

Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

NexPoint Residential Trust, Inc.  
Form 10-Q  
November 10, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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 001-36663

NexPoint Residential Trust, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Maryland 47-1881359  
(State or other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

300 Crescent Court, Suite 700, Dallas, Texas 75201  
(Address of Principal Executive Offices) (Zip Code)

(972) 628-4100

Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

(Telephone Number, Including Area Code)

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of November 9, 2016, the registrant had 21,060,479 shares of common stock, \$0.01 par value, outstanding.

---

NEXPOINT RESIDENTIAL TRUST, INC.

Form 10-Q

Quarter Ended September 30, 2016

Page

PART I—FINANCIAL INFORMATION

Item Financial Statements

1.		
	<u>Consolidated Balance Sheets as of September 30, 2016 (Unaudited) and December 31, 2015</u>	1
	<u>Consolidated Unaudited Statements of Operations and Comprehensive Income (Loss) for the Three Months Ended September 30, 2016 and 2015 and Combined Consolidated Unaudited Statements of Operations and Comprehensive Income (Loss) for the Nine Months Ended September 30, 2016 and 2015</u>	2
	<u>Consolidated Unaudited Statement of Equity for the Nine Months Ended September 30, 2016</u>	3
	<u>Consolidated Unaudited Statements of Cash Flows for the Nine Months Ended September 30, 2016 and Combined Consolidated Unaudited Statements of Cash Flows for the Nine Months Ended September 30, 2015</u>	4
	<u>Notes to Combined Consolidated Unaudited Financial Statements</u>	6
Item	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	
2.		31
Item	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
3.		48
Item	<u>Controls and Procedures</u>	
4.		48

PART II—OTHER INFORMATION

Item	<u>Legal Proceedings</u>	
1.		50
Item	<u>Risk Factors</u>	
1A.		50
Item	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	
2.		50
	<u>Defaults Upon Senior Securities</u>	50

Item		
3.		
Item	<u>Mine Safety Disclosures</u>	
4.		50
Item	<u>Other Information</u>	
5.		50
Item	<u>Exhibits</u>	
6.		51
	<u>Signatures</u>	52

### Cautionary Statement Regarding Forward-Looking Statements

This quarterly report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. In particular, statements relating to our liquidity and capital resources, the performance of our properties, results of operations, strategy, plans or intentions contain forward-looking statements. Furthermore, all of the statements regarding future financial performance (including market conditions and demographics) are forward-looking statements. We caution investors that any forward-looking statements presented in this quarterly report are based on management's beliefs and assumptions made by, and information currently available to, management. When used, the words "anticipate," "believe," "expect," "intend," "may," "might," "plan," "estimate," "project," "should," "will," "would," "result" and similar expressions that do not relate solely to historical results are intended to identify forward-looking statements.

Forward-looking statements are subject to risks, uncertainties and assumptions and may be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. We caution you therefore against relying on any of these forward-looking statements.

Some of the risks and uncertainties that may cause our actual results, performance, liquidity or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the following:

- unfavorable changes in market and economic conditions in the United States and globally and in the specific markets where our properties are located;
- risks associated with ownership of real estate;
- limited ability to dispose of assets because of the relative illiquidity of real estate investments;
- intense competition in the real estate market that, combined with low residential mortgage rates that could encourage potential renters to purchase residences rather than lease them, may limit our ability to acquire or lease and re-lease property or increase or maintain rent;
- risks associated with our ability to issue additional debt or equity securities in the future;
- failure of acquisitions and development projects to yield anticipated results;
- risks associated with our strategy of acquiring value-enhancement multifamily properties, which involves greater risks than more conservative investment strategies;
- the lack of experience of NexPoint Real Estate Advisors, L.P. (our "Adviser") in operating under the constraints imposed by REIT requirements;
- loss of key personnel;
- the risk that we may not replicate the historical results achieved by other entities managed or sponsored by affiliates of our Adviser, members of our Adviser's management team or by Highland Capital Management, L.P. (our "Sponsor" or "Highland") or its affiliates;
- risks associated with our Adviser's ability to terminate the Advisory Agreement;
- our ability to change our major policies, operations and targeted investments without stockholder consent;
- the substantial fees and expenses we will pay to our Adviser and its affiliates;
- risks associated with the potential internalization of our management functions;
- the risk that we may compete with other entities affiliated with our Sponsor or property manager for tenants;
- conflicts of interest and competing demands for time faced by our Adviser, our Sponsor and their officers and employees;
- our dependence on information systems;
  - lack of or insufficient amounts of insurance;
  -

contingent or unknown liabilities related to properties or businesses that we have acquired or may acquire;

high costs associated with the investigation or remediation of environmental contamination, including asbestos, lead-based paint, chemical vapor, subsurface contamination and mold growth;

ii

---

the risk that our environmental assessments may not identify all potential environmental liabilities and our remediation actions may be insufficient;

high costs associated with the compliance with various accessibility, environmental, building and health and safety laws and regulations, such as the ADA and FHA;

risks associated with our high concentrations of investments in the Southeastern and Southwestern United States;

risks associated with limited warranties we may obtain when purchasing properties;

exposure to decreases in market rents due to our short-term leases;

risks associated with operating through joint ventures and funds;

potential reforms to Fannie Mae and Freddie Mac;

risks associated with our reduced public company reporting requirements as an “emerging growth company”;

costs associated with being a public company, including compliance with securities laws;

risks associated with breaches of our data security;

the risk that our business could be adversely impacted if there are deficiencies in our disclosure controls and procedures or internal control over financial reporting;

risks associated with our substantial current indebtedness and indebtedness we may incur in the future;

risks associated with derivatives or hedging activity;

the risk that we may be unable to achieve some or all of the benefits that we expect to achieve from the Spin-Off;

failure to qualify as or to maintain our status as a REIT;

compliance with REIT requirements, which may limit our ability to hedge our liabilities effectively and cause us to forgo otherwise attractive opportunities, liquidate certain of our investments or incur tax liabilities;

failure of our operating partnership to qualify as a partnership for federal income tax purposes, causing us to fail to qualify for or to maintain REIT status;

the ineligibility of dividends payable by REITs for the reduced tax rates available for some dividends;

risks associated with the stock ownership restrictions of the Code for REITs and the stock ownership limit imposed by our charter;

the ability of the Board of Directors to revoke our REIT qualification without stockholder approval;

potential legislative or regulatory tax changes or other actions affecting REITs;

risks associated with the market for our common stock and the general volatility of the capital and credit markets;

failure to generate sufficient cash flows to service our outstanding indebtedness or pay distributions at expected levels;

risks associated with limitations of liability for and our indemnification of our directors and officers; or

any of the other risks included under Part I, Item 1A, “Risk Factors” of our annual report on Form 10-K, filed with the Securities and Exchange Commission on March 21, 2016.

While forward-looking statements reflect our good faith beliefs, they are not guarantees of future performance. They are based on estimates and assumptions only as of the date of this quarterly report. We undertake no obligation to update or revise any forward-looking statement to reflect changes in underlying assumptions or factors, new information, data or methods, future events or other changes, except as required by law.

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	September 30, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
Operating Real Estate Investments		
Land (including from VIEs of \$94,962 and \$163,462, respectively)	\$ 155,992	\$ 177,152
Buildings and improvements (including from VIEs of \$365,133 and \$642,936, respectively)	652,342	729,675
Intangible lease assets	491	2,573
Construction in progress (including from VIEs of \$1,935 and \$5,070, respectively)	2,690	5,346
Furniture, fixtures, and equipment (including from VIEs of \$18,863 and \$25,715, respectively)	33,612	28,009
Total Gross Operating Real Estate Investments	845,127	942,755
Accumulated depreciation and amortization (including from VIEs of \$29,580 and \$36,112, respectively)	(55,455 )	(39,873 )
Total Net Operating Real Estate Investments	789,672	902,882
Real estate held for sale (net of accumulated depreciation of \$1,577 and \$0, respectively) (including from VIEs of \$22,411 and \$0, respectively)	22,411	—
Total Net Real Estate Investments	812,083	902,882
Cash and cash equivalents (including from VIEs of \$12,154 and \$13,271, respectively)	34,086	16,226
Restricted cash (including from VIEs of \$25,277 and \$43,500, respectively)	34,110	46,869
Accounts receivable (including from VIEs of \$936 and \$1,517, respectively)	1,750	2,122
Prepaid and other assets (including from VIEs of \$1,621 and \$1,724, respectively)	4,189	1,961
<b>TOTAL ASSETS</b>	<b>\$ 886,218</b>	<b>\$ 970,060</b>
<b>LIABILITIES AND EQUITY</b>		
Mortgages payable, net (including from VIEs of \$335,434 and \$609,703, respectively)	\$ 404,915	\$ 676,324
Mortgages payable held for sale, net (including from VIEs of \$18,424 and \$0, respectively)	18,424	—
Credit facility, net	196,480	—
Bridge facility, net	—	28,805
Accounts payable and other accrued liabilities (including from VIEs of \$2,190 and \$4,049, respectively)	5,122	5,106
Accrued real estate taxes payable (including from VIEs of \$4,371 and \$5,723, respectively)	8,315	6,057
Accrued interest payable (including from VIEs of \$803 and \$1,332, respectively)	971	1,462
Security deposit liability (including from VIEs of \$614 and \$1,277, respectively)	1,195	1,544
Prepaid rents (including from VIEs of \$732 and \$1,633, respectively)	1,211	1,824
Total Liabilities	636,633	721,122
NexPoint Residential Trust, Inc. stockholders' equity:		



Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

Preferred stock, \$0.01 par value: 100,000,000 shares authorized; 0 shares issued	—	—
Common stock, \$0.01 par value: 500,000,000 shares authorized; 21,293,825 shares issued	213	213
Additional paid-in capital	240,921	240,625
Accumulated deficit	(10,082 )	(18,593 )
Accumulated other comprehensive loss	(1,713 )	(697 )
Common stock held in treasury at cost; 81,214 and 0 shares, respectively	(1,524 )	—
Noncontrolling interests	21,770	27,390
Total Equity	249,585	248,938
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 886,218</b>	<b>\$ 970,060</b>

See Notes to Combined Consolidated Financial Statements

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES  
 COMBINED CONSOLIDATED STATEMENTS OF OPERATIONS  
 AND COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share amounts)

(Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2016	2015	September 30, 2016	2015
<b>Revenues</b>				
Rental income	\$ 28,632	\$ 26,965	\$ 87,406	\$ 75,184
Other income	4,447	3,806	12,841	9,872
Total revenues	33,079	30,771	100,247	85,056
<b>Expenses</b>				
Property operating expenses	9,874	9,187	28,947	24,799
Acquisition costs	386	618	386	2,787
Real estate taxes and insurance	3,973	3,775	12,326	10,730
Property management fees (related party)	989	910	3,007	2,527
Advisory and administrative fees (related party)	1,698	1,454	4,944	4,170
Corporate general and administrative expenses	1,023	817	2,649	1,648
Property general and administrative expenses	1,527	1,143	4,473	3,778
Depreciation and amortization	8,667	9,135	26,363	30,795
Total expenses	28,137	27,039	83,095	81,234
Operating income	4,942	3,732	17,152	3,822
Interest expense	(5,679 )	(4,622 )	(17,372 )	(12,869 )
Gain on sales of real estate	9,562	—	25,932	—
Net income (loss)	8,825	(890 )	25,712	(9,047 )
Net income (loss) attributable to noncontrolling interests	1,735	174	4,047	(332 )
Net income (loss) attributable to common stockholders	\$ 7,090	\$ (1,064 )	\$ 21,665	\$ (8,715 )
<b>Other comprehensive income (loss)</b>				
Net losses related to interest rate derivatives valuations	(1,096 )	(112 )	(1,128 )	(508 )
Total comprehensive income (loss)	7,729	(1,002 )	24,584	(9,555 )
Comprehensive income (loss) attributable to noncontrolling interests	1,626	164	3,935	(378 )
Comprehensive income (loss) attributable to common stockholders	\$ 6,103	\$ (1,166 )	\$ 20,649	\$ (9,177 )
<b>Weighted average common shares outstanding - basic</b>	21,260	21,294	21,282	21,294
<b>Weighted average common shares outstanding - diluted</b>	21,376	21,294	21,322	21,294
<b>Basic earnings (loss) per share (see Note 2)</b>	\$ 0.33	\$ (0.05 )	\$ 1.02	\$ (0.41 )
<b>Diluted earnings (loss) per share (see Note 2)</b>	\$ 0.33	\$ (0.05 )	\$ 1.02	\$ (0.41 )

Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

Dividends declared per common share	\$ 0.206	\$ 0.206	\$ 0.618	\$ 0.412
-------------------------------------	----------	----------	----------	----------

See Notes to Combined Consolidated Financial Statements

2

---

## NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF EQUITY

(in thousands)

(Unaudited)

	Preferred Stock		Common Stock				Common Stock Held in Treasury		Noncontrolling Interests	Total
	Number of Shares	Par Value	Number of Shares	Par Value	Additional Paid-in Capital	Accumulated Deficit	Other Comprehensive Loss	at Cost		
Balances, December 31, 2015	—	\$ —	21,294	\$ 213	\$ 240,625	\$(18,593)	\$(697)	\$ —	\$ 27,390	\$ 248,938
Contributions by noncontrolling interests					—	—	—	—	710	710
Buyout of noncontrolling interests					—	—	—	—	(1,381)	(1,381)
Purchase of common stock					—	—	—	(1,524)	—	(1,524)
Vesting of stock-based compensation					296	—	—	—	—	296
Distributions / Dividends					—	(13,154)	—	—	(8,884)	(22,038)
Other comprehensive income (loss)					—	—	(1,016)	—	(112)	(1,128)
Net income					—	21,665	—	—	4,047	25,712
	—	\$ —	21,294	\$ 213	\$ 240,921	\$(10,082)	\$(1,713)	\$(1,524)	\$ 21,770	\$ 249,585

Balances,  
September 30,  
2016

See Notes to Combined Consolidated Financial Statements

3

---

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES  
 COMBINED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	For the Nine Months Ended	
	September 30, 2016	2015
Cash flows from operating activities		
Net income (loss)	\$25,712	\$(9,047 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Gain on sales of real estate	(25,932 )	—
Depreciation and amortization	26,363	30,795
Amortization of deferred financing costs	1,782	809
Change in fair value on derivative instruments included in interest expense	(99 )	182
Amortization of fair market value adjustment of assumed debt	(98 )	(82 )
Vesting of stock-based compensation	296	—
Noncash contributions	—	1,277
Gain on disposal from eminent domain	—	(158 )
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	372	(775 )
Prepaid and other assets	(2,645 )	(771 )
Restricted cash	2,207	(7,161 )
Accounts payable and other accrued liabilities	530	1,928
Net cash provided by operating activities	28,488	16,997
Cash flows from investing activities		
Net proceeds from sales of real estate	131,786	—
Change in restricted cash	10,552	62
Cash from eminent domain disposal	—	326
Prepaid acquisition deposits	(1,425 )	—
Additions to operating real estate investments	(18,022 )	(29,609 )
Acquisitions of operating real estate investments	(6,474 )	(238,463 )
Net cash provided by (used in) investing activities	116,417	(267,684)
Cash flows from financing activities		
Mortgage proceeds received	—	169,866
Mortgage payments	(271,274)	(6,935 )
Credit facility proceeds received	200,000	—
Bridge facility proceeds received	—	29,000
Bridge facility payments	(29,000 )	—
Deferred financing fees paid	(2,538 )	(2,280 )

Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

Interest rate cap fees paid	—	(307 )
Due to affiliates	—	454
Purchase of common stock held in treasury	(1,524 )	—
Buyout of noncontrolling interests	(1,381 )	—
Distributions to noncontrolling interests	(8,884 )	(1,744 )
Dividends	(13,154 )	(8,774 )
Contributions from noncontrolling interests	710	9,320
Contributions	—	68,383
Net cash provided by (used in) financing activities	(127,045)	256,983
Net increase in cash	17,860	6,296
Cash, beginning of period	16,226	12,662
Cash, end of period	\$34,086	\$18,958

See Notes to Combined Consolidated Financial Statements

NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES  
 COMBINED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

Supplemental Disclosure of Cash Flow Information

Interest paid	\$16,279	\$11,515
Supplemental Disclosure of Noncash Activities		
Capitalized construction costs included in accounts payable and other accrued liabilities	935	533
Prepaid acquisition deposits included in due to affiliates	—	285
Change in fair value on derivative instruments designated as hedges	1,128	508
Liabilities assumed from acquisitions	232	1,938
Other assets acquired from acquisitions	63	385
Assumed debt on acquisitions of operating real estate investments	15,812	18,000

See Notes to Combined Consolidated Financial Statements



NEXPOINT RESIDENTIAL TRUST, INC. AND SUBSIDIARIES

NOTES TO COMBINED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of Business

NexPoint Residential Trust, Inc. (the “Company”, “we”, “our”) was incorporated on September 19, 2014, and has elected to be taxed as a real estate investment trust (“REIT”). The Company is focused on “value-add” multifamily investments primarily located in the Southeastern and Southwestern United States. Substantially all of the Company’s business is conducted through NexPoint Residential Trust Operating Partnership, L.P. (the “OP”), the Company’s operating partnership. The Company holds all or a majority interest in its properties (the “Portfolio”) through the OP. The Company’s wholly owned subsidiary, NexPoint Residential Trust Operating Partnership GP, LLC (the “OP GP”), is the sole general partner of the OP. The sole limited partner of the OP is the Company.

The Company began operations on March 31, 2015 as a result of the transfer and contribution by NexPoint Credit Strategies Fund (“NHF”) of all but one of the multifamily properties owned by NHF through its subsidiary Freedom REIT, LLC (“Freedom REIT”). We use the term “predecessor” to mean the carve-out business of Freedom REIT. On March 31, 2015, NHF distributed all of the outstanding shares of the Company's common stock held by NHF to holders of NHF common shares. We refer to the distribution of our common stock by NHF as the “Spin-Off.”

We are externally managed by NexPoint Real Estate Advisors, L.P., (the “Adviser”), through an agreement, as amended, dated March 16, 2015 (the “Advisory Agreement”), by and among the Company, the OP and our Adviser. The Advisory Agreement has a term of two years. Our Adviser conducts substantially all of our operations and provides asset management services for our real estate investments. We will only have accounting employees while the Advisory Agreement is in effect. All of our investment decisions are made by our Adviser, subject to general oversight by our Adviser’s investment committee and our Board of Directors (the “Board”). Our Adviser is wholly owned by NexPoint Advisors, L.P. and is an affiliate of Highland Capital Management, L.P. (our “Sponsor” or “Highland”).

The Company’s investment objectives are to maximize the cash flow and value of properties owned, acquire properties with cash flow growth potential, provide quarterly cash distributions and achieve long-term capital appreciation for its stockholders through targeted management and a capex value-add program. Consistent with the Company’s policy to acquire assets for both income and capital gain, the Company intends to hold majority interests in the properties for long-term appreciation and to engage in the business of directly or indirectly acquiring, owning, and operating well-located multifamily properties with a value-add component in large cities and suburban submarkets of large cities primarily in the Southeastern and Southwestern United States consistent with its investment objectives. Economic and market conditions may influence the Company to hold properties for different periods of time. From time to time, the Company may sell a property if, among other deciding factors, the sale would be in the best interest of its stockholders.

The Company may also participate with third parties in property ownership, through limited liability companies (“LLCs”), funds or other types of co-ownership or acquire real estate or interests in real estate in exchange for the issuance of common stock, units, preferred stock or options to purchase stock. These types of investments may permit the Company to own interests in larger assets without unduly restricting diversification which provides flexibility in structuring the Company’s portfolio.

The Company may allocate up to thirty percent of the portfolio to investments in real estate-related debt and securities with the potential for high current income or total returns. These allocations may include first and second mortgages, subordinated, bridge, mezzanine, construction and other loans, as well as debt securities related to or secured by multifamily real estate and common and preferred equity securities, which may include securities of other REIT or real estate companies.

## 2. Summary of Significant Accounting Policies

### Predecessor

With the exception of a nominal amount of initial cash funded at inception, the Company did not own any assets prior to March 31, 2015. The business and operations of the Company prior to March 31, 2015 occurred under the predecessor. Our predecessor included all of the properties in our Portfolio that were held directly or indirectly by Freedom REIT, a wholly owned subsidiary of NHF, prior to the Spin-Off that occurred on March 31, 2015. However, our combined consolidated statements of operations and comprehensive income (loss) and combined consolidated statements of cash flows reflect operations of our predecessor through March 31, 2015 as if they were incurred by us. Our predecessor was determined in accordance with the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). References throughout these combined consolidated financial statements to the "Company", "we", or "our", include the activity of the predecessor defined above.

## Basis of Accounting

The accompanying unaudited combined consolidated financial statements of the Company are prepared in accordance with Generally Accepted Accounting Principles (“GAAP”). The consolidated balance sheets include the accounts of the Company and its subsidiaries. Our predecessor’s combined consolidated financial statements were derived from the historical accounting records of our predecessor and reflect the historical results of operations and cash flows for the period prior to the Spin-Off. All intercompany balances and transactions are eliminated in combination and consolidation. The financial statements of the Company’s subsidiaries are prepared using accounting policies consistent with those of the Company. In addition, the Company evaluates relationships with other entities to identify whether there are variable interest entities (“VIE’s”) as required by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810, Consolidation, and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the financial statements in accordance with FASB ASC 810. In the opinion of the Company’s management, the accompanying combined consolidated financial statements include all adjustments and eliminations, consisting only of normal recurring items necessary for their fair presentation in conformity with GAAP. The unaudited information included in this quarterly report on Form 10-Q should be read in conjunction with our audited financial statements for the year ended December 31, 2015 and notes thereto included in our annual report on Form 10-K filed with the SEC on March 21, 2016. There have been no significant changes to the Company’s significant accounting policies during the nine months ended September 30, 2016.

## Use of Estimates

The preparation of the combined consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the combined consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. It is at least reasonably possible that these estimates could change in the near term.

## Real Estate Investments

Upon acquisition, in accordance with FASB ASC 805, Business Combinations, the purchase price of a property is allocated to land, buildings, improvements, furniture, fixtures, and equipment, and intangible lease assets. The purchase price allocation is based on management’s estimate of the property’s “as-if” vacant fair value, which is calculated by using all available information such as the replacement cost of such asset, appraisals, property condition reports, market data and other related information. The allocation of the purchase price to intangible lease assets represents the value associated with the in-place leases, which may include lost rent, leasing commissions, legal and other related costs, which the Company, as buyer of the property, did not have to incur to obtain the residents.

If any debt is assumed in an acquisition, the difference between the fair value and the face value of debt is recorded as a premium or discount and amortized as interest expense over the life of the debt assumed. Costs associated with the acquisition of a property, including acquisition fees paid, are expensed upon closing the acquisition.

The results of operations for acquired properties are included in the combined consolidated statements of operations and comprehensive income (loss) from their respective acquisition dates.

Real estate assets, including land, buildings, improvements, furniture, fixtures and equipment, and intangible lease assets are stated at historical cost less accumulated depreciation and amortization. Costs incurred in making repairs

and maintaining real estate assets are expensed as incurred. Expenditures for improvements, renovations, and replacements are capitalized at cost. Real estate-related depreciation and amortization are computed on a straight-line basis over the estimated useful lives as described in the following table:

Land	Not depreciated
Buildings	30 years
Improvements	15 years
Furniture, fixtures, and equipment	3 years
Intangible lease assets	6 months

Construction in progress includes the cost of renovation projects being performed at the various properties. Once a project is complete, the historical cost of the renovation is placed into service in one of the categories above depending on the type of renovation project and is depreciated over the estimated useful lives as described in the table above.

The Company periodically classifies real estate assets as held for sale. An asset is classified as held for sale after an active program to sell the asset has commenced or the asset is under contract for sale and after the evaluation of other factors. Upon the

classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its estimated fair value, less costs to sell the asset, and no further depreciation expense is recorded. Upon a decision to no longer market an asset for sale, the asset is classified as an operating asset and depreciation expense is reinstated. Real estate assets and the related debt held for sale are stated separately on the accompanying consolidated balance sheets.

### Impairment

Real estate assets that are determined to be held and used will be reviewed periodically for impairment and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In such cases, the Company will evaluate the recoverability of such real estate assets based on estimated future cash flows and the estimated liquidation value of such real estate assets, and provide for impairment if such undiscounted cash flows are insufficient to recover the carrying amount of the real estate asset. If impaired, the real estate asset will be written down to its estimated fair value. For the three and nine month periods ended September 30, 2016 and 2015, the Company did not record any impairment charges related to real estate assets.

### Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents may include cash, short-term investments, and cash placed with a qualified intermediary for reinvestment in accordance with Section 1031 of the Code related to like-kind exchanges. Short-term investments are stated at cost, which approximates fair value. Cash placed with a qualified intermediary may not be immediately accessible; due to the short-term nature of the restrictions imposed by a qualified intermediary, the Company considers such cash to be cash equivalents.

### Restricted Cash

Restricted cash is comprised of security deposits, operating escrows, and renovation value-add reserves. Security deposits are held until they are due to tenants and are credited against the balance. Operating escrows are required and held by our first mortgage lender(s) for items such as real estate taxes, insurance, and required repairs. Lender held escrows are released back to the joint venture upon the borrower's proof of payment of such expenses. Renovation value-add reserves are funds identified to finance our value-add renovations at each of our properties and are not required to be held in escrow by a third party. The Company may reallocate these funds, at its discretion, to pursue other investment opportunities. The following is a summary of the restricted cash held as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Security deposits	\$ 876	\$ 1,034
Operating escrows	19,263	21,312
Renovation value-add reserves	13,971	24,523
	\$ 34,110	\$ 46,869

### Prepaid acquisition deposits

In the normal course of business, the Company incurs costs in connection with future acquisitions that may include good faith deposits made prior to probable acquisitions. Prepaid acquisition deposits are held in escrow and are applied upon closing of the acquisition. Until an acquisition closes, the Company records these deposits in prepaid and other assets on the consolidated balance sheet. As of September 30, 2016, prepaid acquisition deposits were approximately \$1.4 million (see Note 11). The Company did not have any prepaid acquisition deposits as of December 31, 2015.

#### Deferred Financing Costs

The Company defers costs incurred in obtaining financing and amortizes the costs over the terms of the related loans using the straight-line method, which approximates the effective interest method. Upon repayment of or in conjunction with a material change in the terms of the underlying debt agreement, any unamortized costs are charged to interest expense. Deferred financing costs, net of amortization, of \$3.4 million and \$6.0 million are recorded as a deduction from mortgages payable on the accompanying consolidated balance sheets as of September 30, 2016 and December 31, 2015, respectively. Deferred financing costs, net of amortization, of \$3.5 million are recorded as a deduction from the debt related to the Company's credit facility on the accompanying consolidated balance sheet as of September 30, 2016. Deferred financing costs, net of amortization, of \$0.2 million are recorded as a deduction from the debt related to the Company's bridge facility on the accompanying consolidated balance sheet as of December 31, 2015. Amortization of deferred financing costs of \$0.8 million and \$0.3 million is included in interest expense on the consolidated statements of

operations and comprehensive income (loss) for the three months ended September 30, 2016 and 2015, respectively. For the three months ended September 30, 2016, the Company incurred amortization of deferred financing costs of approximately \$0.4 million related to its sales of four properties during the period (see Note 4). Amortization of deferred financing costs of \$1.8 million and \$0.8 million is included in interest expense on the combined consolidated statements of operations and comprehensive income (loss) for the nine months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016, the Company incurred amortization of deferred financing costs of approximately \$0.7 million related to its sales of seven properties during the period (see Note 4).

#### Noncontrolling Interests

Noncontrolling interests are comprised of the Company's joint venture partners' interests in the joint ventures in multifamily properties that the Company consolidates. The Company reports its joint venture partners' interests in its consolidated real estate joint ventures and other subsidiary interests held by third parties as noncontrolling interests. The Company records these noncontrolling interests at their initial fair value, adjusting the basis prospectively for their share of the respective consolidated investment's net income or loss, equity contributions, return of capital and distributions. These noncontrolling interests are not redeemable by the equity holders and are presented as part of permanent equity. Income and losses are allocated to the noncontrolling interest holder based on its economic ownership percentage.

#### Accounting for Joint Ventures

The Company first analyzes its investments in joint ventures to determine if the joint venture is a VIE in accordance with FASB ASC 810, and if so, whether the Company is the primary beneficiary requiring consolidation. A VIE is an entity that has (i) insufficient equity to permit it to finance its activities without additional subordinated financial support or (ii) equity holders that lack the characteristics of a controlling financial interest. VIEs are consolidated by the primary beneficiary, which is the entity that has both the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits from the VIE that potentially could be significant to the primary beneficiary. Variable interests in a VIE are contractual, ownership, or other financial interests that change with changes in the fair value of the VIE's net assets. The Company assesses at each level of the joint venture whether the entity is (i) a VIE, and (ii) if the Company is the primary beneficiary of the VIE. If an entity in which the Company holds a joint venture interest qualifies as a VIE and the Company is determined to be the primary beneficiary, the joint venture is consolidated.

Edgar Filing: NexPoint Residential Trust, Inc. - Form 10-Q

The following table represents the Company's investments in variable interest entities as of September 30, 2016 and December 31, 2015:

Property Name	Location	Year Acquired	Effective Ownership Percentage at September 30, 2016	Effective Ownership Percentage at December 31, 2015
Meridian	Austin, Texas	2014	—	—