PREFERRED APARTMENT COMMUNITIES INC
Form 10-K/A
August 31, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

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

For the fiscal year ended December 31, 2011

Commission File No. 001-34995

Preferred Apartment Communities, Inc.

(Exact name of registrant as specified in its charter)

MARYLAND	**27-1712193**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

3625 Cumberland Boulevard, Suite 400, Atlanta, GA 30339

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (770) 818-4100

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	NYSE MKT

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Exchange Act Rule 12b-2).

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of June 30, 2011, the last business day of registrant's most recently completed second fiscal quarter, was $30,454,827 based on the closing price of the common stock on the NYSE Amex (now known as the NYSE MKT) on such date.

The number of shares outstanding of the registrant's common stock, as of March 12, 2012 was 5,178,313.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information is incorporated by reference to the registrant's definitive Proxy Statement filed on March 23, 2012 for the registrant's 2012 Annual Meeting of Stockholders in PART III of this Annual Report on Form 10-K.

Explanatory Note

This Amendment No. 1 on Form 10-K/A (this “Amendment No. 1”) amends the Preferred Apartment Communities, Inc. Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission on March 15, 2012 (the “Original Filing”) as follows:

(i) The Report of Independent Registered Public Accounting Firm, or Audit Report, is amended to include the city and state of the principal local office of our independent registered public accounting firm;

(ii) The Audit Report is also amended to clarify that the independent registered public accounting firm’s audit included audits of Schedule III, Real Estate Investments and Accumulated Depreciation, and Schedule IV, Mortgage Loans on Real Estate; and

(iii) The cover of this Amendment No. 1 reflects the change in name of the exchange on which our common stock is registered from NYSE Amex to NYSE MKT. This was a change in the name of the exchange only, not a change of the exchange on which our common stock is registered.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, or the Exchange Act, the certifications required pursuant to the rules promulgated under the Exchange Act, as adopted pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, which were included as exhibits to the Original Report, have been amended, restated and re-executed as of the date of this Amendment No. 1 and are included as Exhibits 31.1, 31.2, 32.1 and 32.2 hereto.

Except as expressly set forth above, this Amendment No. 1 does not, and does not purport to, amend, update, change or restate the information in any other item of the Original Filing or reflect any events that have occurred after the date of the Original Filing. Please refer to our Quarterly Reports on Form 10-Q for the periods ended March 31, 2012 and June 30, 2012 and current reports on Form 8-K for such subsequent events or transactions.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

(a)(3) Exhibits

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

of Preferred Apartment Communities, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15 (a)(1) present fairly, in all material respects, the financial position of Preferred Apartment Communities, Inc. and its subsidiaries at December 31, 2011 and December 31, 2010, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15 (a)(1) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Atlanta, GA

March 15, 2012

F-2

Preferred Apartment Communities, Inc.

Consolidated Balance Sheets

	December 31, 2011	December 31, 2010
Assets		
Real estate		
Land	$ 13,052,000	$ -
Building and improvements	60,268,867	-
Furniture, fixtures, and equipment	8,392,446	-
Construction in progress	67,877	-
Gross real estate	81,781,190	-
Less: accumulated depreciation	(2,698,305)	-
Net real estate	79,082,885	-
Real estate loan	6,000,000	-
Total real estate and real estate loan, net	85,082,885	-
Cash and cash equivalents	4,548,020	22,275
Restricted cash	567,346	-
Tenant receivables, net of allowance of $15,924	23,811	-
Deferred loan costs, net of amortization of $64,480	551,660	-
Deferred offering costs	1,388,421	620,237
Other assets	303,397	187,300
Total assets	$ 92,465,540	$ 829,812
Liabilities and equity		
Liabilities		
Mortgage notes payable	$ 55,637,000	$ -
Accounts payable and accrued expenses	1,158,530	-
Note payable, related party	-	465,050
Revolving line of credit, related party	-	200,000
Non-revolving line of credit, related party	-	805,898
Accrued interest payable	176,084	15,064
Dividends payable	646,916	-
Security deposits and prepaid rents	163,663	-
Deferred real estate loan income	65,446	-
Total liabilities	57,847,639	1,486,012

Commitments and contingencies (Note 12)		
Equity (deficit)		
Stockholder's equity (deficit)		
Series A Redeemable Preferred Stock, $0.01 par value per share; 150,000 shares authorized; 0 shares issued and outstanding at December 31, 2011	-	-
Common Stock, $0.01 par value per share; 400,066,666 shares authorized; 5,149,325 shares issued and outstanding at December 31, 2011; 36,666 shares issued and outstanding at December 31, 2010	51,493	366
Additional paid in capital	43,828,030	109,632
Accumulated deficit	(9,261,623)	(766,199)
Total stockholders' equity (deficit)	34,617,900	(656,201)
Non-controlling interest	1	1
Total equity (deficit)	34,617,901	(656,200)
Total liabilities and equity	$ 92,465,540	$ 829,812

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

F-3

Preferred Apartment Communities, Inc.

Consolidated Statements of Operations

	Twelve months ended December 31, 2011	December 31, 2010
Revenues:		
Rental revenues	$6,199,946	$ -
Other property revenues	700,512	-
Interest income on real estate loan	250,245	-
Total revenues	7,150,703	-
Operating expenses:		
Property operating and maintenance	1,591,962	-
Property management fees	276,358	-
Real estate taxes	519,500	-
General and administrative	141,078	-
Depreciation and amortization	8,238,444	-
Acquisition costs	1,680,432	388,266
Organizational costs	172,395	360,179
Insurance	111,900	-
Professional fees	380,382	-
Other	109,655	2,690
Total operating expenses	13,222,106	751,135
Operating loss	(6,071,403)	(751,135)
Management fees	505,441	-
Insurance	167,689	-
Interest expense	1,514,581	15,064
Other expense	236,310	-
Net loss	(8,495,424)	(766,199)
Less consolidated net loss attributable to non-controlling interests	-	-
Net loss attributable to the Company	$(8,495,424)	$ (766,199)
Net loss per share of Common Stock, basic and diluted	$(2.23)	$ (20.90)
Weighted average number of shares of Common Stock outstanding, basic and diluted	3,822,303	36,666

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

Preferred Apartment Communities, Inc.

Consolidated Statements of Equity and Accumulated Deficit

For the twelve months ended December 31, 2011 and December 31, 2010

	Series A Redeemable Preferred Stock	Common Stock	Additional Paid in Capital	Accumulated Deficit	Total Stockholders Equity (Deficit)	Non Controlling Interest	Total Equity (Deficit)
Balance at January 1, 2010	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Issuance of Common Stock	-	366	109,632	-	109,998	-	109,998
Issuance of partnership interest in Operating Partnership to noncontrolling interest	-	-	-	-	-	1	1
Net loss	-	-	-	(766,199)	(766,199)	-	(766,199)
Balance at December 31, 2010	-	366	109,632	(766,199)	(656,201)	1	(656,200)
Issuance of warrant to purchase Common Stock	-	-	462,330	-	462,330	-	462,330
Proceeds from sale of Common Stock	-	51,074	51,022,536	-	51,073,610	-	51,073,610
Issuance of stock compensation	-	53	238,099	-	238,152	-	238,152
Syndication and offering costs	-	-	(6,064,489)	-	(6,064,489)	-	(6,064,489)
Net loss	-	-	-	(8,495,424)	(8,495,424)	-	(8,495,424)
Dividends to common stockholders	-	-	(1,940,078)	-	(1,940,078)	-	(1,940,078)
Balance at December 31, 2011	$ -	$ 51,493	$ 43,828,030	$ (9,261,623)	$ 34,617,900	$ 1	$ 34,617,901

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

Preferred Apartment Communities, Inc.

Consolidated Statements of Cash Flows

	Twelve months ended December 31, 2011	December 31, 2010
Operating activities:		
Net loss	$(8,495,424)	$ (766,199)
Reconciliation of net loss to net cash provided by (used in) operating activities:		
Depreciation expense	2,698,305	-
Amortization expense	5,540,139	-
Deferred fee income amortization	(8,887)	-
Deferred loan cost amortization	64,479	-
Non-cash stock compensation	238,152	-
Changes in operating assets and liabilities:		
(Increase) in tenant accounts receivable	(23,811)	-
Decrease (increase) in other assets	6,327	(37,300)
Increase in accounts payable and accrued expenses	340,844	15,064
Increase in accrued interest	161,020	-
Increase in security deposits	6,578	-
Increase in prepaid rents	238	-
Net cash provided by (used in) operating activities	527,960	(788,435)
Investing activities:		
Investment in real estate loan	(6,000,000)	-
Deferred acquisition fee on real estate loan	(60,000)	-
Deferred real estate loan income	134,333	-
Refund (payment) of deposit on real estate investment	150,000	(150,000)
Acquisition of properties, net of cash acquired	(87,449,341)	-
Additions to real estate assets - improvements	(458,272)	-
Increase in cash held in escrow and restricted cash	(1,631)	-
Net cash used in investing activities	(93,684,911)	(150,000)
Financing activities:		
Proceeds from mortgage notes payable	55,637,000	-
Payments for mortgage loan costs	(616,139)	-
Payments on revolving lines of credit	(200,000)	-
Payments on non-revolving lines of credit	(1,240,000)	-
Proceeds from revolving lines of credit	-	200,000
Proceeds from non-revolving lines of credit	434,102	805,898
Proceeds from note payable to related parties	-	465,050
Payments on note payable to related parties	(465,050)	-
Proceeds from sales of common stock, net of offering costs	46,117,663	109,998
Dividends declared and paid	(1,293,162)	-
Increase in deferred offering costs, net of non cash items	(691,718)	(620,237)
Proceeds from noncontrolling interest	-	1

Net cash provided by financing activities	97,682,696	960,710
Net increase in cash and cash equivalents	4,525,745	22,275
Cash beginning of period	22,275	-
Cash end of period	$4,548,020	$ 22,275
Supplemental cash flow information:		
Cash paid for interest	$1,287,240	$ -
Supplemental disclosure of non-cash activities:		
Accrued capital expenditures	$32,486	$ -
Dividends payable	$646,916	$ -
Accrued and payable deferred offering costs	$701,899	$ -
Other net non-cash property assets acquired	$599,341	$ -

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

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements

December 31, 2011

1. Organization

Preferred Apartment Communities, Inc., or the Company, was formed as a Maryland corporation on September 18, 2009, and intends to elect and qualify as a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our tax year ended December 31, 2011. The Company was formed primarily to acquire and operate multifamily properties in select targeted markets throughout the United States. As part of its property acquisition strategy, the Company may enter into forward purchase contracts or purchase options for to-be-built multifamily communities and it may make mezzanine loans, provide deposit arrangements, or provide performance assurances, as may be necessary or appropriate, in connection with the construction of these properties. As a secondary strategy, the Company may acquire senior mortgage loans, subordinated loans or mezzanine debt secured by interests in multifamily properties, membership or partnership interests in multifamily properties and other multifamily related assets as determined by our manager. The Company is externally managed and advised by Preferred Apartment Advisors, LLC ("PAA"), a Delaware limited liability company and related party, or our Manager (see Note 6).

On January 26, 2010, the Company concluded a private placement of 33,333 shares of Class B Common Stock to NELL Partners, Inc., a Georgia corporation, and a related party, at a price of $3.00 per share of Class B Common Stock. In addition, on that same day the Company conducted a private placement of 3,333 shares of Class A Common Stock to NELL Partners, Inc. at a price of $3.00 per share of Class A Common Stock.

On February 22, 2011, the Company effected a change in the designation of its issued and outstanding and authorized but unissued shares of Class A Common Stock, $0.01 par value per share, to shares of common stock, par value $0.01 per share, or Common Stock, and effected a change of each of its issued and outstanding shares of Class B Common Stock, $0.01 par value per share, into one issued and outstanding share of Common Stock, all pursuant to an amendment to the Company's charter. As a result of these actions, NELL Partners, Inc. held 36,666 shares of the Company's Common Stock as of February 22, 2011. The consolidated balance sheets and consolidated statement of equity and accumulated deficit at December 31, 2010 have been retroactively restated to reflect this change.

The Company completed its initial public offering (the "IPO") on April 5, 2011. The IPO resulted in the sale of 4,500,000 shares of Common Stock at a price per share of $10.00, generating gross proceeds of $45.0 million. The aggregate proceeds to the Company, net of underwriters' discounts and commissions and other offering costs, were approximately $39.8 million. Concurrently with the closing of the IPO, in a separate private placement pursuant to Regulation D under the Securities Act of 1933, as amended (the "Securities Act"), the Company sold 500,000 shares of its Common Stock to the Williams Opportunity Fund, LLC, or WOF, at the public offering price of $10.00 per share, for gross proceeds to the Company of $5 million. Aggregated estimated offering expenses in connection with the private placement were approximately $297,700. WOF is an affiliate of the Company and PAA.

On May 4, 2011, in conjunction with the IPO, the Company issued and sold 107,361 shares of Common Stock at $10.00 per share pursuant to the underwriters' exercise of their over-allotment option, for gross proceeds of approximately $1.1 million. After deducting underwriters’ commissions and offering expenses, net proceeds to the Company from the over-allotment option were approximately $1.0 million.

On November 18, 2011, the Securities and Exchange Commission declared effective our registration statement on Form S-11 (registration number 333-176604) for our offering of a minimum of 2,000 and a maximum of 150,000 Units, with each Unit consisting of one share of our Series A redeemable preferred stock, or Preferred Stock, and one warrant, or Warrant, to purchase 20 shares of our Common Stock.

The consolidated financial statements include the accounts of the Company and Preferred Apartment Communities Operating Partnership, L.P., or the Operating Partnership. The Company controls through its sole general partner interest the Operating Partnership and plans to conduct substantially all of its business through the Operating Partnership.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include all of the accounts of the Company and the Operating Partnership as of December 31, 2011, presented in accordance with accounting principles generally accepted in the United States of America, or GAAP. All significant intercompany transactions have been eliminated in consolidation. Certain adjustments have been made consisting of normal recurring accruals, which in the opinion of management, are necessary for a fair presentation of the Company's financial condition and results of operations.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Acquisitions and Impairments of Real Estate Assets

The Company generally records its initial investments in income-producing real estate at fair value at the acquisition date, in accordance with ASC 805-10, *Business Combinations*. Acquisition costs, which include fees and expenses for due diligence, legal, environmental and consulting services, will be expensed as incurred.

The aggregate purchase price of acquired properties is apportioned to the tangible and identifiable intangible assets and liabilities acquired at their estimated fair values. The value of acquired land, buildings and improvements is estimated by formal appraisals, observed comparable sales transactions, and information gathered during pre-acquisition due diligence activities and the valuation approach considers the value of the property as if it were vacant. The values of furniture, fixtures, and equipment are estimated by calculating their replacement cost and reducing that value by factors based upon estimates of their remaining useful lives.

Intangible assets include the values of in-place leases and customer relationships. In-place lease values are estimated by calculating the estimated time to fill a hypothetically empty apartment complex to its stabilization level (estimated to be 92% occupancy) based on historical observed move-in rates for each property. Carrying costs during these hypothetical expected lease-up periods are estimated, considering current market conditions and include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates. The intangible assets are calculated by estimating the net cash flows of the in-place leases to be realized, as compared to the net cash flows that would have occurred had the property been vacant at the time of acquisition and subject to lease-up. The acquired in-place lease values are amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. The above-market or below-market lease values are recorded as a reduction or increase, respectively, to rental income over the remaining average non-cancelable term of the respective leases. The values of customer relationships are estimated by calculating the product of the avoided hypothetical lost revenue and the average renewal probability and are likewise amortized to operating expense over the average remaining non-cancelable term of the respective in-place leases. Acquired intangible assets generally have no residual value.

The Company evaluates its tangible and identifiable intangible real estate assets for impairment annually or when events such as declines in a property's operating performance, deteriorating market conditions, or environmental or legal concerns bring recoverability of the carrying value of one or more assets into question. The total undiscounted cash flows of the asset, including proceeds from disposition, are compared to the net book value of the asset. If this test indicates that impairment exists, an impairment loss is recorded in earnings equal to the shortage of the book value versus the discounted net cash flows of the asset.

Loans Held for Investment

The Company records its investments in real estate loans at cost with assessments made for impairment in the event recoverability of the principal amount becomes doubtful. If, upon testing for impairment, the fair value result is lower than the carrying amount of the loan, a valuation allowance is recorded to lower the carrying amount to fair value, with a loss recorded in earnings. Recoveries of valuation allowances are only recognized in the event of maturity or a sale or disposition in an amount above amortized cost.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Restricted cash includes cash restricted by state law or contractual requirement and, as of December 31, 2011, relates primarily to tax and insurance escrows and resident security deposits.

Fair Value Measurements

Certain assets and liabilities are required to be carried at fair value, or if they are deemed impaired, to be adjusted to reflect this condition. The Company follows the guidance provided by ASC 820, *Fair Value Measurements and Disclosures*, in accounting and reporting for real estate assets where appropriate, as well as debt instruments both held for investment and as liabilities. The standard requires disclosure of fair values calculated under each level of inputs within the following hierarchy:

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

- Level 1 – Quoted prices in active markets for identical assets or liabilities at the measurement date.
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs for the asset or liability.

Deferred Loan Costs

Deferred loan costs are amortized using the straight-line method, which approximates the effective interest method, over the terms of the related indebtedness.

Deferred Offering Costs

Deferred offering costs represent offering costs incurred by the Company related to, but prior to the issuance of equity offerings. Following the issuance, these offering costs are reclassified to the stockholders' equity section of the consolidated balance sheet as a reduction of proceeds raised.

Non-controlling Interest

Non-controlling interest represents the equity interest of the Operating Partnership that is not owned by the Company. Non-controlling interest is adjusted for contributions, distributions and earnings (loss) attributable to the non-controlling interest in the consolidated entity in accordance with the Agreement of Limited Partnership of the Operating Partnership, as amended.

Revenue Recognition

Rental revenue is recognized when earned from residents, which is over the terms of rental agreements, typically of 13 months' duration. Differences from the straight-line method, which recognize the effect of any up-front concessions and other adjustments ratably over the lease term, have not been material. The Company evaluates the collectability of amounts due from residents and maintains an allowance for doubtful accounts for estimated losses resulting from the inability of residents to make required payments then due under lease agreements. The balance of amounts due from residents are generally deemed uncollectible 30 days beyond the due date, at which point they are written off.

Interest income on the real estate loan is recognized on an accrual basis over the life of the loan using the effective interest method. Direct loan origination fees and origination or acquisition costs are amortized over the life of the loan as an adjustment to interest income. The accrual of interest is stopped when there is concern as to the ultimate collection of principal or interest of the loan, which is generally a delinquency of 30 days in required payments of interest or principal. Any payments received on such non-accrual loans are recorded as interest income when the payments are received. Real estate loan investments are reclassified as accrual-basis once interest and principal payments become current.

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with guidance provided by ASC 505, *Equity-Based Payments to Non-Employees* and ASC 718, *Stock Compensation*. We calculate the fair value of equity compensation instruments at the date of grant based upon estimates of their expected term, the expected volatility of and dividend yield on our Common Stock over this expected term period and the market risk-free rate of return. We will also estimate forfeitures of these instruments and accrue the compensation expense, net of estimated forfeitures, over the vesting period(s). We record the fair value of restricted stock awards based upon the closing stock price on the trading day immediately preceding the date of grant.

Acquisition Costs

The Company expenses property acquisition costs as incurred, which include costs such as due diligence, legal, environmental and consulting.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

Capitalization and Depreciation

The Company capitalizes replacements of furniture, fixtures and equipment which exceed $500, as well as carpet, appliances, air conditioning units, certain common area items, and other assets. Significant repair and renovation costs that improve the usefulness or extend the useful life of the properties are also capitalized. These assets are then depreciated on a straight-line basis over their estimated useful lives, as follows:

· Buildings	40 years
· Furniture, fixtures & equipment	5 - 10 years
· Improvements to buildings and land	5 - 10 years
· Acquired customer intangibles	average remaining lease term

Operating expenses related to unit turnover costs, such as carpet cleaning, painting, mini-blind replacements, and minor repairs are expensed as incurred.

Income Taxes

The Company intends to elect and qualify as a real estate investment trust for U.S. federal income tax purposes, commencing with its tax year ended December 31, 2011. To qualify as a REIT, the Company must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of the Company's annual REIT taxable income to its stockholders (which is computed without regard to the dividends paid deduction or net capital gain which does not necessarily equal net income as calculated in accordance with GAAP). As a REIT, the Company generally will not be subject to federal income tax to the extent it distributes qualifying dividends to its stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income tax on its taxable income at regular corporate income tax rates and generally will not be permitted to qualify for treatment as a REIT for federal income tax purposes for the four taxable years following the year during which qualification is lost unless the Internal Revenue Service grants the Company relief under certain statutory provisions. Such an event could materially adversely affect the Company's net income and net cash available for distribution to stockholders. The Company intends to operate in such a manner as to qualify for treatment as a REIT.

Since the Company intends for its REIT election to be effective January 1, 2011 (See Note 11), it expects to be subject to U.S. federal and state income taxes for the period prior to that date. The provision for income taxes is based on income before taxes reported for financial statement purposes after adjustment for transactions that do not have tax consequences. Deferred tax assets and liabilities are realized according to the estimated future tax consequences attributable to differences between the carrying value of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates as of the date of the balance sheet. The effect of a change in tax rates on deferred tax assets and liabilities is reflected in the period that includes the statutory enactment date. A deferred tax asset valuation allowance is recorded when it has been determined that it is more likely than not that deferred tax assets will not be realized. If a valuation allowance is needed, a subsequent change in circumstances in future periods that causes a change in judgment about the realization of the related deferred tax amount could result in the reversal of the deferred tax valuation allowance.

The Company recognizes a liability for uncertain tax positions. An uncertain tax position is defined as a position taken or expected to be taken in a tax return that is not based on clear and unambiguous tax law and which is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company measures the tax benefits recognized based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company recognizes interest and penalties related to unrecognized tax benefits in its provision for income taxes.

Loss Per Share

Basic loss per share is computed by dividing net loss available to the Company by the weighted average number of shares of Common Stock outstanding for the period. Diluted loss per share is computed by dividing net loss available to the Company by the weighted average number of shares of Common Stock outstanding plus potentially dilutive securities such as share grants or warrants. No adjustment is made for potential Common Stock equivalents that are anti-dilutive during the period.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

Recent Adoption of Accounting Pronouncements

In December 2010, the FASB issued ASU 2010-29, *Business Combination (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. This new guidance requires pro forma disclosure of revenue and earnings for the combined entity as though all business combinations that occurred during the period had occurred as of the beginning of the current annual reporting period. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. This new guidance was effective for the first annual reporting period beginning after December 15, 2010. Adoption had no effect on the Company's financial position or results of operations.

In April 2011, the FASB issued *ASU 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. This new guidance sets forth specific criteria for a creditor to evaluate whether a debt modification constitutes a troubled debt restructuring. Specifically, the creditor must conclude (i) that a restructuring involves the granting of a concession and (ii) that the debtor is experiencing financial difficulties. The new guidance will be effective for annual and interim periods beginning on or after June 15, 2011. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

In May 2011, the FASB issued ASU 2011-04*, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The substantive changes in this new guidance require the application of a premium or discount in valuing an instrument that is absent Level 1 inputs, when a market participant would apply such a factor in valuing an instrument. The guidance also enhances disclosure requirements: (i) for fair values of Level 3 assets, the valuation process used for those assets and the sensitivity of those calculations to changes in the amount of unobservable inputs; (ii) a reporting entity's use of a nonfinancial asset in a way that differs from the asset's highest and best use when that asset is measured at fair value in the statement of financial position; and (iii) the categorization by level within the fair value hierarchy of items that are not measured at fair value in the statement of financial position but for which the fair value is required to be disclosed. This guidance will be effective for interim and annual periods beginning after December 15, 2011. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05*, Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. This new guidance removes the option of presenting elements of other comprehensive income within the statements of changes to stockholders' equity. Instead, the total of comprehensive income, the components of net income, and the components of other comprehensive income may be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance will be effective for interim and annual periods beginning after December 15, 2011, with retrospective application required. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

In September 2011, the FASB issued ASU 2011-08*, Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. This new standard provides the option to utilize a qualitative assessment of facts and circumstances to determine whether the carrying value of a reporting segment is more likely than not greater than its fair value, for purposes of proceeding with annual goodwill impairment testing. If this qualitative assessment indicates that the existence of an impairment condition is more likely than not, then the analysis proceeds according to existing guidance. If not, then no further action is necessary. This guidance will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

In December 2011, the FASB issued ASU 2011-10, *Property, Plant and Equipment (Topic 360): Derecognition of in Substance Real Estate – a Scope Clarification.* This new standard clarifies the guidance concerning deconsolidation of a subsidiary that is in substance real estate upon the event of default of that subsidiary's nonrecourse debt. Generally, deconsolidation of a subsidiary in this circumstance is not appropriate until the collateral is legally transferred to the lender and the indebtedness is extinguished. This guidance will be effective for annual and interim periods beginning after June 15, 2012. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.* This new standard enhances the required disclosures concerning derivatives and certain other financial instruments that are either netted together and presented as one amount, or are subject to a master netting arrangement. Retrospective adoption of this guidance will be effective for annual and interim periods beginning on or after January 1, 2013. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05.* This new standard defers the effective date for the presentation requirements for reclassification adjustments into accumulated other comprehensive income by component as mandated by ASU 2011-08. This guidance as well as all other guidance from ASU 2011-08 are effective for fiscal years beginning after December 15, 2011. The Company does not expect its adoption of this guidance to have a material effect on its financial position or results of operations.

3. Real Estate Assets

The Company acquired the following three properties which were either partly or wholly owned by parties related to the Company. The acquisition price for each property was determined pursuant to the appraisals of two independent real estate appraisers.

On April 15, 2011, the Company acquired 100% of the membership interests in Stone Rise Apartments, LLC, a Delaware limited liability company (f/k/a Oxford Rise JV LLC), the fee-simple owner of a 216-unit multifamily community located in suburban Philadelphia, Pennsylvania, or Stone Rise, for a total purchase price of $30.15 million, exclusive of acquisition-related and financing-related transaction costs. The membership interests in Oxford Rise JV LLC were owned by WOF.

On April 21, 2011, the Company acquired 100% of the membership interests in PAC Summit Crossing, LLC, a Georgia limited liability company (f/k/a Oxford Summit Partners, LLC), the fee-simple owner of a 345-unit multifamily community located in suburban Atlanta, Georgia, or Summit Crossing, for a total purchase price of $33.2 million, exclusive of acquisition-related and financing-related transaction costs. Williams Realty Fund I, LLC, or WRF, owned a majority of the membership interests in PAC Summit Crossing, LLC.

On April 29, 2011, the Company, through its wholly owned subsidiary Trail Creek Apartments, LLC, acquired Oxford Trail, a 204-unit multifamily community located in Hampton, Virginia, or Trail Creek, for a total purchase price of $23.5 million, exclusive of acquisition-related and financing-related transaction costs. The Company purchased a fee-simple interest in the property from Oxford Trail JV LLC. WRF owned indirectly an approximately 10%

membership interest in Oxford Trail JV LLC.

Reported revenues and expenses related to these three acquired properties are from results of operations beginning from the respective dates of acquisition through December 31, 2011.

The Company allocated the purchase prices of the three properties to the acquired assets and liabilities based upon their fair values, as follows:

	Trail Creek	Stone Rise	Summit Crossing	Total
Land	$2,652,000	$6,950,000	$ 3,450,000	$13,052,000
Buildings and improvements	17,257,845	18,637,356	24,112,767	60,007,968
Furniture, fixtures and equipment	1,841,990	2,819,094	3,591,881	8,252,965
Intangibles	1,748,165	1,743,550	2,045,352	5,537,067
Cash	9,301	16,101	486	25,888
Deposits	28,160	61,276	41,525	130,961
Prepaids and reserves	93,967	439,041	154,744	687,752
Accounts payable and accrued expenses	(48,374)	(81,677)	(89,321)	(219,372)
Net assets acquired	$23,583,054	$30,584,741	$ 33,307,434	$87,475,229
Net assets excluding cash	$23,573,753	$30,568,640	$ 33,306,948	$87,449,341

The Company recorded depreciation and amortization of tangible and identifiable intangible assets as follows:

F-12

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

	Twelve months ended December 31, 2011
Depreciation:	
Buildings and improvements	$ 1,129,835
Furniture, fixtures, and equipment	1,568,470
	2,698,305
Amortization of acquired intangible assets	5,537,067
Website development costs	3,072
Total depreciation and amortization	$ 8,238,444

Acquired intangible assets consist of the values of leases in place, customer relationships, and above-market or below-market leases, each of which are amortized over the non-cancelable remaining average lease terms. The combined balance of acquired intangible assets for the three multifamily communities was amortized in full during 2011.

Contributions of revenues and earnings by the acquisitions of Stone Rise, Summit Crossing, and Trail Creek to the Company's results of operations from the dates of acquisition (April 15, 2011, April 21, 2011 and April 29, 2011 for Stone Rise, Summit Crossing and Trail Creek, respectively) through December 31, 2011 were:

	Stone Rise	Summit Crossing	Trail Creek	Total
Revenues	$2,467,435	$2,607,715	$1,825,308	$6,900,458
Depreciation and amortization expense	2,543,979	3,203,627	2,487,765	8,235,371
Other expenses	1,385,894	1,627,817	1,035,534	4,049,245
Earnings	$(1,462,438)	$(2,223,729)	$(1,697,991)	$(5,384,158)

4. Real Estate Loan

On June 30, 2011, the Company made a mezzanine loan investment of $6.0 million to Oxford Hampton Partners LLC ("Hampton Partners"), a Georgia limited liability company and a related party, to partially finance the construction of a 96-unit multifamily community located adjacent to the Company's existing Trail Creek multifamily community in Hampton, Virginia. Hampton Partners was required to fully draw down the mezzanine loan on the closing date. Approximately 100% of the membership interests in Hampton Partners are owned by WRF.

The mezzanine loan matures on June 29, 2016, with no option to extend and pays interest at a fixed rate of 8.0% per annum. Interest will be paid monthly with principal and any accrued but unpaid interest due at maturity. Under the terms of a purchase option agreement entered into in connection with the closing of the mezzanine loan, the Company has an option (but not an obligation) to purchase the property between and including April 1, 2014 and June 30, 2014 for $17,825,600, which is the amount of the aggregate project costs as set forth in the approved construction budget on the closing date. If the property is sold to, or refinanced by, a third party before July 1, 2014, the Company will be entitled to receive an exit fee equal to the amount required to provide it with a 14% cumulative internal rate of return on the loan. If the property is sold to, or refinanced by, a third party on or after July 1, 2014, then the Company will be entitled to receive an exit fee equal to the amount required to provide it with a 12% cumulative internal rate of return on the loan. The calculation of the cumulative internal rate of return will include the loan's fees received at closing. Since the minimum exit fee, assuming the purchase option is not exercised, is the amount needed to provide a 12% cumulative internal rate of return, the Company will accrue each period the additional exit fee earned based on the 12% rate assuming the loan was paid off at period end as the borrower cannot control whether the option is exercised. The accrued exit fee will be recorded as interest income in the consolidated statements of operations. As of December 31, 2011, no additional exit fee was earned by the Company.

If the Company exercises the purchase option and acquires the property, any accrued and unpaid exit fee will be treated as additional basis in the acquired project.

The mezzanine loan is secured by a pledge of 100% of the membership interests of Hampton Partners. Partial prepayment of the mezzanine loan is not permitted without the Company's consent. The mezzanine loan is subordinate to a senior loan of up to an aggregate amount of $10 million that is held by an unrelated third party. W. Daniel Faulk, Jr. and Richard A. Denny, both unaffiliated third parties, have guaranteed the completion of the project in accordance with the plans and specifications. This guaranty is subject to the rights held by the senior lender pursuant to a standard intercreditor agreement with the senior lender.

In connection with the closing of the mezzanine loan, the Company received a loan fee of 2% of the loan amount, or $120,000, and a loan commitment fee of $14,333. The Company paid an acquisition fee of $60,000 to PAA out of these funds. The net fees received by the Company will be recognized as an adjustment of yield over the term of the loan using the effective interest method.

5. Stockholders' Equity (Deficit)

On January 26, 2010, the Company issued to NELL Partners, Inc. 3,333 shares of Class A Common Stock at $3.00 per share and 33,333 shares of Class B Common Stock at $3.00 per share in a private placement.

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

On February 22, 2011, the Company effected a change in the designation of its shares of Class A Common Stock, $0.01 par value per share, to shares of Common Stock, par value $0.01 per share, and effected a change of each of its issued and outstanding shares of Class B Common Stock, $0.01 par value per share, into one issued and outstanding share of Common Stock, all pursuant to an amendment to the Company's charter. As a result of these actions, NELL Partners, Inc. held 36,666 shares of Common Stock as of February 22, 2011.

On July 29, 2010, the Board of Directors of the Company authorized the issuance and sale of up to $75.0 million in Class A Common Stock in an underwritten public offering. On February 25, 2011, the Company amended its prior authorization to issue up to $75.0 million in Class A Common Stock in accordance with the change in designation of all shares of Class A Common Stock to shares of Common Stock, as described above, and, as a result, the Board of Directors of the Company authorized the issuance and sale of up to $75.0 million in Common Stock in an initial public offering.

On July 29, 2010, WOF entered into a subscription agreement with the Company. Pursuant to this agreement, WOF subscribed for the purchase from the Company such number of shares of Class A Common Stock ($0.01 par value per share) of the Company having an aggregate value of $5.0 million. The price per share would equal the price per share of Class A Common Stock sold in the underwritten public offering. The subscription agreement between the Company and WOF was amended on February 28, 2011, to reflect the charter amendment changing all shares of Class A Common Stock to shares of Common Stock, as described above.

Pursuant to this amendment, a subscription by WOF for such shares of Common Stock of the Company having an aggregate value of $5.0 million replaced WOF's original subscription for shares of Class A Common Stock. On April 5, 2011, WOF purchased 500,000 shares of the Company's Common Stock pursuant to this subscription agreement.

6. Related Party Transactions

John A. Williams, the Company's Chief Executive Officer, President and Chairman of the Board of Directors and Leonard A. Silverstein, the Company's Executive Vice President, General Counsel, Secretary and Vice Chairman of the Board of Directors, are also executive officers and directors of NELL Partners, Inc., which controls PAA, the Company’s external management company. Mr. Williams is the Chief Executive Officer and President and Mr.

Silverstein is the Executive Vice President, General Counsel and Secretary of PAA.

Mr. Williams, Mr. Silverstein and Michael J. Cronin, the Company's Chief Accounting Officer, are executive officers of Williams Realty Advisors, LLC, or WRA, which is the manager of the day-to-day operations of WOF. WRA is also the manager of the day-to-day operations of WRF.

The third amended and restated management agreement, or Management Agreement, between the Company, the Operating Partnership and PAA entitles PAA to receive compensation for various services it performs related to acquiring and managing properties on the Company's behalf:

Type of Compensation	Basis of Compensation	**Twelve months ended** December 31, 2011
Acquisition fees	1% of the gross purchase price of real estate assets acquired or loans advanced	$ 928,500
Asset management fees	Monthly fee equal to one-twelfth of 0.50% of the total value of assets, as adjusted	362,427
Property management fees	Monthly fee equal to 4% of the monthly gross revenues of the properties managed	276,358
General and administrative expense fees	Monthly fee equal to 2% of the monthly gross revenues of the Company	143,014
		$ 1,710,299

Preferred Apartment Communities, Inc.

Notes to Consolidated Financial Statements – (continued)

December 31, 2011

As of December 31, 2011, the Company owed PAA $5,164 in fees pursuant to the Management Agreement, which are included in accounts payable and accrued expenses.

In addition to property management fees, the Company incurred reimbursable expenses owed to the affiliate's property manager at the properties of $676,413 during the twelve-month period ended December 31, 2011. These reimbursed expenses consisted of on-site personnel salary and related benefits.

PAA utilizes certain personnel of its affiliates to accomplish certain tasks related to raising capital, including, but not limited to, legal, and marketing functions. As permitted under the Management Agreement, PAA has requested reimbursement of $203,762 for the twelve-month period ended December 31, 2011. These costs are recorded as deferred offering costs until such time as closings occur on the Series A Redeemable Preferred Stock and Warrant Unit offering, at which time they are reclassified on a pro-rata basis as a reduction of offering proceeds within stockholders' equity.

In addition to the fees described above, the management agreement also entitles PAA to other potential fees, as follows:

- Disposition fees - Based on the lesser of (A) one-half of the commission that would be reasonable and customary; and (B) 1% of the sale price of the asset
- Construction, development, and landscaping fees - Customary and competitive market rates in light of the size, type and location of the asset