arrangement is a "non-recourse" obligation that is secured by a first mortgage or deed of trust on one or two of the Company's apartment complexes. Principal and interest payments on debt obligations are made solely from the net cash flow and/or net sale or refinancing proceeds of the mortgaged properties.

Forward Looking Statements

This report contains forward looking statements that reflect management's current beliefs and estimates of future economic circumstances, industry conditions, the Company's performance and financial results. All statements, trend analysis and other information concerning possible or assumed future results of operations of the Company and the real estate investments it has made (including, but not limited to, the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations"), constitute forward looking statements. Shareholders and others should understand that these forward looking statements are subject to numerous risks and uncertainties and a number of factors could affect the future results of the Company and could cause those results to differ materially from those expressed in the forward looking statements contained herein. These factors include local and national economic conditions, the amount of new construction, interest rates on single-family home mortgages, government regulation, price inflation, the level of real estate and other taxes imposed on the properties, labor problems and natural disasters.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's primary market risk exposure is interest rate risk. The Company's exposure to market risk for changes in interest rates relates primarily to its long-term borrowings used to fund expansion of the Company's real estate portfolio.

Interest rate risk is highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. The Company's interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. To achieve its objectives, the Company borrows primarily at fixed rates and may enter into derivative financial instruments, such as interest rate swaps, in order to mitigate its interest rate risk on the fixed-rate borrowings. The Company does not enter into derivative instrument transactions for speculative purposes.

At September 30, 2003, approximately 87% of the Company's long-term borrowings consisted of fixed-rate financing. The remaining 13% consisted of variable-rate financing obtained through interest rate swap transactions. The Company had no short-term financing at September 30, 2003. Variations in interest rates affect the Company's cost of borrowing on its variable-rate financing. The interest rates payable by the Company on these obligations increase or decrease with certain index interest rates. If the Company's borrowing costs increase, the amount of cash available for distribution to shareholders would decrease.

The tables below present information about the Company's financial instruments that are sensitive to changes in interest rates, including principal amounts and weighted average interest rates, by year of maturity for the Company's borrowings:

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	<u>Maturity</u>	<u>Principal Amount</u>	<u>Weighted Average Interest Rate</u>
Fixed-Rate Borrowings			
	2003	\$ 140,587	5.65%
	2004	747,404	5.65%
	2005	5,578,583	5.60%
	2006	672,818	5.48%
	2007	23,226,991	5.49%
	Thereafter	41,079,648	5.76%
		<u>\$ 71,446,031</u>	

	<u>Maturity</u>	<u>Principal Amount</u>	<u>Weighted Average Interest Rate</u>
Variable-Rate Borrowings			
	2004	<u>\$ 10,910,000</u>	1.61%

Interest Rate Swaps				
	<u>Maturity</u>	<u>Notional Amount</u>	<u>Pay Rate ⁽¹⁾</u>	<u>Receive Rate ⁽¹⁾</u>
Fixed to Variable	2004	\$ 10,910,000	1.61%	7.30%
	2004	\$ 15,600,000	1.66%	7.30%
Variable to Fixed	2004	\$ 15,600,000	4.50%	0.96%

⁽¹⁾ Weighted average for the nine months ended September 30, 2003

The \$15,600,000 variable to fixed swap was entered into after the \$15,600,000 fixed to variable swap and effectively fixes the interest rate on \$15,600,000 of bonds and mortgage notes payable at a fixed pay rate of 4.50% through 2004. The variable interest rate on the Company's \$10,910,000 of borrowings was obtained using the fixed to variable rate swap, as noted above.

As the table above incorporates only those exposures that existed as of September 30, 2003, it does not consider those exposures or positions that could arise after that date. The Company's ultimate economic impact with respect to interest rate fluctuations will depend on the exposures that arise during the period, the Company's risk mitigating strategies at that time and interest rates.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. The Company's Principal Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) as of the end of the period covered by this quarterly report. Based on that evaluation, the Principal Executive Officer and the Chief Financial Officer

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have concluded that the Company's current disclosure controls and procedures are effective, providing them with material information relating to the Company as required to be disclosed in the reports the Company files or submits under the Exchange Act on a timely basis.

(b) Changes in internal controls. There were no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to affect, the Company's internal controls over financial reporting.

Part II. Other Information

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

The following exhibits are filed as part of this report. Exhibit numbers refer to the paragraph numbers under Item 601 of Regulation S-K:

2. Agreement and Plan of Merger, dated June 18, 2002, between the Company and America First Apartment Investors, L.P. (incorporated by reference to Exhibit 2.1 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by America First Apartment Investors, Inc. on June 18, 2002).

3.1 Articles of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by America First Apartment Investors, Inc. on June 18, 2002).

3.2 Bylaws of the Company (incorporated by reference to Exhibit 3.2 to Amendment No. 1 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by Company on August 1, 2002).

4.1 Form of Common Stock Certificate of the Company (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by the Company on June 18, 2002).

10.1 Advisory Agreement, dated June 18, 2002, by and between the Company and America First Apartment Advisory Corporation (incorporated by reference to Exhibit 10.1 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by the Company on June 18, 2002).

10.2 2002 Stock Option Plan of the Company (incorporated by reference to Exhibit 10.2 to Registration Statement on Form S-4 (Commission File No. 333-90690) filed by the Company on June 18, 2002).

31 (a) Certification of CEO pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

31 (b) Certification of CFO pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

32 (a) Certification of CEO pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

32 (b) Certification of CFO pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

(b) Reports on Form 8-K

The Company did not file a report on Form 8-K during the quarter for which this report is filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 6, 2003 AMERICA FIRST APARTMENT INVESTORS, INC.

/s/ John. H. Cassidy

John H. Cassidy

President and Chief Executive Officer