

NOVAVAX INC  
Form PRE 14A  
March 12, 2004

**SCHEDULE 14A**

**(Rule 14a-101)**

**INFORMATION REQUIRED IN PROXY STATEMENT**

**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934 (Amendment No. )**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

NOVAVAX, INC.

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(Name of Registrant as Specified in Its Charter)

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(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(5) Total fee paid:

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Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

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(2) Form, schedule or registration statement no.:

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(3) Filing party:

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(4) Date filed:

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**NOVAVAX, INC.**

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**NOTICE OF THE ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD MAY 5, 2004**

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NOTICE IS HEREBY GIVEN that the Annual Meeting of the Stockholders of Novavax, Inc., a Delaware corporation (the Company), will be held on Wednesday, May 5, 2004 at 9:00 a.m. at the The Westin Philadelphia, 99 South 17th Street, Philadelphia, Pennsylvania 19103 (the Meeting) for the purpose of considering and voting upon the following matters:

1. To approve an amendment to the Company's Amended and Restated Certificate of Incorporation to increase the number of authorized shares of Common Stock (\$.01 par value) of the Company by 50,000,000 shares from 50,000,000 to 100,000,000.
2. To elect two directors as Class III directors to serve on the Board of Directors for a three-year term expiring at the 2007 Annual Meeting of Stockholders.
3. To ratify the appointment of Ernst & Young LLP as independent auditors of the Company for the current fiscal year ending December 31, 2004.
4. To transact such other business as may properly come before the Meeting or any adjournment thereof.

The Board of Directors has no knowledge of any other business to be transacted at the Meeting.

The Board of Directors has fixed the close of business on Friday, March 12, 2004 as the record date for the determination of stockholders entitled to notice of and to vote at the Meeting and any adjournments thereof.

A copy of the Company's Annual Report to Stockholders for the year ended December 31, 2003, which contains financial statements and other information of interest to stockholders, accompanies this Notice and the attached Proxy Statement.

*By Order of the Board of Directors*

David A. White,  
Secretary

March 25, 2004

**WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE PROMPTLY VOTE VIA THE INTERNET OR TELEPHONE AS PER THE INSTRUCTIONS ON THE ENCLOSED PROXY OR COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY IN THE ACCOMPANYING ENVELOPE. NO POSTAGE NEED BE AFFIXED IF THE PROXY IS MAILED IN THE UNITED STATES.**

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**NOVAVAX, INC.**

**8320 Guilford Road**

**Columbia, Maryland 21046**

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**PROXY STATEMENT  
For the Annual Meeting of Stockholders  
To Be Held May 5, 2004**

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This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Novavax, Inc. ( Novavax or the Company ) for use at the Annual Meeting of Stockholders to be held on Wednesday, May 5, 2004 at 9:00 a.m. local time at the The Westin Philadelphia, 99 South 17th Street, Philadelphia, Pennsylvania 19103 and at any adjournments thereof (the Meeting ). The Notice of Meeting, this Proxy Statement, the enclosed proxy and the Company s Annual Report to Stockholders for the year ended December 31, 2003 are being mailed to stockholders on or about March 25, 2004.

**VOTING PROCEDURE AND QUORUM**

The close of business on March 12, 2004 (the Record Date ) has been fixed as the record date to determine stockholders entitled to receive notice of and to vote at the Meeting. The only class of stock of the Company entitled to vote at the Meeting is its common stock, \$.01 par value (the Common Stock ). Only the record holders of shares of Common Stock at the close of business on the Record Date may vote at the Meeting. On the Record Date, there were [34, , ] shares of Common Stock outstanding and entitled to be voted at the Meeting. Each share entitles the holder to one vote on each of the matters to be voted upon at the Meeting. A stockholder may vote by mail, internet or telephone as directed by the enclosed proxy card.

All properly executed proxies will be voted in accordance with the instructions of the stockholder. If no contrary instructions have been indicated, the proxies will be voted in favor of proposals 1, 2 and 3 as set forth in the accompanying Notice of Meeting. The Board of Directors knows of no other matters to be presented for consideration at the Meeting.

Stockholders may revoke proxies at any time before they are exercised at the Meeting by (a) signing and submitting a later-dated proxy to the Secretary of the Company, (b) delivering written notice of revocation to the Secretary of the Company, or (c) voting in person at the Meeting. Attendance at the Meeting will not itself be deemed to revoke a proxy unless the stockholder gives affirmative notice at the Meeting that the stockholder intends to revoke the stockholder s proxy and vote in person.

The presence in person or by proxy of the holders of a majority of the shares of Common Stock issued and outstanding on the Record Date and entitled to vote is required to constitute a quorum at the Annual Meeting. If a quorum is not present, the stockholders entitled to vote who are present in person or represented by proxy at the Meeting have the power to adjourn the Meeting from time to time, without notice other than an announcement at the Meeting, until a quorum is present. At any adjourned meeting at which a quorum is present, any business may be transacted that might have been transacted at the Meeting as originally scheduled. Abstentions and broker non-votes will count in determining whether a quorum is present at the Meeting. A broker non-vote occurs when a broker or other nominee holds shares represented by a proxy and either does not have discretionary authority to vote such shares or has not received voting instructions with respect to a particular item.

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**PROPOSAL ONE AMENDMENT TO CERTIFICATE OF INCORPORATION TO  
INCREASE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK**

On March 9, 2004, the Board of Directors adopted, subject to stockholder approval, an amendment to the Company's Amended and Restated Certificate of Incorporation providing for an increase in the number of authorized shares of Common Stock from 50,000,000 to 100,000,000 shares (the Amendment). On March 12, 2004 the Company had a total of [34, , ] shares of Common Stock outstanding and 4,543,258 shares of Common Stock reserved for issuance upon exercise of stock options outstanding under its stock option plans, 70,000 shares of Common Stock reserved for issuance under outstanding warrants, and 5,188,147 shares of Common Stock reserved for issuance upon the conversion of outstanding convertible notes.

If the Amendment is approved by stockholders, it will become effective upon filing with the Delaware Secretary of State. Upon approval, the additional authorized shares of Common Stock would be available for issuance in the future for corporate purposes, including without limitation financings, acquisitions, strategic business partnerships and joint ventures, stock splits and stock dividends, and management incentive and employee benefit plans, as the Board of Directors may deem advisable, without the necessity of further stockholder action except as may be required by law, SEC rules or Nasdaq listing requirements. The Common Stock, including the shares proposed for authorization, do not have pre-emptive or similar rights; this means that current stockholders do not have the right to purchase any new shares in order to maintain their proportionate ownership in the Company. While the increase would not have any immediate effect on existing stockholders, the future issuance of additional shares of Common Stock (other than in connection with stock splits and stock dividends), while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, would have the effect of diluting the Company's current stockholders and could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. Other than in connection with the Company's existing stock option plans, presently outstanding warrants to purchase Common Stock, and presently outstanding notes convertible into Common Stock, the Company has no present intention or plans to issue any shares of Common Stock.

The affirmative vote of the holders of a majority of the issued and outstanding shares of Common Stock entitled to vote at the Meeting is required in order to adopt the proposed Amendment. Unless indicated to the contrary, the enclosed proxy will be voted for the proposed Amendment. Votes withheld or abstaining from voting will have the same effect as a negative vote or against the proposed Amendment. If you do not attend the Meeting in person or return a properly completed and signed proxy card, you will effectively be voting against the Amendment.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE **FOR** THE PROPOSED AMENDMENT.

**PROPOSAL TWO ELECTION OF DIRECTORS**

Pursuant to the Company's Amended and Restated Certificate of Incorporation, the Company's Board of Directors may consist of no fewer than three directors, with the specific number to be authorized by the Board of Directors from time to time at its discretion. The Board of Directors is currently authorized to consist of eight members.

The members of the Company's Board of Directors are divided into three classes, designated Class I, Class II and Class III, each serving staggered three-year terms. The terms of the Class III directors expire at this Meeting. The terms of the Class I and Class II directors will expire at the 2005 and 2006 Annual Meetings of Stockholders, respectively. A director of any class who is elected by the Board of Directors to fill a vacancy resulting from an increase in the number of directors holds office for the remaining term of the class to which he is elected. A director who is elected by the Board to fill a vacancy arising in any other manner holds office for the remaining term of his predecessor. Directors elected by the stockholders at an annual meeting to succeed those whose terms expire are of the same class as the directors they succeed and are elected for a term to expire at the third annual meeting of stockholders after their election and until their successors are duly elected and qualified.

Directors elected by the Board to fill vacancies or newly created directorships are to be assigned to classes by the Board so as to ensure, as nearly as possible, that each class consists of one-third of the total number of members of the Board. However, no existing director may be reclassified from one class to another and, therefore, the number of directors in each class may become temporarily imbalanced.

Two directors are to be elected at this Meeting to fill the terms of the Class III directors that expire at this Meeting. The Board of Directors, by all of its independent directors, has designated Mitchell J. Kelly and Michael A. McManus, Jr. as nominees for reelection as Class III directors of the Company at this Meeting. If elected to be Class III directors, such nominees will serve until the expiration of their terms at the Annual Meeting of Stockholders in 2007 and until their successors are elected and qualified. Mr. Kelly and Mr. McManus are currently directors of the Company and have consented to being named in this Proxy Statement and to serve if elected. The Board of Directors has no reason to believe that either of the nominees will be unable to serve if elected. If a nominee becomes unavailable to serve as a director, the persons named as proxies in the accompanying proxy may vote the proxy for a substitute nominee.

The election of directors requires the affirmative vote of a plurality of the shares of Common Stock present or represented by proxy and entitled to vote at the Meeting. Accordingly, abstentions, broker non-votes and votes withheld for a nominee will not have any effect on the election of a director.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE **FOR** THE ELECTION OF THE NOMINEES.

**Members of the Board of Directors**

The following table provides certain information with respect to the directors of the Company. Comparable information regarding the executive officers of the Company is provided in the Company's Annual Report on Form 10-K.

**Nominees for Class III Directors**

<b>Name</b>	<b>Age</b>	<b>Director Since</b>	<b>Principal Occupation, Other Business Experience and Other Directorships</b>
Mitchell J. Kelly	44	1997	Chairman of the Board, Chief Executive Officer and Managing Member of Anaconda Capital Management, L.L.C., an investment management firm, since 1995, and in various capacities with affiliates of Anaconda Capital since 1993. President and Chief Executive Officer of Novavax from September 2002 to August 2003 and from September 1998 to May 1999.
Michael A. McManus, Jr.	61	1998	President, Chief Executive Officer and Director of Misonix, Inc., a medical, scientific and industrial provider of ultrasonic and air pollution systems, since 1998. President and Chief Executive Officer of N.Y. Bancorp from 1990 to 1998. Assistant to the President of the United States from 1982 to 1985. Currently a director of L.Q. Corp., National Wireless, Inc. and American Home Mortgage Corp.

**Directors Continuing as Class I Directors**

<b>Name</b>	<b>Age</b>	<b>Director Since</b>	<b>Principal Occupation, Other Business Experience and Other Directorships</b>
Denis M. O'Donnell, M.D.	50	1998	Chairman of the Board of Directors of Novavax since May 2000. Chief Executive Officer and Director of Molecular Diagnostics, Inc. since February 2003. General Partner at Seaside Partners, L.P., a private equity firm from 1997 to 2003. Vice Chairman of the Board of Directors of Novavax from 1999 to 2000. Senior Advisor to Novavax from 1997 to 1998. President of Novavax from 1995 to 1997. Vice President, Business Development of Novavax from 1992 to 1995. Currently a director of Columbia Laboratories, Inc. and ELXSI Corporation.
Nelson M. Sims	56	2003	President and Chief Executive Officer of Novavax since August 2003. Retired from Eli Lilly and Company in June 2001 after 28 years of service. Executive management positions at Eli Lilly included Executive Director of Strategic Alliance Management for Eli Lilly and Company from November 1999 to June 2001, President of Eli Lilly Canada Inc. from January 1991 to November 1999, and Vice President of Hybritech, Inc., a Lilly subsidiary. Currently a director of MDS Inc. and Hemosol Inc.



Name	Age	Director Since	Principal Occupation, Other Business Experience and Other Directorships
Ronald H. Walker	66	1995	Currently retired. Chairman of the Board of Directors of Novavax from 1998 to 2000. Senior Partner/Managing Director of Korn/Ferry International, an executive search firm, from 1978 to 1999. Director of the National Park Service from 1972 to 1975. Special Assistant to the President of the United States from 1969 to 1972.

#### Directors Continuing as Class II Directors

Name	Age	Director Since	Principal Occupation, Other Business Experience and Other Directorships
Gary C. Evans	47	1998	President, Chief Executive Officer and Chairman of the Board of Magnum Hunter Resources, Inc., an oil and gas exploration company, since 1995 and Chief Executive Officer of its predecessor, Hunter Resources, Inc., since 1985. Currently a trustee of TEL Offshore Trust, an oil and gas trust.
J.Michael Lazarus, M.D.	66	1995	Chief Medical Officer and Senior Vice President of Fresenius Medical Care North America since 1996. Professor of Medicine at Harvard Medical School from 1979 to 1996.
John O. Marsh, Jr.	77	1991	Visiting Professor, George Mason University, since 2001. Visiting Professor, Virginia Military Institute, 1998. Interim Chief Executive Officer of Novavax from July 1996 to March 1997 and Chairman of the Board of Directors from July 1996 to February 1997. Secretary of the Army from 1981 to 1989. Counselor with Cabinet rank to the President of the United States from 1974 to 1977. Assistant for National Security Affairs to Vice President of the United States, 1974. Assistant Secretary of Defense from 1973 to 1974. U.S. Representative in Congress from 1963 to 1971.

There are no family relationships among any of the directors or executive officers (or any nominee therefor) of Novavax.

#### Board of Directors and Committee Information

The Board of Directors has determined that, with the exception of Messrs. Kelly and Sims and Dr. O'Connell, each of whom is or was within the last three fiscal years an employee or executive officer of the Company, all of the members of the Board are independent directors, as that term is defined in Rule 4200(a)(15) of the listing standards of The Nasdaq Stock Market, Inc. and Rule 10A-3 of the Securities Exchange Act of 1934, as amended.

The Board of Directors met 10 times during 2003 and acted by written consent once. Each of the directors attended at least 75% of the total number of meetings of the Board of Directors and the committees on which they served.

The Board of Directors of Novavax currently has three standing committees: a Compensation Committee, an Audit Committee and a Nominating and Corporate Governance Committee. In addition to the

descriptions below, please refer to the Report of the Compensation Committee and Report of the Audit Committee included in this Proxy Statement.

*Compensation Committee*

The Compensation Committee, whose members during 2003 were Messrs. Evans (Chairman), Marsh, McManus and Walker, reviews and recommends salaries and other compensatory benefits for the executive officers of Novavax. The Compensation Committee also administers the option plans of the Company, pursuant to which the committee grants stock options to executive officers, key employees and directors of Novavax and its subsidiaries. During 2003, the Compensation Committee met seven times and acted by written consent once. In March 2004, the Board appointed a new Compensation Committee to consist of Mr. Walker (Chairman), Mr. Kelly and Dr. Lazarus.

*Audit Committee*

During 2003, the Audit Committee consisted of Messrs. McManus (Chairman) and Evans and Dr. Lazarus, each of whom is a non-employee director and qualifies as independent as defined in the listing standards of Nasdaq. The Board has determined that Mr. McManus qualifies as the committee's audit committee financial expert as that term is defined by the rules and regulations of the Securities and Exchange Commission, and is financially sophisticated as required by Nasdaq listing standards.

The Audit Committee acts pursuant to the Audit Committee Charter as adopted by the Board, which was recently materially amended; a copy of the amended and restated charter is attached as an exhibit to this Proxy Statement and will be made available on the Company's website at [www.novavax.com](http://www.novavax.com). The Audit Committee reviews and evaluates the charter annually to ensure its adequacy and accuracy, and is charged with performing an annual self-evaluation with the goal of continuing improvement.

The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of the work of the Company's outside auditors. To this end, the committee meets with the Company's independent public accountants to discuss the scope and results of their examination and reviews the financial statements and reports contained in the Company's Forms 10-Q and 10-K. The Audit Committee also reviews the adequacy and efficacy of the Company's accounting, auditing and financial control systems, as well as the Company's disclosure controls and procedures, monitors the adequacy of the Company's accounting and financial reporting processes and practices, and considers any issues raised by its members, the Company's independent public accountants and the Company's employees. To assist in carrying out its duties, the Audit Committee is authorized to investigate any matter brought to its attention, retain the services of independent advisors (including legal counsel, auditors and other experts), and receive and respond to concerns and complaints relating to accounting, internal accounting controls and auditing matters. During 2003, the Audit Committee met five times. In March 2004, the Board appointed a new Audit Committee to consist of Messrs. McManus (Chairman), Evans and Marsh.

*Nominating and Corporate Governance Committee*

The Nominating and Corporate Governance Committee (the Governance Committee) consists of Messrs. Evans (Chairman), Marsh, McManus and Walker and Dr. Lazarus, each of whom qualifies as independent as defined in the listing standards of Nasdaq. The Governance Committee was established in March 2004, replacing the Nominating Committee.

The Governance Committee acts pursuant to a written charter, a copy of which is attached to this Proxy Statement and which will be made available on the Company's website at [www.novavax.com](http://www.novavax.com). As provided in the charter, the primary function of the Governance Committee is to assist the Board in fulfilling its responsibilities by: reviewing and making recommendations to the Board regarding the Board's size, structure and composition; establishing criteria for Board membership; identifying and evaluating candidates qualified to become members of the Board, including candidates proposed by stockholders; selecting, or recommending to the Board for selection, director nominees to be presented for approval at the annual meeting of stockholders and to fill vacancies on the Board; evaluating Company policies relating to the recruitment of

Board members; developing and recommending to the Board corporate governance policies and practices applicable to the Company; monitoring compliance with the Company's Code of Business Conduct and Ethics; and handling such other matters as the Board or committee deems appropriate. The Governance Committee's goal is to contribute to the effective representation of the Company's stockholders and play a leadership role in shaping the Company's corporate governance.

As noted above, it is the Governance Committee's responsibility to review and evaluate director candidates, including candidates submitted by stockholders. In performing its evaluation and review, the Governance Committee does not differentiate between candidates based on the proposing constituency, but rather applies the same criteria to each candidate.

Stockholders who wish to nominate qualified candidates to serve as directors of the Company may do so in accordance with the procedures set forth in the Company's By-laws, which procedures did not change during the last fiscal year. As set forth in the By-laws, a stockholder must notify the Company in writing, by notice delivered to the attention of the Secretary of the Company at the address set forth on the first page of this Proxy Statement, of a proposed nominee. In order to ensure meaningful consideration of such candidates, notice must be received not less than 60 days nor more than 90 days prior to the meeting (with certain exceptions).

The notice must set forth as to each proposed nominee:

- the name, age, business address and, if known, residence address,
- his or her principal occupation or employment,
- the number of shares of stock of the Company, if any, which are beneficially owned by such nominee, and
- any other information concerning the nominee that must be disclosed as to nominees in proxy solicitations pursuant to applicable law.

The notice must also set forth with respect to the stockholder giving the notice:

- the name and address, as they appear on the Company's books, of such stockholder, and
- the number of shares of the Company that are beneficially owned by such stockholder.

The Company may require any proposed nominee to furnish such other information as may reasonably be required to determine the eligibility of the nominee to serve as a director. Submissions received through this process will be forwarded to the committee for review.

When considering candidates, the Governance Committee strives to achieve a balance of knowledge, experience and achievement such that the Company's Board reflects a broad range of talents, ages, skills and expertise, particularly in the specialty pharmaceutical field. While there are no set minimum requirements, a candidate should:

- be intelligent, thoughtful and analytical,
- possess superior business-related knowledge, skills and experience,
- reflect the highest integrity, ethics and character,
- have excelled in both academic and professional settings,
- demonstrate achievement in his or her chosen field,
- be free of actual or potential conflicts of interest,
- have the ability to devote sufficient time to the business and affairs of the Company, and
- demonstrate the capacity and desire to represent the best interests of the Company's stockholders as a whole.

In addition to the above criteria (which may be modified from time to time), the Governance Committee may consider such other factors as the committee deems in the best interests of the Company and its stockholders and that may enhance the effectiveness and responsiveness of the Board and its committees. Finally, the Governance Committee must consider both a candidate's independence to make certain that the Board includes at least a majority of independent directors so as to satisfy all applicable independence requirements, and a candidate's financial sophistication and special competencies.

The Governance Committee identifies potential candidates through referrals and recommendations, including by incumbent directors, management and stockholders, as well as through business and other organizational networks. To date, the Governance Committee has not retained or paid any third party to identify or evaluate, or assist in identifying or evaluating, potential director nominees, although it reserves the right to engage executive search firms and other third parties to assist in finding suitable candidates.

Current members of the Board with the requisite skills and experience are considered for re-nomination, balancing the value of the member's continuity of service with that of obtaining a new perspective, and considering each individual's contributions, performance and level of participation, the current composition of the Board, and the Company's needs. If any existing members do not want to continue in service or if it is decided not to re-nominate a director, new candidates are identified in accordance with those skills, experience and characteristics deemed necessary for new nominees, and are evaluated based on the qualifications set forth above. In every case, the Governance Committee meets (in person or telephonically) to discuss each candidate, and may require personal interviews before final approval. Once a slate is selected, the Governance Committee presents it to the full Board.

Both of this year's nominees for director, Messrs. Kelly and McManus, are current directors of the Company and were selected and approved by the independent members of the Board of Directors in accordance with applicable law and listing requirements. There were no candidates submitted for consideration by stockholders of the Company.

#### *Executive Committee*

During 2003, the Company had an Executive Committee which met three times. The Executive Committee, whose members were Dr. O'Donnell (Chairman) and Messrs. Evans, Kelly, McManus and Sims, had the authority to exercise the powers of the Board of Directors between Board meetings. The Executive Committee was disbanded in 2004.

#### **Stockholder Communications**

The Board welcomes communications from stockholders and has adopted a procedure for receiving and addressing such communications. Stockholders may send written communications to the entire Board or individual directors, addressing them to Novavax, Inc., 8320 Guilford Road, Columbia, MD 21046, Attention: Secretary. Communications by e-mail should be addressed to [ir@novavax.com](mailto:ir@novavax.com) and marked "Attention: Secretary" in the Subject field. All such communications will be forwarded to the full Board of Directors or to any individual director or directors to whom the communication is directed unless the communication is clearly of a marketing nature or is unduly hostile, threatening, illegal, or similarly inappropriate, in which case the Company has the authority to discard the communication or take appropriate legal action regarding the communication.

Recognizing that director attendance at the Company's annual meetings of stockholders can provide stockholders with an opportunity to communicate with members of the Board, Novavax strongly encourages (but does not require) members of the Board to attend such meetings. All of the directors attended the 2003 Annual Meeting of the Company.

## Director Compensation

### *Cash Compensation*

During 2003, each director not employed by Novavax received an annual retainer of \$10,000, an additional \$1,500 for each meeting of the Board of Directors he attends in person, and \$750 for each meeting attended telephonically. In addition, each committee member not employed by Novavax received \$250 per committee meeting attended, except that the Chairman of each committee received \$500 per committee meeting attended. No other cash compensation is paid to the directors for their services to the Company as directors. For information relating to shares of the Company owned by each of the directors, see *Beneficial Ownership of Common Stock* below. For information concerning the compensation of directors who are also officers of the Company, see the Summary Compensation Table. Directors are also reimbursed by the Company for reasonable costs and expenses incurred for attending Board and committee meetings.

### *Stock Option Plan*

Directors of Novavax are eligible to participate in the Company's 1995 Stock Option Plan adopted by the Board of Directors and approved by the stockholders of Novavax on September 13, 1995, as amended (the *Plan*). The Plan is administered by the Compensation Committee under delegation by the Board of Directors. There were no options granted to non-officer directors in fiscal 2003 under the Plan or otherwise.

## Compensation Committee Interlocks and Insider Participation

Messrs. Evans, Marsh, McManus and Walker served on the Compensation Committee during 2003, none of whom was at any time during fiscal 2003 an officer or employee of Novavax. No executive officer of the Company currently serves, or during 2003 served, as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of the Company's Board of Directors or Compensation Committee.

## Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company's directors, executive officers and holders of more than 10% of the Company's Common Stock to file with the Securities and Exchange Commission and the Nasdaq National Market initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of the Company. Based solely on a review of the copies of such reports (and any amendments thereto) furnished to the Company or written representations that no other reports were required, the Company believes that during fiscal 2003 its officers, directors and holders of more than 10% of the Company's Common Stock complied with all Section 16(a) filing requirements, except that Dr. Lazarus filed one Form 4 late with respect to an open-market purchase of Common Stock by his wife, which shares were later transferred to a jointly-held account.

## Certain Relationships and Related Transactions

In March 2002, pursuant to our Stock Option Plan, the Company approved the payment of the exercise price of options by two directors, Denis M. O'Donnell, M.D. and Mitchell J. Kelly, through the delivery of full recourse, interest-bearing promissory notes in the amounts of \$1,031,668 and \$447,600, respectively, or an aggregate of \$1,479,268. The borrowings accrued interest at 5.07% per annum and are secured by 166,667 and 95,000 shares of common stock, respectively, or an aggregate of 261,667 shares of common stock owned by the directors. The notes are payable upon the earlier to occur of the following: (i) payable in full upon the date on which the director ceases for any reason to be a director of the Company, (ii) payable in part to the extent of net proceeds, upon the date on which the director sells all or any portion of the pledged shares, or (iii) payable in full on March 21, 2007. In addition, during 2002, the Company executed a conditional guaranty of a brokerage margin account for Dr. O'Donnell in the amount of \$500,000.

In 2002, the Company made a loan to its former general counsel, Ann McGeehan, in the amount of \$92,500. In accordance with Ms. McGeehan's employment agreement, on the anniversary of her employ-

ment with the Company in 2003, the Company forgave \$18,500 principal plus accrued interest thereon. The principal and interest due and outstanding at March 12, 2004 was approximately \$78,000.

## REPORT OF THE COMPENSATION COMMITTEE

### Executive Compensation Policies

The Compensation Committee of the Board of Directors (the Committee) is composed of four non-employee directors, each of whom is independent under applicable rules and regulations. The Committee is responsible for the development and administration of the Company's executive compensation policies and programs and grants stock options to executives, key employees and directors of the Company and its subsidiaries pursuant to its mandate to administer the Company's stock option plans.

The objectives of the Company's executive compensation program are to: (i) support the achievement of the strategic goals and objectives of the Company; (ii) attract and retain key executives critical to the success of the Company; and (iii) align executive officers' interests with the success of the Company. The Company's executive compensation program currently consists of base salary, annual cash incentive compensation and long-term incentive compensation in the form of stock options.

### Cash Compensation

The Committee's policy is to set base salary levels for the Company's executive officers based on a review of compensation for competitive positions in the market, the executives' job skills and experience, and judgments as to past and future contributions of the executives to the Company's success. The corporations whose compensation practices have been studied are not limited to the peer group listed in the stock performance chart, but include the full range of companies with which the Company believes it competes for executive talent. The annual cash incentive compensation is designed to tie annual awards to Company and individual executive performance. The Committee considers a number of factors in determining whether annual incentive awards should be paid, including the achievement by the Company of approved budgets, new product introductions and progress in the development of new products, and the achievement by the executives of their individually-assigned objectives. In considering individual performance, as contrasted to Company performance, the Committee relies more on subjective evaluations of executive performance than on quantitative data or objective criteria.

### Stock-Based Compensation

The Company seeks to provide its executives with opportunities for higher compensation through stock option awards. The Committee believes that stock ownership by executive officers is important in aligning management and stockholder interests for the long-term enhancement of stockholder value. In selecting executives eligible to receive option grants and determining the number of shares subject to such options, the Committee evaluates a variety of factors including:

- the job level of the executive,
- option grants awarded by competitors to executives at a comparable job level, and
- past, current and prospective services rendered, or to be rendered, to the Company by the executive.

The exercise price for the options granted to executives to date has been equal to at least 100% of the fair market value per share on the date of grant and the Committee intends to continue to fix the exercise price of option grants at no less than 100% of the fair market value per share on the date of grant. During 2003, the Committee awarded options for a total of 2,091,000 shares to all employees, including options for 1,460,000 shares awarded to executive officers of the Company.

### Chief Executive Officer Compensation

Nelson M. Sims was elected President and Chief Executive Officer of the Company effective August 2003. The criteria used to establish Mr. Sims' compensation included, among other things, the compensation packages of executive officers of comparable companies of similar size in the specialty pharmaceutical industry and the factors described above for all executive officers. Pursuant to Mr. Sims' employment agreement with the Company, he is entitled to receive an initial base salary of \$400,000, subject to merit-based increases commencing January 1, 2005. In addition, he is entitled to receive performance and incentive bonuses and was granted stock options to purchase 900,000 shares of the Common Stock of the Company at \$5.63 per share, which price was the fair market value at the date of grant. The options vest in three equal increments on the first three anniversaries of the date of the grant.

Mitchell J. Kelly was elected President and Chief Executive Officer of the Company effective September 2002 following the resignation of John A. Spears as President and Chief Executive Officer, and resigned from those positions in August 2003. In recognition of the interim nature of Mr. Kelly's engagement, the Company remitted compensation payable to Mr. Kelly to his employer, Anaconda Capital Management, L.L.C., for Mr. Kelly's services as President and Chief Executive Officer of the Company during 2003 in the amount of \$200,000. The Company also remitted \$93,333 to Anaconda Capital in 2003 for salary accrued during 2002 for Mr. Kelly. The criteria used to establish Mr. Kelly's compensation included, among other things, the compensation packages of executive officers of comparable companies of similar size in the specialty pharmaceutical industry. Prior to his resignation, Mr. Kelly was granted options to purchase 250,000 shares of Common Stock at a purchase price of \$4.05 per share, which price was the fair market value of the Common Stock at the date of grant. One-half of such options vested in May 2003 and one-half in August 2003.

### Tax Considerations

Section 162(m) of the Code generally disallows a tax deduction to public companies for compensation over \$1,000,000 paid to its Chief Executive Officer or its four other most highly compensated executive officers. Qualifying performance-based compensation will not be subject to the deduction limit if certain requirements are met. In 2003, no compensation paid by the Company was nondeductible as a result of the \$1,000,000 limitation. Furthermore, the Committee believes that, given the general range of salaries and bonuses for executive officers of the Company, the \$1,000,000 threshold of Section 162(m) will not be reached by any executive officer of the Company in the foreseeable future. Accordingly, the Committee has not formulated a policy to address non-qualifying compensation.

#### *Compensation Committee*

Gary C. Evans, Chairman

John O. Marsh, Jr.

Michael A. McManus, Jr.

Ronald H. Walker

**REPORT OF THE AUDIT COMMITTEE**

The Audit Committee of the Board of Directors is comprised of three members, each of whom is a non-employee director and satisfies all applicable independence requirements. The responsibilities and duties of the Audit Committee, summarized below, are more fully set forth in the committee's charter, a copy of which is attached to this Proxy Statement and which is available on the Company's website at [www.novavax.com](http://www.novavax.com).

The primary purpose of the Audit Committee is to represent and assist the Board of Directors in fulfilling its responsibilities for oversight of: the Company's accounting and financial reporting processes; the preparation, presentation and integrity of the financial reports and other financial information provided by the Company to any governmental or regulatory body, the public or other users thereof; the adequacy and efficacy of the Company's systems of internal accounting, auditing and financial controls; the Company's compliance with legal and regulatory requirements; the conduct, independence and qualifications of the Company's outside auditor; and the performance of the annual independent audit of the Company's financial statements.

In discharging its oversight role, the Audit Committee is empowered to investigate any matter brought to its attention with full access to all books, records, facilities and personnel of the Company, and to retain outside counsel, auditors and other experts for this purpose. The Board and the Audit Committee are in place to represent the Company's stockholders. Accordingly, the outside auditor is ultimately accountable to the Audit Committee and the Board.

In keeping with its responsibilities, the Audit Committee has reviewed and discussed the Company's audited financial statements with management. The Audit Committee has discussed with Ernst & Young LLP, the Company's independent accountants, the matters required to be discussed by Statement of Auditing Standards No. 61, "Communication with Audit Committees," as currently in effect, which includes, among other items, matters related to the conduct of the audit of the Company's financial statements. The Audit Committee meets with the independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting. The Audit Committee has also received written disclosures and the letter from Ernst & Young LLP required by the Independence Standards Board Standard No. 1 (as currently in effect) relating to the accountant's independence from the Company and its related entities, discussed with Ernst & Young LLP their independence from the Company, and considered the compatibility of the accountants' provision of non-audit services with maintaining the accountants' independence.

Based on the review and discussions referred to above, the Audit Committee recommended to the Company's Board of Directors, and the Board has approved, that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003. The Audit Committee has selected, subject to stockholder ratification, Ernst & Young as the Company's independent auditors for the current fiscal year ending December 31, 2004.

The Audit Committee pre-approved all audit and non-audit services provided to the Company by the independent auditors during fiscal 2003. It is the Audit Committee's policy to pre-approve the audit and permissible non-audit services (both the type and amount) performed by the Company's outside auditor in order to ensure that the provision of such services does not impair the auditor's independence, in appearance or fact.

*Audit Committee*

Michael A. McManus, Jr., Chairman

Gary C. Evans

J. Michael Lazarus, M.D.



**PROPOSAL THREE RATIFICATION OF APPOINTMENT OF AUDITORS**

**Independent Public Accountants**

The Audit Committee has selected Ernst & Young LLP as the independent auditor of the Company for the fiscal year ending December 31, 2004, subject to ratification by stockholders at the Meeting. A representative of Ernst & Young is expected to be present at the Meeting to respond to appropriate questions and to make a statement if he so desires.

**Audit Fees**

The aggregate fees billed by Ernst & Young LLP for professional services rendered for the audit of the Company's annual financial statements for fiscal years 2003 and 2002, and the reviews of the financial statements included within the Company's Forms 10-Q during fiscal years 2003 and 2002, were approximately \$120,220 and \$105,669, respectively.

**Audit-Related Fees**

The aggregate fees billed by Ernst & Young LLP for assurance and related services that were reasonably related to the performance of the outside auditor's audit or review of the Company's financial statements for fiscal years 2003 and 2002 were approximately \$66,377 and \$54,172, respectively. The fees incurred during 2003 related to the preparation of a shelf registration statement on Form S-3 for the Company and a subsequent take-down financing from that registration statement. The fees incurred during 2002 related to several proposed financings by the Company.

**Tax Fees**

The aggregate fees billed by Ernst & Young LLP for professional services rendered for tax compliance, tax advice and tax planning for the Company for fiscal years 2003 and 2002 were approximately \$35,311 and \$53,000, respectively. These amounts represent those billed for tax return preparation for the Company and its subsidiaries.

**All Other Fees**

The aggregate fees billed by Ernst & Young LLP for products and services provided other than those otherwise described above for fiscal years 2003 and 2002 were approximately \$15,540 and \$39,386, respectively. Services for such other fees included audits in connection with a federal grant from the National Institutes of Health.

**Pre-Approval Policies**

As contemplated by applicable law and as provided by the Audit Committee's charter, the Audit Committee is responsible for the appointment, compensation, retention and oversight of the work of the Company's outside auditor. In connection with such responsibilities, the Audit Committee is required, and it is the Audit Committee's policy, to pre-approve the audit and permissible non-audit services (both the type and amount) performed by the Company's outside auditor in order to ensure that the provision of such services does not impair the auditor's independence, in appearance or fact.

Under the policy, unless a type of service to be provided by the outside auditor has received general pre-approval (which services are detailed in an appendix to the policy and periodically reassessed), it will require separate pre-approval by the Audit Committee. Any proposed service of a type that has been pre-approved that exceeds pre-approved cost levels will also require the committee's specific pre-approval.

For audit services (including the annual financial statement audit, required quarterly statement reviews, subsidiary audits, and other procedures required to be performed by the independent auditor to be able to form an opinion on the Company's consolidated financial statements), the outside auditor must provide to the Audit Committee each year during the fourth fiscal quarter an engagement letter, outlining the scope of audit

services proposed to be performed with respect to the audit for that fiscal year and associated fees. If agreed to by the Audit Committee, the engagement letter is formally accepted by the committee at its next regularly scheduled meeting.

All non-audit services not specifically approved in advance must be separately pre-approved by the Audit Committee, as noted above. Requests or applications to provide services must be in writing and include a description of the proposed services, the anticipated costs and fees, and the business reasons for engaging the outside auditor to perform the services. The request must also include a statement as to whether the request or application is consistent with the SEC's rules on auditor independence.

Each service that is approved by the Audit Committee must be reflected in a written engagement letter or writing specifying the services to be performed and the cost associated therewith, and signed by a member of the Audit Committee.

To ensure prompt handling of unexpected matters, the Audit Committee has delegated authority to pre-approve audit and permissible non-audit services between regularly scheduled meetings of the committee to its Chairman, who is responsible for reporting any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee has not and will not delegate to management of the Company the Audit Committee's responsibilities to pre-approve services performed by the outside auditor.

The Audit Committee pre-approved all audit and permissible non-audit services provided to the Company by the independent auditors during fiscal 2003.

#### **Ratification**

Stockholder ratification of the appointment of independent auditors is not required by the Company's By-laws or otherwise, but is being done as a matter of good corporate governance. If stockholders fail to ratify the selection, the Audit Committee will reconsider this selection. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent auditing firm at any time during the year if it determines that such a change would be in the best interests of Novavax and its stockholders.

The affirmative vote of the holders of a majority of the shares of Common Stock present in person or represented by proxy at the Meeting and entitled to vote is required for the ratification of the appointment of Ernst & Young LLP as independent auditors of the Company. Abstentions and broker non-votes will not be counted as shares voting on such matter and accordingly will have no effect on the approval of Proposal Three.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE **FOR** THE RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP AS THE COMPANY'S INDEPENDENT AUDITORS FOR FISCAL YEAR 2004.

**BENEFICIAL OWNERSHIP OF COMMON STOCK**

The following table sets forth information as of March 12, 2004 with respect to the beneficial ownership of shares of Common Stock by (i) each person known to the Company to beneficially own more than 5% of the outstanding shares of Common Stock, (ii) the current directors of the Company, (iii) the Chief Executive Officer and the other named executive officers of the Company during 2003 as identified in the Summary Compensation Table below, and (iv) all current directors and executive officers of the Company as a group. Unless otherwise noted, the persons named in the table have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them.

Beneficial Owner	Shares of Common Stock Beneficially Owned(1)	Percent of Class Outstanding
SJ Strategic Investments LLC 340 Edgemont Ave., Suite 500 Bristol, TN 37620	5,772,339(2)	16.5%
King Pharmaceuticals, Inc. 501 Fifth Street Bristol, Tennessee 37620	5,513,468(3)	13.7%
Mitchell J. Kelly c/o Anaconda Opportunity Fund, L.P. 730 Fifth Avenue New York, NY 10019	2,445,101(4)	6.9%
Anaconda Opportunity Fund, L.P. 730 Fifth Avenue New York, NY 10019	2,080,962(5)	6.0%
Gary C. Evans	170,500(6)	*
J. Michael Lazarus, M.D.	109,427(7)	*
John O. Marsh, Jr.	233,500(8)	*
Michael A. McManus, Jr.	112,500(9)	*
Denis M. O'Donnell, M.D.	642,519(10)	1.7%
Nelson M. Sims	0(11)	*
Ronald H. Walker	138,880(12)	*
Dennis W. Genge	173,067(13)	*
Ford R. Lynch	0(14)	*
D. Craig Wright, M.D.	445,150(15)	1.3%
Ann P. McGeehan	0(16)	*
All executive officers and directors, as a group (12 Persons)	4,470,644(17)	12.1%

\* Less than 1% of the Common Stock outstanding.

- (1) In accordance with Rule 13d-3 of the Securities and Exchange Commission, a person is deemed to have beneficial ownership of securities that such person has the right to acquire within 60 days. For purposes of calculating percentage ownership, each person's holdings have been calculated assuming full exercise of outstanding options and warrants exercisable by such person within 60 days of March 12, 2004, but not the exercise of options or warrants held by any other person.
- (2) As reported on Schedule 13D dated February 18, 2003 and Form 4 dated February 27, 2003, each as filed with the Securities and Exchange Commission by SJ Strategic Investments LLC.
- (3) Includes 5,188,147 shares that may be acquired pursuant the terms of four convertible notes and related agreements.
- (4) Includes 250,000 shares issuable upon the exercise of options. Also includes 2,080,962 shares (listed below) beneficially owned by Anaconda Opportunity Fund, L.P., of which Mitchell J. Kelly is the general partner of the general partner.

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- (5) Includes 2,080,962 shares owned by Anaconda Opportunity Fund, L.P. Excludes shares directly owned by Mitchell J. Kelly, the general partner of Anaconda Capital, L.P., the general partner of Anaconda Opportunity Fund, L.P.
- (6) Includes 82,500 shares issuable upon the exercise of options. Also includes 12,500 shares owned of record by Mr. Evans as trustee of the Evans 1997 Trust. Mr. Evans disclaims control or beneficial ownership of shares held by the Evans 1997 Trust.
- (7) Includes 97,500 shares issuable upon the exercise of options.
- (8) Includes 202,500 shares issuable upon the exercise of options.
- (9) Includes 82,500 shares issuable upon the exercise of options.
- (10) Includes 239,469 shares issuable upon the exercise of options and 2,000 shares owned of record by Dr. O'Donnell as custodian for the benefit of his minor children.
- (11) Mr. Sims was granted options to purchase 900,000 shares of Common Stock on August 11, 2003, one-third of which are exercisable on the first three anniversaries of the date of grant.
- (12) Includes 132,500 shares issuable upon the exercise of options.
- (13) Includes 166,667 shares issuable upon the exercise of options.
- (14) Mr. Ford was granted options to purchase 175,000 shares of Common Stock on September 24, 2003, one-third of which are exercisable on the first three anniversaries of the date of grant.
- (15) Includes 393,524 shares issuable upon the exercise of options.
- (16) Options granted in 2002 and 2003 were cancelled following Ms. McGeehan's departure from the Company in October 2003.
- (17) Includes 1,647,160 shares issuable upon the exercise of options.

## EXECUTIVE COMPENSATION

## Summary of Compensation

The following table sets forth the cash and non-cash compensation paid during each of the last three fiscal years to each of the individuals who served as the Company's Chief Executive Officer during the last completed fiscal year, the four other most highly compensated individuals who were serving as executive officers of the Company at the end of the last completed fiscal year and who received compensation in excess of \$100,000 during fiscal 2003 for services provided to the Company, and one former executive officer (collectively, the Named Executive Officers).

## Summary Compensation Table

Name and Principal Position	Year	Annual Compensation			Long Term Compensation Awards(1)
		Salary (\$)	Bonus(\$)	Other Annual Compensation(2)	Securities Underlying All Other Compensation(3)(\$)
Nelson M. Sims(4) President and Chief Executive Officer	2003	157,692			900,000
	2002				
	2001				
Mitchell J. Kelly(5) President and Chief Executive Officer	2003	202,250			250,000
	2002	112,483			
	2001	10,200			15,000
D. Craig Wright, M.D. Chief Scientific Officer	2003	248,400	62,744		1,715
	2002	225,867	11,223		2,309
	2001	204,149	56,666		2,256
Dennis W. Genge Vice President, Treasurer and Chief Financial Officer	2003	171,600	75,210		50,000 2,873
	2002	165,000	75,000		2,374
	2001		2,682		
Homebuilding-home sales	<b>2,126</b>	<b>7,234</b>			
Management and other fees, substantially all from related entities	<b>243</b>	<b>275</b>			
Reimbursement of expenses related to managed entities	<b>422</b>	<b>532</b>			
Total revenues	<b>20,427</b>	<b>24,070</b>			
<b>Expenses</b>					
Rental property operating expenses	<b>7,758</b>	<b>6,628</b>			
Cost of land sales	<b>1,440</b>	<b>1,430</b>			
Cost of home sales	<b>1,530</b>	<b>5,487</b>			
General, administrative, selling and marketing	<b>2,905</b>	<b>2,102</b>			
Depreciation and amortization	<b>2,397</b>	<b>2,101</b>			

Expenses reimbursed from managed entities	422	532
Total expenses	16,452	18,280
<b>Operating Income</b>	<b>3,975</b>	<b>5,790</b>
<b>Other income (expense)</b>		
Interest and other income	338	89
Equity in earnings from unconsolidated entities	172	173
Interest expense	(4,720)	(3,699)
Minority interest in consolidated entities	(185)	(1,601)
<b>Income (loss) before provision (benefit) for income taxes</b>	<b>(420)</b>	<b>752</b>
<b>Provision (benefit) for income taxes</b>	<b>(235)</b>	<b>295</b>
<b>Net (loss) income</b>	<b>\$ (185)</b>	<b>\$ 457</b>
<b>Earnings per share</b>		
Basic	\$ (0.03)	\$ 0.09
<b>Weighted average shares outstanding</b>		
Basic and Diluted	5,210	5,198
<b>Cash dividends per share</b>	<b>\$ 0.10</b>	<b>\$ 0.10</b>

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

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**AMERICAN COMMUNITY PROPERTIES TRUST  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except share and per share amounts)**

	As of June 30, 2007 (Unaudited)	As of December 31, 2006 (Audited)
<b><u>ASSETS</u></b>		
<b>ASSETS:</b>		
Investments in real estate:		
Operating real estate, net of accumulated depreciation of \$146,832 and \$142,458 respectively	\$ 166,211	\$ 142,046
Land and development costs	75,298	67,993
Condominiums under construction	5,842	9,265
Rental projects under construction or development	488	24,143
Investments in real estate, net	247,839	243,447
Cash and cash equivalents	22,303	27,459
Restricted cash and escrow deposits	22,601	19,677
Investments in unconsolidated real estate entities	6,577	6,591
Receivable from bond proceeds	10,425	13,710
Accounts receivable	3,225	4,320
Deferred tax assets	30,260	18,157
Property and equipment, net of accumulated depreciation	1,184	1,157
Deferred charges and other assets, net of amortization of \$2,319 and \$1,655 respectively	10,663	12,181
<b>Total Assets</b>	<b>\$ 355,077</b>	<b>\$ 346,699</b>
<b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>		
<b>LIABILITIES:</b>		
Non-recourse debt	\$ 280,668	\$ 270,720
Recourse debt	26,383	29,351
Accounts payable and accrued liabilities	19,431	24,191
Deferred income	3,205	3,591
Accrued current income tax liability	12,123	2,992
<b>Total Liabilities</b>	<b>341,810</b>	<b>330,845</b>
<b>SHAREHOLDERS' EQUITY</b>		

Common shares, \$.01 par value, 10,000,000 shares authorized,		
5,229,954 shares issued and outstanding as of June 30, 2007		
and December 31, 2006	<b>52</b>	52
Treasury stock, 67,709 shares at cost	<b>(376)</b>	(376)
Additional paid-in capital	<b>17,302</b>	17,238
Retained (deficit) earnings	<b>(3,711)</b>	(1,060)
Total Shareholders' Equity	<b>13,267</b>	15,854
<b>Total Liabilities and Shareholders'</b>		
<b>Equity</b>	<b>\$ 355,077</b>	\$ 346,699

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



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**AMERICAN COMMUNITY PROPERTIES TRUST**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
(In thousands, except share amounts)

	<u>Common Shares</u>		Treasury Stock	Additional Paid-in Capital	Retained (Deficit) Earnings	Total
	Number	Par Value				
Balance December 31, 2006 (Audited)	5,229,954	\$ 52	\$ (376)	\$ 17,238	\$ (1,060)	\$ 15,854
Net income	-	-	-	-	(161)	(161)
Dividends paid	-	-	-	-	(1,032)	(1,032)
Cumulative effect of change in accounting for FIN 48	-	-	-	-	(1,458)	(1,458)
Amortization of Trustee Restricted Shares	-	-	-	64	-	64
<b>Balance June 30, 2007 (Unaudited)</b>	<b>5,229,954</b>	<b>\$ 52</b>	<b>\$ (376)</b>	<b>\$ 17,302</b>	<b>\$ (3,711)</b>	<b>\$ 13,267</b>

*The accompanying notes are an integral part of those consolidated statements.*

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**AMERICAN COMMUNITY PROPERTIES TRUST  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30**

(In thousands)

(Unaudited)

	2007	2006
<b>Cash Flows from Operating Activities</b>		
Net (loss) income	\$ (161)	\$ 958
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,581	4,074
Distribution to minority interests in excess of basis	1,827	2,646
Benefit for deferred income taxes	(2,229)	(716)
Equity in earnings-unconsolidated entities	(1,845)	(343)
Distribution of earnings from unconsolidated entities	346	339
Cost of land sales	4,356	3,666
Cost of home sales	3,816	8,521
Stock based compensation expense	104	102
Amortization of deferred loan costs	478	275
Changes in notes and accounts receivable	1,095	80
Additions to community development assets	(13,661)	(9,475)
Right of way easement	2,000	-
Homebuilding-construction expenditures	(393)	(4,354)
Deferred income-joint venture	(386)	130
Changes in accounts payable, accrued liabilities	(7,000)	(3,588)
Net cash (used in) provided by operating activities	(7,072)	2,315
<b>CashFlows from Investing Activities</b>		
Investment in apartment construction	(233)	(7,747)
Change in investments - unconsolidated entities	1,513	(1)
Cash from newly consolidated properties	-	4,723
Change in restricted cash	(2,924)	(1,513)
Additions to rental operating properties, net	(4,708)	(18,795)
Other assets	863	248
Net cash used in investing activities	(5,489)	(23,085)
<b>CashFlows from Financing Activities</b>		

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Cash proceeds from debt financing	<b>23,339</b>	37,279
Payment of debt	<b>(18,720)</b>	(19,399)
County Bonds proceeds, net of undisbursed funds	<b>5,645</b>	1,077
Payments of distributions to minority interests	<b>(1,827)</b>	(2,646)
Dividends paid to shareholders	<b>(1,032)</b>	(3,232)
Net cash provided by financing activities	<b>7,405</b>	13,079
<b>Net Decrease in Cash and Cash</b>		
<b>Equivalents</b>	<b>(5,156)</b>	(7,691)
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>27,459</b>	21,156
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 22,303</b>	\$ 13,465

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

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**AMERICAN COMMUNITY PROPERTIES TRUST**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**JUNE 30, 2007**  
(Unaudited)

**(1) ORGANIZATION**

American Community Properties Trust ("ACPT") is a self-managed holding company that is primarily engaged in the investment of rental properties, property management services, community development, and homebuilding. These operations are concentrated in the Washington, D.C. metropolitan area and Puerto Rico and are carried out through American Rental Properties Trust ("ARPT"), American Rental Management Company ("ARMC"), American Land Development U.S., Inc. ("ALD") and IGP Group Corp. ("IGP Group") and their subsidiaries.

ACPT is taxed as a U.S. partnership and its taxable income flows through to its shareholders. ACPT is subject to Puerto Rico taxes on IGP Group's taxable income, generating foreign tax credits that are passed through to ACPT's shareholders. An IRS regulation eliminating the pass through of these tax credits to ACPT's shareholders has been proposed and is expected to become effective in 2007. ACPT's federal taxable income consists of certain passive income from IGP Group, a controlled foreign corporation, distributions from IGP Group, and dividends from ACPT's U.S. subsidiaries. Other than Interstate Commercial Properties ("ICP"), which is taxed as a Puerto Rico corporation, the taxable income from the remaining Puerto Rico operating entities passes through to IGP Group or ALD. Of this taxable income, only the portion of taxable income applicable to the profits, losses or gains on the residential land sold in Parque Escorial passes through to ALD. ALD, ARMC, and ARPT are taxed as U.S. corporations. The taxable income from the U.S. apartment properties flows through to ARPT.

**(2) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying consolidated financial statements include the accounts of American Community Properties Trust and its majority owned subsidiaries and partnerships, after eliminating all intercompany transactions. All of the entities included in the consolidated financial statements are hereinafter referred to collectively as the "Company" or "ACPT."

The Company consolidates entities that are not variable interest entities as defined by Financial Accounting Standard Board ("FASB") Interpretation No. 46 (revised December 2003) ("FIN 46 (R)") in which it owns, directly or indirectly, a majority voting interest in the entity. In addition, the Company consolidates entities, regardless of ownership percentage, in which the Company serves as the general partner and the limited partners do not have substantive kick-out rights or substantive participation rights in accordance with Emerging Issues Task Force Issue 04-05, "*Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*," ("EITF 04-05"). The assets of consolidated real estate partnerships not 100% owned by the Company are generally not available to pay creditors of the Company.

The consolidated group includes ACPT and its four major subsidiaries, American Rental Properties Trust, American Rental Management Company, American Land Development U.S., Inc., and IGP Group Corp. In addition, the consolidated group includes the following other entities:

Alturas del Senorial Associates Limited Partnership	LDA Group, LLC
American Housing Management Company	Milford Station I, LLC
American Housing Properties L.P.	Milford Station II, LLC
Bannister Associates Limited Partnership	Monserrate Associates Limited Partnership
Bayamon Garden Associates Limited Partnership	New Forest Apartments, LLC

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Carolina Associates Limited Partnership S.E.	Nottingham South, LLC
Coachman's Apartments, LLC	Owings Chase, LLC
Colinas de San Juan Associates Limited Partnership	Palmer Apartments Associates Limited Partnership
Crossland Associates Limited Partnership	Prescott Square, LLC
Escorial Office Building I, Inc.	St. Charles Community, LLC
Essex Apartments Associates Limited Partnership	San Anton Associates S.E.
Fox Chase Apartments, LLC	Sheffield Greens Apartments, LLC
Headen House Associates Limited Partnership	Torres del Escorial, Inc.
Huntington Associates Limited Partnership	Turabo Limited Dividend Partnership
Interstate Commercial Properties, Inc.	Valle del Sol Associates Limited Partnership
Interstate General Properties Limited Partnership, S.E.	Village Lake Apartments, LLC
Jardines de Caparra Associates Limited Partnership	Wakefield Terrace Associates Limited Partnership
Lancaster Apartments Limited Partnership	Wakefield Third Age Associates Limited Partnership
Land Development Associates S.E.	

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The Company's investments in entities that it does not control are recorded using the equity method of accounting. Refer to Note 3 for further discussion regarding Investments in Unconsolidated Real Estate Entities.

### **Interim Financial Reporting**

These unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The Company has no items of other comprehensive income for any of the periods presented. In the opinion of management, these unaudited financial statements reflect all adjustments (which are of a normal recurring nature) necessary to present a fair statement of results for the interim period. While management believes that the disclosures presented are adequate to make the information not misleading, these financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report filed on Form 10-K for the year ended December 31, 2006. The operating results for the six and three months ended June 30, 2007 and 2006 are not necessarily indicative of the results that may be expected for the full year. Net income per share is calculated based on weighted average shares outstanding.

### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements, and accompanying notes and disclosures. These estimates and assumptions are prepared using management's best judgment after considering past and current events and economic conditions. Actual results could differ from those estimates and assumptions.

### **Implementation of FIN 48**

In July 2006, the FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" ("FIN 48"). FIN 48 is an interpretation of FASB Statement No. 109, "*Accounting for Income Taxes*," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes. The Company implemented FIN 48 as of January 1, 2007. See Note 7 for further discussions.

### **Cash Dividends**

On February 28, 2007, the Board of Trustees declared a cash dividend of \$0.10 per share, payable on March 28, 2007, to shareholders of record on March 14, 2007. On May 15, 2007, the Board of Trustees declared a cash dividend of \$0.10 per share, payable on June 13, 2007, to shareholders of record on May 30, 2007.

### **Impairment of Long-Lived Assets**

ACPT carries its rental properties, homebuilding inventory, land and development costs at the lower of cost or fair value in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." For real estate assets such as our rental properties which the Company plans to hold and use, which includes property to be developed in the future, property currently under development and real estate projects that are completed or substantially complete, we evaluate whether the carrying amount of each of these assets will be recovered from their undiscounted future cash flows arising from their use and eventual disposition. If the carrying value were to be greater than the undiscounted future cash flows, we would recognize an impairment loss to the extent the carrying amount is not recoverable. Our estimates of the undiscounted operating cash flows expected to be generated by each asset are performed on an individual project basis and based on a number of assumptions that are subject to economic and market uncertainties, including, among others, demand for apartment units, competition, changes in market rental rates, and costs to operate and complete each project. There have been no impairment charges for the six- and three-month periods ended June 30, 2007 and 2006.

The Company evaluates, on an individual project basis, whether the carrying value of its substantially completed real estate projects, such as our homebuilding inventory that are to be sold, will be recovered based on the fair value less cost to sell. If the carrying value were to be greater than the fair value less costs to sell, we would recognize an impairment loss to the extent the carrying amount is not recoverable. Our estimates of the fair value less costs to sell are based on a number of assumptions that are subject to economic and market uncertainties, including, among others, comparable sales, demand for commercial and residential lots and competition. The Company performed similar reviews for land held for future development and sale considering such factors as the cash flows associated with future development expenditures. Should this evaluation indicate an impairment has occurred, the Company will record an impairment charge equal to the excess of the historical cost over fair value less costs to sell. There have been no impairment charges for the six- and three-month periods ended June 30, 2007 and 2006.

### **Depreciable Assets and Depreciation**

The Company's operating real estate is stated at cost and includes all costs related to acquisitions, development and construction. The Company makes assessments of the useful lives of our real estate assets for purposes of determining the amount of depreciation expense to reflect on our income statement on an annual basis. The assessments, all of which are judgmental determinations, are as follows:

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- Buildings and improvements are depreciated over five to forty years using the straight-line or double-declining balance methods,
  - Furniture, fixtures and equipment are depreciated over five to seven years using the straight-line method,
- Leasehold improvements are capitalized and depreciated over the lesser of the life of the lease or their estimated useful life,
  - Maintenance and other repair costs are charged to operations as incurred.

The table below presents the major classes of depreciable assets as of June 30, 2007 and December 31, 2006 (in thousands):

	<b>June 30, 2007 (Unaudited)</b>	December 31, 2006 (Audited)
	\$	\$
Building	<b>264,410</b>	240,264
Building improvements	<b>9,448</b>	8,022
Equipment	<b>13,673</b>	12,569
	<b>287,531</b>	260,855
<i>Less: Accumulated depreciation</i>	<b>146,832</b>	142,458
	<b>140,699</b>	118,397
Land	<b>25,512</b>	23,649
	\$	\$
Operating properties, net	<b>166,211</b>	142,046

***Other Property and Equipment***

In addition, the Company owned other property and equipment of \$1,184,000 and \$1,157,000, net of accumulated depreciation of \$2,202,000 and \$2,101,000 respectively, as of June 30, 2007, and December 31, 2006, respectively.

***Depreciation***

Total depreciation expense was \$4,581,000 and \$4,074,000 for the six months ended June 30, 2007 and 2006, respectively, and \$2,397,000 and \$2,101,000 for the three months ended June 30, 2007 and 2006, respectively.

**Impact of Recently Issued Accounting Standards*****SFAS 157 and 159***

In September 2006, the FASB issued SFAS 157, “*Fair Value Measurements*” and in February 2007, the FASB issued SFAS 159, “*The Fair Value Option for Financial Assets and Financial Liabilities.*” SFAS 157 defines fair values as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS 157 applies whenever other standards require assets or liabilities to be measured at fair value and does not expand the use of fair value in any new circumstances. SFAS 157 establishes a hierarchy that prioritizes the information used in developing fair value estimates. The hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity’s own data. SFAS 157 requires fair value measurements to be disclosed by level within the fair value hierarchy. SFAS 157 is effective for fiscal years beginning after November 15, 2007.

SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value election is designed to improve financial reporting by providing entities with the opportunity to mitigate



volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We have not yet determined the impact that SFAS 157 and SFAS 159 will have on our financial statements.

*EITF Issue No. 06-08*

In November 2006, the Emerging Issues Task force of the FASB (“EITF”) reached a consensus on EITF Issue No. 06-08, “*Applicability of a Buyer’s Continuing Investment under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums*” (“EITF 06-08”). EITF 06-08 will require condominium sales to meet the continuing investment criterion in FAS No. 66 in order for profit to be recognized under the percentage-of-completion method. EITF 06-08 will be effective for annual reporting periods beginning after March 15, 2007. The cumulative effect of applying EITF 06-08, if any, is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption. We are evaluating the impact that EITF 06-08 may have, if any, on our financial statements.

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**Table of Contents****(3) INVESTMENT IN UNCONSOLIDATED REAL ESTATE ENTITIES**

The Company accounts for investments in unconsolidated real estate entities that are not considered variable interest entities under FIN 46(R) in accordance with SOP 78-9 "Accounting for Investments in Real Estate Ventures" and APB Opinion No. 18 "The Equity Method of Accounting for Investments in Common Stock". For entities that are considered variable interest entities under FIN 46(R), the Company performs an assessment to determine the primary beneficiary of the entity as required by FIN 46(R). The Company accounts for variable interest entities in which the Company is not a primary beneficiary and does not bear a majority of the risk of expected loss in accordance with the equity method of accounting.

The Company considers many factors in determining whether or not an investment should be recorded under the equity method, such as economic and ownership interests, authority to make decisions, and contractual and substantive participating rights of the partners. Income and losses are recognized in accordance with the terms of the partnership agreements and any guarantee obligations or commitments for financial support. The Company's investments in unconsolidated real estate entities accounted for under the equity method of accounting currently consists of general partnership interests in two limited partnerships which own apartment properties in the United States; a limited partnership interest in a limited partnership that owns a commercial property in Puerto Rico; and a 50% ownership interest in a joint venture formed as a limited liability company.

*Apartment Partnerships*

The unconsolidated apartment partnerships as of June 30, 2007 and December 31, 2006 included Brookside Gardens Limited Partnership and Lakeside Apartments Limited Partnership that collectively represent 110 rental units. We have determined that these two entities are variable interest entities under FIN 46(R). However, the Company is not required to consolidate the partnerships due to the fact that it is not the primary beneficiary and does not bear the majority of the risk of expected losses. The Company holds an economic interest in Brookside and Lakeside but, as a general partner, we have significant influence over operations of these entities that is disproportionate to our economic ownership. In accordance with SOP 78-9 and APB No. 18, these investments are accounted for under the equity method. The Company is exposed to losses consisting of our net investment, loans and unpaid fees for Brookside of \$201,000 and \$189,000 and for Lakeside of \$168,000 and \$172,000 as of June 30, 2007, and December 31, 2006, respectively. All amounts are fully reserved. Pursuant to the partnership agreement for Brookside, the Company, as general partner, is responsible for providing operating deficit loans to the partnership in the event that it is not able to generate sufficient cash flows from its operating activities.

*Commercial Partnerships*

The Company holds a limited partner interest in a commercial property in Puerto Rico that it accounts for under the equity method of accounting. ELI, S.E. ("ELI"), is a partnership formed for the purpose of constructing a building for lease to the State Insurance Fund of the Government of Puerto Rico. ACPT contributed the land in exchange for \$700,000 and a 27.82% ownership interest in the partnership's assets, equal to a 45.26% interest in cash flow generated by the thirty-year lease of the building.

On April 30, 2004, the Company purchased a 50% limited partnership interest in El Monte Properties, S.E. ("El Monte") from Insular Properties Limited Partnership ("Insular") for \$1,462,500. Insular is owned by the J. Michael Wilson Family, a related party. In December 2004, a third-party buyer purchased El Monte for \$20,000,000; \$17,000,000 in cash and \$3,000,000 in two notes of \$1,500,000 each that bear an interest rate of prime plus 2%, with a ceiling of 9%, and mature on December 3, 2009. The net cash proceeds from the sale of the real estate were distributed to the partners. As a result, the Company received \$2,500,000 in cash and recognized \$986,000 of income in 2004. The gain on sale was reduced by the amount of the seller's note which is subject to future subordination. In January 2005, El Monte distributed the notes to the partners whereby the Company received a \$1,500,000 note. The Company determined that the cost recovery method of accounting was appropriate for this transaction and

accordingly, deferred revenue recognition on this note until cash payment was received. In January 2007, the Company received \$1,707,000, equal to the full principal amount due plus all accrued interest outstanding and, accordingly, recognized \$1,500,000 of equity in earnings from unconsolidated entities and \$207,000 of interest income. The Company has no required funding obligations and management expects to wind up El Monte's affairs in 2007.

*Land Development Joint Venture*

In September 2004, the Company entered into a joint venture agreement with Lennar Corporation for the development of a 352-unit, active adult community located in St. Charles, Maryland. The Company manages the project's development for a market rate fee pursuant to a management agreement. In September 2004, the Company transferred land to the joint venture in exchange for a 50% ownership interest and \$4,277,000 in cash. The Company's investment in the joint venture was recorded at 50% of the historical cost basis of the land with the other 50% recorded within our deferred charges and other assets. The proceeds received are reflected as deferred revenue. The deferred revenue and related deferred costs will be recognized into income as the joint venture sells lots to Lennar. In March 2005, the joint venture closed a non-recourse development loan, which was amended in June 2006 and again in December 2006. Per the terms of the loan, both the Company and Lennar provided development completion guarantees. In the six and three months ended June 30, 2007, the joint venture delivered 30 and 16 lots to Lennar, recognizing \$655,000 and \$363,000 in deferred revenue, off-site fees and management fees and \$218,000 and \$125,000 of deferred costs, respectively.

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The following table summarizes the financial data and principal activities of the unconsolidated real estate entities, which the Company accounts for under the equity method. The information is presented to segregate the apartment partnerships from the commercial partnerships as well as our 50% ownership interest in the land development joint venture, which are all accounted for as “investments in unconsolidated real estate entities” on the balance sheet.

	Apartment Properties	Commercial Property	Land Development Joint Venture	Total
	(in thousands)			
<b>Summary Financial Position:</b>				
<b>Total Assets</b>				
June 30, 2007	\$ 5,050	\$ 27,861	\$ 12,710	\$ 45,621
December 31, 2006	5,142	27,726	12,154	45,022
<b>Total Non-Recourse Debt</b>				
June 30, 2007	3,230	22,960	4,486	30,676
December 31, 2006	3,244	22,960	3,476	29,680
<b>Total Other Liabilities</b>				
June 30, 2007	1,261	693	1,287	3,241
December 31, 2006	1,242	722	1,744	3,708
<b>Total Equity</b>				
June 30, 2007	559	4,208	6,937	11,704
December 31, 2006	656	4,044	6,934	11,634
<b>Company's Investment, net</b>				
<b>(1)</b>				
June 30, 2007	-	4,749	1,828	6,577
December 31, 2006	-	4,763	1,828	6,591
<b>Summary of Operations:</b>				
<b>Total Revenue</b>				
Six Months Ended June 30, 2007	\$ 401	\$ 1,821	\$ 3,609	\$ 5,831
Six Months Ended June 30, 2006	392	1,828	-	2,220
Three Months Ended June 30, 2007	231	912	1,735	2,878
Three Months Ended June 30, 2006	193	915	-	1,108
<b>Net Income (Loss)</b>				
Six Months Ended June 30, 2007	(97)	937	3	843
Six Months Ended June 30, 2006	(58)	926	-	868
Three Months Ended June 30, 2007	(58)	469	3	414
Three Months Ended June 30, 2006	(31)	468	-	437
<b>Company's recognition of equity in earnings</b>				

Six Months Ended June 30, 2007	(1)	346	-	345
Six Months Ended June 30, 2006	-	343	-	343
Three Months Ended June 30, 2007	(1)	173	-	172
Three Months Ended June 30, 2006	-	173	-	173

## Notes:

(1) Represents the Company's net investment, including assets and accrued liabilities in the consolidated balance sheet for unconsolidated real estate entities.

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	Apartment Partnerships	Commercial Partnerships	Land Development Joint Venture	Total
	(In thousands)			
<b>Summary of Cash Flows:</b>				
<b>Cash Flows from Operating Activities</b>				
Six Months Ended June				
30, 2007	\$ 50	\$ 845	\$ 3,149	\$ 4,044
Six Months Ended June				
30, 2006	77	1,032	132	1,241
Three Months Ended June				
30, 2007	16	(17)	1,791	1,790
Three Months Ended June				
30, 2006	24	173	721	918
<b>Company's Share of Cash Flows from Operating Activities</b>				
Six Months Ended June				
30, 2007	1	382	1,575	1,958
Six Months Ended June				
30, 2006	1	467	66	534
Three Months Ended June				
30, 2007	1	(8)	896	889
Three Months Ended June				
30, 2006	-	78	361	439
<b>Operating Cash Distributions</b>				
Six Months Ended June				
30, 2007	-	794	-	794
Six Months Ended June				
30, 2006	-	747	-	747
Three Months Ended June				
30, 2007	-	383	-	383
Three Months Ended June				
30, 2006	-	388	-	388
<b>Company's Share of Operating Cash Distributions</b>				
Six Months Ended June				
30, 2007	-	360	-	360
Six Months Ended June				
30, 2006	-	339	-	339
Three Months Ended June				
30, 2007	-	174	-	174
Three Months Ended June				
30, 2006	-	176	-	176



Table of Contents**(4) DEBT**

The Company's outstanding debt is collateralized primarily by land, land improvements, receivables, investment properties, investments in partnerships, and rental properties. The following table summarizes the indebtedness of the Company at June 30, 2007 and December 31, 2006 (in thousands):

	Maturity Dates From/To	Interest Rates From/To	Outstanding as of <b>June 30,</b> <b>2007</b> <b>(Unaudited)</b>	December 31, 2006 <b>(Audited)</b>
<b>Recourse Debt</b>				
Community Development (a), (b), (c)	08-31-08/03-01-22	4%/8%	\$ 26,255	\$ 24,694
Investment Properties (d)	PAID	P+1.25%/6.98%	-	4,473
General obligations (e)	07-29-07/01-01-12	Non-interest bearing/8.10%	128	184
<b>Total Recourse Debt</b>			<b>26,383</b>	<b>29,351</b>
<b>Non-Recourse Debt</b>				
Community Development (f)	11-23-07	Non-interest bearing	500	500
Investment Properties (g)	04-30-09/08-01-47	4.95%/10%	280,168	270,220
<b>Total Non-Recourse Debt</b>			<b>280,668</b>	<b>270,720</b>
<b>Total debt</b>			<b>\$ 307,051</b>	<b>\$ 300,071</b>

- a) As of June 30, 2007, \$24,455,000 of the community development recourse debt relates to the general obligation bonds issued by the Charles County government as described in detail under the heading "Financial Commitments" in Note 5.
- b) On April 14, 2006, the Company closed a three year \$14,000,000 revolving acquisition and development line of credit loan ("the Revolver") secured by a first lien deed of trust on property located in St. Charles, MD. The maximum amount of the loan at any one time is \$14,000,000. The facility includes various sub-limits on a revolving basis for amounts to finance apartment project acquisitions and land development in St. Charles. The terms require certain financial covenants to be calculated annually as of December 31, including a tangible net worth to senior debt ratio for ALD and a minimum net worth test for ACPT. As of June 30, 2007, the Company was in compliance with these financial covenants. However, no amounts were outstanding on the Revolver.
- c) On September 1, 2006, LDA secured a revolving line of credit facility of \$15,000,000 to be utilized as follows: (i) to repay its outstanding loan of \$800,000; and (ii) to fund development costs of a project in which the Company plans to develop a planned community in Canovanas, Puerto Rico, to fund acquisitions and/or investments mainly in estate ventures, to fund transaction costs and expenses, to fund future payments of interest under the line of credit and to fund any future working capital needs of the Company. The line of credit bears interest at a fluctuating rate equivalent to the LIBOR Rate plus 200 basis points (7.35% at June 30, 2007) and matures on August 31, 2008. The outstanding balance of this facility on June 30, 2007, was \$1,800,000.
- d) The outstanding recourse debt within the investment properties was comprised of a loan borrowed to finance the acquisition of our properties Village Lake and Coachman's in January 2003, as well as a two-year, \$3,000,000 recourse note that the Company obtained in June 2005. Both of these loans were repaid in full in January 2007.
- e) The general recourse debt outstanding as of June 30, 2007, is made up of various capital leases outstanding within our U.S. and Puerto Rico operations, as well as installment loans for vehicles and other miscellaneous equipment.
- f) In 2005, the Company purchased 22 residential acres adjacent to the Sheffield Neighborhood for \$1,000,000. The Company funded half of the purchase price with cash and signed a two-year note for \$500,000 due in November



2007. The Company plans to annex the land into the St. Charles master plan community.

- g) The non-recourse debt related to the investment properties is collateralized by the multifamily rental properties and the office building in Parque Escorial. As of June 30, 2007, approximately \$73,558,000 of this debt is secured by the Federal Housing Administration ("FHA") or the Maryland Housing Fund. The non-recourse debt related to the investment properties also includes a construction loan for Sheffield Greens Apartments LLC (Sheffield Greens). As of June 30, 2007, the balance of the construction loan was \$25,390,000. The construction loan will convert to a 40-year non-recourse permanent mortgage not later than September of 2007.

The Company's loans contain various financial, cross collateral, cross default, technical and restrictive provisions. As of June 30, 2007, the Company is in compliance with the financial covenants and the other provisions of its loan agreements.

**(5) COMMITMENTS AND CONTINGENT LIABILITIES**

*Financial Commitments*

Pursuant to an agreement reached between ACPT and the Charles County Commissioners in 2002, the Company agreed to accelerate the construction of two major roadway

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links to the Charles County (the "County") road system. As part of the agreement, the County agreed to issue general obligation public improvement bonds (the "Bonds") to finance \$20,000,000 of this construction guaranteed by letters of credit provided by Lennar as part of a residential lot sales contract for 1,950 lots in Fairway Village. The Bonds were issued in three installments with the final \$6,000,000 installment issued in March 2006. The Bonds bear interest rates ranging from 4% to 8%, for a blended lifetime rate for total Bonds issued to date of 5.1%, and call for semi-annual interest payments and annual principal payments and mature in fifteen years. Under the terms of Bond repayment agreements between the Company and the County, the Company is obligated to pay interest and principal to the County based on the full amount of the Bonds; as such, the Company recorded the full amount of the debt and a receivable from the County representing the remaining Bond proceeds to be advanced to the Company as major infrastructure development within the project occurs. As part of the agreement, the Company will pay the County a monthly payment equal to one-sixth of the semi-annual interest payments and one-twelfth of the annual principal payment. The County will also require ACPT to fund an escrow account from lot sales that will be used to repay these Bonds.

In August 2005, the Company signed a memorandum of understanding ("MOU") with the Charles County Commissioners regarding a land donation that is anticipated to house a planned minor league baseball stadium and entertainment complex. Under the terms of the MOU, the Company donated 42 acres of land in St. Charles to the County on December 31, 2005. The Company also agreed to expedite off-site utilities, storm-water management and road construction improvements that will serve the entertainment complex and future portions of St. Charles so that the improvements will be completed concurrently with the entertainment complex. In return, the County agreed to issue \$7,000,000 of general obligation bonds to finance the infrastructure improvements. In March 2006, the County issued \$4,000,000 of bonds for this project and in March 2007, the County issued an additional \$3,000,000. The funds for this project will be repaid by ACPT over a 15-year period. In addition, the County agreed to issue an additional 100 school allocations a year to St. Charles commencing with the issuance of bonds.

During 2006, the Company reached an agreement with Charles County whereby the Company receives interest payments on any undistributed bond proceeds held in escrow by the County. The agreement covers the period from July 1, 2005 through the last draw made by the Company. For the six and three months ended June 30, 2007, the Company recognized \$299,000 and \$147,000 of interest income on these escrowed funds.

As of June 30, 2007, ACPT is guarantor of \$22,845,000 of surety bonds for the completion of land development projects with Charles County; substantially all are for the benefit of the Charles County Commissioners.

*Consulting Agreement and Arrangement*

ACPT entered into a consulting and retirement compensation agreement with Interstate General Company L.P.'s ("IGC") founder and Chief Executive Officer, James J. Wilson, effective October 5, 1998 (the "Consulting Agreement"). IGC was the predecessor company to ACPT. Under the terms of the Consulting Agreement, the Company will pay Mr. Wilson \$200,000 per year through October 2008.

*Guarantees*

ACPT and its subsidiaries typically provide guarantees for another subsidiary's loans. In many cases more than one company guarantees the same debt. Since all of these companies are consolidated, the debt or other financial commitment made by the subsidiaries to third parties and guaranteed by ACPT, is included within ACPT's consolidated financial statements. As of June 30, 2007, ACPT has guaranteed \$24,455,000 of outstanding debt owed by its subsidiaries. IGP has guaranteed \$1,800,000 of its subsidiaries' outstanding debt. The guarantees will remain in effect until the debt service is fully repaid by the respective borrowing subsidiary. The terms of the debt service guarantees outstanding range from one to nine years. In addition to debt service guarantees, both the Company and Lennar provided development completion guarantees related to the St. Charles Active Adult Community Joint Venture. We do not expect any of these guarantees to impair the individual subsidiary or the Company's ability to conduct business or to pursue its future development plans.

*Legal Matters*

There have been no other material changes to the legal proceedings previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

The Company and/or its subsidiaries have been named as defendants, along with other companies, in tenant-related lawsuits. The Company carries liability insurance against certain types of claims that management believes meets industry standards. To date, payments made to the plaintiffs of the settled cases were covered by our insurance policy. The Company believes it has strong defenses to the pending unresolved claims, and intends to continue to defend itself vigorously in these matters.

In the normal course of business, ACPT is involved in various pending or unasserted claims. In the opinion of management, these are not expected to have a material impact on the financial condition or future operations of ACPT.

**(6) RELATED PARTY TRANSACTIONS**

Certain officers and trustees of ACPT have ownership interests in various entities that conduct business with the Company. The financial impact of the related party transactions on the accompanying consolidated financial statements is reflected below (in thousands):

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Table of Contents**CONSOLIDATED STATEMENT OF INCOME:**

	Six Months Ended June 30, 2007		Three Months Ended June 30, 2006	
<b><u>Management and Other Fees (A)</u></b>				
Unconsolidated subsidiaries with third party partners	\$ 21	\$ 19	\$ 11	\$ 9
Affiliates of J. Michael Wilson, CEO and Chairman	43	248	-	117
	\$ 64	\$ 267	\$ 11	\$ 126
<b><u>Rental Property Revenues</u></b>	(B) \$ 28	\$ -	\$ 14	\$ -
<b><u>Interest and Other Income</u></b>				
Unconsolidated real estate entities with third party partners	\$ 4	\$ 2	\$ 2	\$ 2
<b><u>General and Administrative Expense</u></b>				
Affiliates of J. Michael Wilson, CEO and Chairman	(C1) \$ -	\$ 19	\$ -	\$ -
Reserve additions and other write-offs-				
Unconsolidated real estate entities with third party partners	(A) 11	5	7	(1)
Reimbursement to IBC for ACPT's share of J. Michael Wilson's salary	195	188	97	94
Reimbursement of administrative costs-				
Affiliates of J. Michael Wilson, CEO and Chairman	(13)	(5)	(7)	(2)
Reimbursement of legal fees to attorney for J. Michael Wilson	(C4) 48	-	48	-
Consulting Fees -				
James J. Wilson, IGC Chairman and Director	(C2) 100	100	50	50
Thomas J. Shafer, Trustee	(C3) 30	30	15	15
	\$ 371	\$ 337	\$ 210	\$ 156
<b>BALANCE SHEET:</b>			<b>Balance</b>	<b>Balance</b>
			<b>June 30,</b>	<b>December 31,</b>
			<b>2007</b>	<b>2006</b>
<b><u>Other Assets</u></b>				
Receivables - All unsecured and due on demand				
Affiliate of J. Michael Wilson, CEO and Chairman			\$ 10	\$ 128

(A) **Management and Other Services**

The Company provides management and other support services to its unconsolidated subsidiaries and other affiliated entities in the normal course of business. The fees earned from these services are typically collected on a monthly basis, one month in arrears. Receivables are unsecured and due on demand. Certain partnerships experiencing cash shortfalls have not paid timely. Generally, receivable balances of these partnerships are fully reserved, until satisfied or the prospect of collectibility improves. The collectibility of management fee receivables is evaluated quarterly. Any increase or decrease in the reserves is reflected accordingly as additional bad debt expenses or recovery of such expenses.

Chastleton Associates, LP, previously owned by an affiliate of J. Michael Wilson, was sold to a third party during April 2007, resulting in a termination of our management agreement. The Company earned an agreed-upon management fee for administrative services through the end of the second quarter 2006. Management fees generated by this property accounted for less than 1% of the Company's total revenue.

At the end of February 2007, G.L. Limited Partnership, which was owned by affiliates of J. Michael Wilson, was sold to a third party. Accordingly, we are no longer the management agent for this property effective March 1, 2007. Management fees generated by this property accounted for less than 1% of the Company's total revenue.

(B) **Rental Property Revenue**

On September 1, 2006, the Company, through one of its Puerto Rican subsidiaries, Escorial Office Building I, Inc. ("Landlord"), executed a lease with Caribe Waste Technologies, Inc. ("CWT"), a company owned by the J. Michael Wilson Family. The lease provides for 1,842 square feet of office space to be leased by CWT for five years at \$19.00 per rentable square foot. The company provided CWT with an allowance of \$9,000 in tenant improvements which are being amortized over the life of the lease. In addition, CWT shall have the right to terminate this lease at any time after one year, provided it gives Landlord written notice six (6) months prior to termination. The lease agreement is unconditionally guaranteed by Interstate Business Corporation ("IBC"), a company owned by the J. Michael Wilson Family.

(C) **Other**

Other transactions with related parties are as follows:

- 1) In 2005, the Company rented executive office space and other property from an affiliate in the United States pursuant to leases that were assigned to the new owners when the property was sold in January 2006. In management's opinion, all leases with affiliated persons were on terms at least as favorable as these generally available from unaffiliated persons for comparable property.
- 2) Represents fees paid to James J. Wilson pursuant to a consulting and retirement agreement. At Mr. Wilson's request, payments are made to IWT.
  - 3) Represents fees paid to Thomas J. Shafer, a trustee, pursuant to a consulting agreement.
- 4) The Independent Trustees concluded that certain legal fees and expenses incurred by J. Michael Wilson in connection with the preliminary work being done in seeking a strategic partner to recapitalize the company are in the best interest of the Company and the minority shareholders. Accordingly, the Independent Trustees authorized the Company to fund up to \$170,000 of such costs, \$48,000 of which had been incurred as of June 30, 2007.

**Related Party Acquisitions**

*El Monte*

On April 30, 2004, the Company purchased a 50% limited partnership interest in El Monte Properties S.E. ("El Monte") from Insular Properties Limited Partnership ("Insular") for \$1,462,500. Insular is owned by the J. Michael Wilson Family. Per the terms of the agreement, the Company was responsible to fund \$400,000 of capital improvements and lease stabilization costs, and had a priority on cash distributions up to its advances plus accrued interest at 8%, investment and a 13% cumulative preferred return on its investment. The purchase price was based on a third party appraisal of \$16,500,000 dated April 22, 2003. The Company's limited partnership investment was accounted for under the equity method of accounting.

In December 2004, a third party buyer purchased El Monte for \$20,000,000: \$17,000,000 in cash and \$3,000,000 in two notes of \$1,500,000 each that bear an interest rate of prime plus 2%, with a ceiling of 9%, and mature on December 3, 2009. The net cash proceeds from the sale of the real estate were distributed to the partners. As a result, the Company received \$2,500,000 in cash and recognized \$986,000 of income in 2004. El Monte distributed a \$1,500,000 note to the Company in January 2005. On January 24, 2007, the Company received \$1,707,000 as payment in full of the principal balance and all accrued interest related to the El Monte note receivable. Accordingly, the Company recorded \$1,500,000 as equity in earnings and \$207,000 as interest income. As previously noted, the Company deferred revenue recognition on this note until the cash was received.

(7) **INCOME TAXES**

We adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, we recorded a \$1,458,000 increase in the net liability for unrecognized tax positions, which was recorded as a cumulative effect of a change in accounting principle, reducing the opening balance of retained earnings on January 1, 2007. The total amount of unrecognized tax benefits as of January 1, 2007, was \$13,544,000. Included in the balance at January 1, 2007, were \$2,605,000 of tax positions that, if recognized, would impact the effective tax rate.

In accordance with our accounting policy, we recognize accrued interest related to unrecognized tax benefits as a component of interest expense and penalties as a component of tax expense on the Consolidated Statements of Income. This policy did not change as a result of the adoption of FIN 48. Our Consolidated Statements of Income for the six and three months ended June 30, 2007, and our Consolidated Balance Sheet as of that date included interest of \$551,000, \$282,000 and \$2,181,000, respectively and penalties of \$72,000, \$14,000 and \$669,000, respectively. The Company currently does not have any tax returns under audit by the United States Internal Revenue Service or the Puerto Rico Treasury Department. However, the tax returns filed in the United States for the years ended December 31, 2003 through 2006 remain subject to examination. For Puerto Rico, the tax returns for the years ended December 31, 2002 through 2006 remain subject to examination. Within the next twelve months, the Company anticipates the payment of \$252,000 related to a closing agreement being pursued with the Puerto Rico Treasury Department. The Company does not anticipate any other payments related to settlement of any tax examinations. Additionally, as certain United States and Puerto Rico income tax returns will no longer be subject to examination, and as a result, there is a reasonable possibility that the amount of unrecognized tax benefits will decrease by \$26,000 when the related statutes of limitations expire.

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**(8) SEGMENT INFORMATION**

ACPT has two reportable segments: U.S. operations and Puerto Rico operations. The Company's chief decision-makers allocate resources and evaluate the Company's performance based on these two segments. The U.S. segment is comprised of different components grouped by product type or service, to include: investments in rental properties, community development and property management services. The Puerto Rico segment entails the following components: investment in rental properties, community development, homebuilding and property management services. The U.S. segment bears substantially all of the corporate costs associated with being a public company and other corporate governance. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

*Customer Dependence*

Residential land sales to Lennar within our U.S. segment were \$3,309,000 for the six months ended June 30, 2007, which represents 13% of the U.S. segment's revenue and 8% of our total year-to-date consolidated revenue. No customers accounted for more than 10% of our consolidated revenue for the six months ended June 30, 2007.



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The following presents the segment information for the six months ended June 30, 2007 and 2006 (in thousands):

	United States	Puerto Rico	Inter- Segment	Total
<b>Six Months Ended June 30, 2007</b>				
<b>(Unaudited):</b>	\$	\$	\$	\$
Rental property revenues	18,706	11,126	-	29,832
Rental property operating expenses	9,489	5,638	(13)	15,114
Land sales revenue	5,969	-	-	5,969
Cost of land sales	4,356	-	-	4,356
Home sales revenue	-	5,214	-	5,214
Cost of home sales	-	3,816	-	3,816
Management and other fees	208	313	(15)	506
General, administrative, selling and marketing expense	3,923	1,448	(3)	5,368
Depreciation and amortization	2,745	1,836	-	4,581
Operating income	4,370	3,915	1	8,286
Interest income	591	226	(55)	762
Equity in earnings from unconsolidated entities	(1)	1,846	-	1,845
Interest expense	6,226	3,166	(55)	9,337
Minority interest in consolidated entities	173	1,384	-	1,557
Income before provision/(benefit) for income taxes	(1,436)	1,563	-	127
Income tax provision/(benefit)	(481)	769	-	288
<b>Net income</b>	<b>(955)</b>	<b>794</b>	<b>-</b>	<b>(161)</b>
Gross profit on land sale	1,613	-	-	1,613
Gross profit on home sales	-	1,398	-	1,398
<b>Total assets</b>	<b>254,637</b>	<b>102,060</b>	<b>(1,620)</b>	<b>355,077</b>
Additions to long lived assets	4,519	422	-	4,941
<b>Six Months Ended June 30, 2006</b>				
<b>(Unaudited):</b>	\$	\$	\$	\$
Rental property revenues	15,606	10,532	-	26,138
Rental property operating expenses	7,373	5,443	-	12,816
Land sales revenue	6,626	-	-	6,626
Cost of land sales	3,666	-	-	3,666
Home sales revenue	-	11,259	-	11,259
Cost of home sales	-	8,521	-	8,521
Management and other fees	269	296	-	565
General, administrative, selling and marketing expense	3,178	1,356	-	4,534
Depreciation and amortization	2,275	1,799	-	4,074
Operating income	6,009	4,968	-	10,977
Interest income	59	60	(18)	101
Equity in earnings from unconsolidated entities	-	343	-	343
Interest expense	4,048	3,170	(18)	7,200

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Minority interest in consolidated entities	312	2,354	-	2,666
Income before provision/(benefit) for income taxes	1,710	(38)	-	1,672
Income tax provision/(benefit)	729	(15)	-	714
<b>Net income</b>	<b>981</b>	<b>(23)</b>	<b>-</b>	<b>958</b>
Gross profit on land sale	2,960	-	-	2,960
Gross profit on home sales	-	2,738	-	2,738
<b>Total assets</b>	<b>208,106</b>	<b>109,767</b>	<b>(369)</b>	<b>317,504</b>
Additions to long lived assets	24,208	908	-	25,116

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The following presents the segment information for the three months ended June 30, 2007 and 2006 (in thousands):

	United States	Puerto Rico	Inter- Segment	Total
<b>Three Months Ended June 30, 2007</b>				
<b>(Unaudited):</b>	\$	\$	\$	\$
Rental property revenues	9,801	5,621	-	15,422
Rental property operating expenses	4,864	2,907	(13)	7,758
Land sales revenue	2,214	-	-	2,214
Cost of land sales	1,440	-	-	1,440
Home sales revenue	-	2,126	-	2,126
Cost of home sales	-	1,530	-	1,530
Management and other fees	98	160	(15)	243
General, administrative, selling and marketing expense	2,176	732	(3)	2,905
Depreciation and amortization	1,474	923	-	2,397
Operating income	2,159	1,815	1	3,975
Interest income	294	11	(25)	280
Equity in earnings from unconsolidated entities	(1)	173	-	172
Interest expense	3,160	1,585	(25)	4,720
Minority interest in consolidated entities	173	12	-	185
Income before provision/(benefit) for income taxes	(879)	459	-	(420)
Income tax provision/(benefit)	(406)	171	-	(235)
<b>Net income</b>	<b>(473)</b>	<b>288</b>	<b>-</b>	<b>(185)</b>
Gross profit on land sale	774	-	-	774
Gross profit on home sales	-	596	-	596
<b>Total assets</b>	<b>254,637</b>	<b>102,060</b>	<b>(1,620)</b>	<b>355,077</b>
Additions to long lived assets	1,693	195	-	1,888
<b>Three Months Ended June 30, 2006</b>				
<b>(Unaudited):</b>				
Rental property revenues	8,059	5,288	-	13,347
Rental property operating expenses	3,834	2,794	-	6,628
Land sales revenue	2,682	-	-	2,682
Cost of land sales	1,440	(10)	-	1,430
Home sales revenue	-	7,234	-	7,234
Cost of home sales	-	5,487	-	5,487
Management and other fees	128	147	-	275
General, administrative, selling and marketing expense	1,496	606	-	2,102
Depreciation and amortization	1,199	902	-	2,101
Operating income	2,900	2,890	-	5,790
Interest income	34	15	(18)	31
Equity in earnings from unconsolidated entities	-	173	-	173
Interest expense	2,115	1,602	(18)	3,699

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Minority interest in consolidated entities	304	1,297	-	1,601
Income before provision/(benefit) for income taxes	515	237	-	752
Income tax provision/(benefit)	228	67	-	295
<b>Net income</b>	<b>287</b>	<b>170</b>	<b>-</b>	<b>457</b>
Gross profit on land sale	1,242	10	-	1,252
Gross profit on home sales	-	1,747	-	1,747
<b>Total assets</b>	<b>208,106</b>	<b>109,767</b>	<b>(369)</b>	<b>317,504</b>
Additions to long lived assets	20,228	842	-	21,070

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**(9) SUBSEQUENT EVENTS**

*Cash Dividend*

On August 13, 2007, the Board of Trustees declared a \$0.10 per share cash dividend on its common shares, payable on September 12, 2007, to shareholders of record as of August 28, 2007.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FORWARD-LOOKING STATEMENTS**

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing in this report. Historical results set forth in Management's Discussion and Analysis of Financial Condition and Results of Operation and the Financial Statements should not be taken as indicative of our future operations. This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These include statements about our business outlook, market and economic conditions, strategies, future plans, anticipated costs and expenses, capital spending, and any other statements that are not historical. The accuracy of these statements is subject to a number of risks, uncertainties, and other factors that may cause our actual results, performance or achievements of the Company to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Those items are discussed under "Risk Factors" in Part I, Item 1A to the Form 10-K for the year ended December 31, 2006.

**NEW ACCOUNTING PRONOUNCEMENTS AND CHANGE IN BASIS OF PRESENTATION**

In July 2006, the FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" ("FIN 48"). FIN 48 is an interpretation of FASB Statement No. 109, "*Accounting for Income Taxes*," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes. We adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, we recorded a \$1,458,000 increase in the net liability for unrecognized tax positions, which was recorded as a cumulative effect of a change in accounting principle, reducing the opening balance of retained earnings on January 1, 2007. See Note 7 to the consolidated financial statements for further discussion.

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States, which we refer to as GAAP, requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of our financial statements.

Refer to the Company's 2006 Annual Report on Form 10-K for a discussion of critical accounting policies, which include sales, profit recognition and cost capitalization, investment in unconsolidated real estate entities, impairment of long-lived assets, depreciation of investments in real estate, income taxes and contingencies. For the six months ended June 30, 2007, there were no material changes to our policies except as noted above related to the implementation of FIN 48.

**RESULTS OF OPERATIONS**

The following discussion is based on the consolidated financial statements of the Company. It compares the results of operations of the Company for the six and three months ended June 30, 2007 (unaudited), with the results of

operations of the Company for the six and three months ended June 30, 2006 (unaudited). Historically, the Company's financial results have been significantly affected by the cyclical nature of the real estate industry. Accordingly, the Company's historical financial statements may not be indicative of future results. This discussion should be read in conjunction with the accompanying consolidated financial statements and notes included elsewhere in this report and within our Annual Report on Form 10-K for the year ended December 31, 2006.

**Results of Operations - U.S. Operations:**

For the six- and three-month periods ended June 30, 2007, our U.S. segment generated \$4,370,000 and \$2,159,000 of operating income compared to \$6,009,000 and \$2,900,000 of operating income generated by the segment for the same periods in 2006, respectively. Additional information and analysis of the U.S. operations can be found below.

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**Rental Property Revenues and Operating Expenses - U.S. Operations:**

As of June 30, 2007, nineteen U.S.-based apartment properties in which we hold an ownership interest qualified for the consolidation method of accounting. The rules of consolidation require that we include within our financial statements the consolidated apartment properties' total revenue and operating expenses. The portions of net income attributable to the interests of the outside owners of these properties and any losses and distributions in excess of the minority owners' basis in those properties are reflected as minority interest expense.

As of June 30, 2007, thirteen of the consolidated properties were market rent properties, allowing us to determine the appropriate rental rates. Even though we can determine the rents, a portion of our units at some of our market rent properties must be leased to tenants with low to moderate income. HUD subsidizes four of the properties and the two remaining properties are a mix of subsidized units and market rent units. HUD dictates the rents of the subsidized units.

*Apartment Construction and Acquisitions*

On January 31, 2007, we completed the newest addition to our rental apartment portfolio located in St. Charles' Fairway Village, the Sheffield Greens Apartments. The 252-unit apartment project consists of nine, 3-story buildings and offers 1 and 2 bedroom units ranging in size from 800 to 1,400 square feet. Leasing efforts continue to be successful, with 98% of the total complex leased as of June 30, 2007.

On April 28, 2006, the Company acquired two apartment properties, Milford Station I LLC and Milford Station II LLC, in Baltimore, Maryland containing a combined total of 250 units for approximately \$14,300,000. All of the acquired properties are operated as market rate properties.

*Six months ended*

For the six months ended June 30, 2007, rental property revenues increased \$3,100,000 or 20% to \$18,706,000 compared to \$15,606,000 for the same period in 2006. The increase in rental revenues was primarily the result of additional revenues for Sheffield Greens Apartments, Milford Station I and Milford Station II which accounted for approximately \$2,335,000 of the difference. The increase was also attributable to an overall 5% increase in rents between periods. These rental revenue increases were offset in part by an increase in our vacancy rate, primarily resulting from the supply of new units to the area upon completion of the Sheffield Greens Apartments. As Sheffield became fully occupied in the 2<sup>nd</sup> quarter, we have seen increased absorption of vacant units at our other competing properties.

Rental property operating expenses increased \$2,116,000 or 29% for the second quarter of 2007 to \$9,489,000 compared to \$7,373,000 for the second quarter of 2006. The overall increase in rental property operating expenses was primarily the result of additional expenses for Sheffield Greens Apartments, Milford Station I and Milford Station II, which accounted for approximately \$1,236,000 of the difference. The remainder of the increase resulted from overall inflationary adjustments as well as specific increases in advertising, security, office and maintenance salaries, utilities, rehabilitation and concessions awarded to residents. We are currently working to reduce our overall operating expenses. Specific reduction efforts include reducing advertising and concessions expenses now that Sheffield Greens is leased and occupancy rates at other competing properties are increasing. We are also pursuing measures to reduce security expenditures.

*Three months ended*

For the three months ended June 30, 2007, rental property revenues increased \$1,742,000 or 22% to \$9,801,000 compared to \$8,059,000 for the same period in 2006. The increase in rental revenues was primarily the result of additional revenues for Sheffield Greens Apartments, Milford Station I and Milford Station II which accounted for approximately \$1,287,000 of the difference. The increase was also attributable to an overall 5% increase in rents between periods. These rental revenue increases were offset in part by an increase in our vacancy rate in the US, primarily resulting from the supply of new units to the area upon completion of the Sheffield Greens Apartments. As Sheffield became fully occupied in the 2<sup>nd</sup> quarter, we have seen increased absorption of vacant units at our other competing properties.

Rental property operating expenses increased \$1,030,000 or 27% for the second quarter of 2007 to \$4,864,000 compared to \$3,834,000 for the second quarter of 2006. The overall increase in rental property operating expenses was primarily the result of additional expenses for Sheffield Greens Apartments, Milford Station I and Milford Station II, which accounted for approximately \$628,000 of the difference. The remainder of the increase resulted from overall inflationary adjustments as well as specific increases in advertising, security, office and maintenance salaries, rehabilitation and concessions awarded to residents. We are currently working to reduce our overall operating expenses. Specific reduction efforts include reducing advertising and concessions expenses now that Sheffield greens is leased and occupancy rates at other competing properties are increasing. We are also pursuing measures to reduce security expenditures.

**Community Development – U.S. Operations:**

Land sales revenue in any one period is affected by the mix of lot sizes and, to a greater extent, the mix between residential and commercial sales. In March 2004, the Company executed an agreement with Lennar Corporation to sell 1,950 residential lots (1,359 single family lots and 591 town home lots) in Fairway Village in St. Charles, Maryland. The agreement requires the homebuilder to provide \$20,000,000 in letters of credit to secure the purchase of the lots and purchase 200 residential lots per year, provided that they are developed and available for delivery as defined by the development agreement. Based on 200 lot sales per year,



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it is estimated that lot settlements will take place through 2015. Sales are closed on a lot by lot basis at the time when the builder purchases the lot. The ultimate selling price per lot sold to Lennar may exceed the amount recognized at closing since the final lot price is equal to 30% of the base price of the home sold on the lot. Additional revenue exceeding the established take down price per lot will be recognized upon Lennar's settlement with the respective homebuyers. Residential lots can vary in size and location resulting in pricing differences. Gross margins of residential lots are fairly consistent within any given village in St. Charles. Commercial land is typically sold by contract that allows for a study period and delayed settlement until the purchaser obtains the necessary permits for development. The sales prices and gross margins for commercial parcels vary significantly depending on the location, size, extent of development and ultimate use. Commercial land sales are generally cyclical. Community development land sales revenue decreased \$657,000 or 10% for the six months ended June 30, 2007, to \$5,969,000 as compared to \$6,626,000 for the six months ended June 30, 2006. The overall decrease was primarily the result of a decrease in the number of residential lots settled during the first six months of 2007, offset in part by an increase in the amount of commercial sales for the period.

Community development land sales revenue decreased \$468,000 or 17% for the three months ended June 30, 2007, to \$2,214,000 as compared to \$2,682,000 for the three months ended June 30, 2006. The overall decrease for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 resulted from decreased commercial sales and decreased true-up payments received, offset in part by an increase in the number of residential lots delivered. Further discussion of the components of this variance is as follows:

*Residential Land Sales*

For the six months ended June 30, 2007, we recognized \$1,579,000 related to the delivery of 17 residential lots to Lennar, of which 14 were townhome lots and 3 were single-family lots, as compared to \$3,317,000 related to 26 single-family lots delivered in the six months ended June 30, 2006. For the six months ended June 30, 2007, we delivered 14 townhome lots to Lennar, recognizing as revenue an average price of \$87,560 per lot, which includes the initial recognition of \$85,000 per lot plus water and sewer fees, road fees and other off-site fees. The Company also delivered 3 single family lots to Lennar, recognizing as revenue an average price of \$117,860 per lot, which includes the initial recognition of \$115,300 per lot plus water and sewer fees, road fees and other off-site fees. For the six months ended June 30, 2006, we delivered 26 single family lots to Lennar, recognizing as revenue an average price of \$127,560 per lot, which includes the initial recognition of \$125,000 per lot plus water and sewer fees, road fees and other off-site fees.

For the three months ended June 30, 2007, we recognized \$967,000 related to the delivery of 10 residential lots to Lennar, of which 7 were townhome lots and 3 were single-family lots, as compared to \$765,000 related to 6 single-family lots delivered in the three months ended June 30, 2006. For the three months ended June 30, 2007, we delivered 7 townhome lots to Lennar, recognizing as revenue an average price of \$87,560 per lot, which includes the initial recognition of \$85,000 per lot plus water and sewer fees, road fees and other off-site fees. The Company also delivered 3 single family lots to Lennar, recognizing as revenue an average price of \$117,860 per lot, which includes the initial recognition of \$115,300 per lot plus water and sewer fees, road fees and other off-site fees. For the three months ended June 30, 2006, we delivered 6 single family lots to Lennar, recognizing as revenue an average price of \$127,560 per lot, which includes the initial recognition of \$125,000 per lot plus water and sewer fees, road fees and other off-site fees.

As of June 30, 2007, 1,626 lots remained under contract to Lennar of which 154 single family lots and 39 townhome lots were developed and ready for delivery.

In addition to initial lot settlement, during the first six months of 2007 and 2006 we also recognized \$1,075,000 and \$1,707,000, respectively, of additional revenue for lots that were previously sold to Lennar in 2006 and 2005. During the second quarter of 2007 and 2006, we recognized \$761,000 and \$1,115,000, respectively, of additional revenue for lots previously sold to Lennar. This additional revenue is based on the final settlement price of the homes as provided by our agreement with Lennar.

*Commercial Land Sales*

For the six months ended June 30, 2007, we sold 5.78 commercial acres in St. Charles for \$2,660,000 as compared to 10.46 acres for \$1,602,000 for the six months ended June 30, 2006. For the three months ended June 30, 2007, we did not close any contracts for commercial acres, but did recognize \$123,000 of revenue related to work completed on incomplete parcels previously sold as compared to the sale of 7.81 acres for \$802,000 for the three months ended June 30, 2006. As of June 30, 2007, our commercial sales backlog contained 95.22 acres under contract for a total of \$16,941,000.

*St. Charles Active Adult Community, LLC – Land Joint Venture*

In September 2004, the Company entered into a joint venture agreement with Lennar Corporation for the development of a 352-unit, active adult community located in St. Charles, Maryland. The Company manages the project's development for a market rate fee pursuant to a management agreement. In September 2004, the Company transferred land to the joint venture in exchange for a 50% ownership interest and \$4,277,000 in cash. The Company's investment in the joint venture was recorded at 50% of the historical cost basis of the land with the other 50% recorded within our deferred charges and other assets. The proceeds received are reflected as deferred revenue. The deferred revenue and related deferred costs will be recognized into income as the joint venture sells lots to Lennar. In March 2005, the joint venture closed a non-recourse development loan which was amended in June 2006 and again in December 2006. Per the terms of the loan, both the Company and Lennar provided development completion guarantees.

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In the six and three months ended June 30, 2007, the joint venture delivered 30 and 16 lots to Lennar as compared to none for the six and three months ended June 30, 2006. Accordingly, for the six and three months ended June 30, 2007, the Company recognized \$655,000 and \$363,000 in deferred revenue, off-site fees and management fees and \$218,000 and \$125,000 of deferred costs.

### *Gross Margin on Land Sales*

The gross margin on land sales for the six and three months ended June 30, 2007, were 27% and 35% as compared to 45% and 46% for the same period of 2006. Gross margins differ from period to period depending on the mix of land sold. In the six months ended June 30, 2007, our commercial acres represented a significant portion of our land sales and the commercial parcels sold had lower margins than our residential lot sales. For the commercial sales in the six and three months ended June 30, 2006, the parcels sold had higher margins relative to those sold in the same periods of 2007. The gross margins on our residential land sales for the U.S. have remained relatively stable for the six and three months ended June 30, 2007, and the six and three months ended June 30, 2006.

### *Customer Dependence*

Residential land sales to Lennar within our U.S. segment were \$3,309,000 for the six months ended June 30, 2007, which represents 13% of the U.S. segment's revenue and 8% of our total year-to-date consolidated revenue. No customers accounted for more than 10% of our consolidated revenue for the six months ended June 30, 2007. However, loss of all or a substantial portion of our land sales, as well as the joint venture's land sales, to Lennar would have a significant adverse effect on our financial results until such lost sales could be replaced.

### **Management and Other Fees – U.S. Operations:**

We earn monthly management fees from all of the apartment properties that we own, as well as our management of apartment properties owned by third parties and affiliates of J. Michael Wilson. Effective February 28, 2007, the Company's management agreement with G.L. Limited Partnership was terminated upon the sale of the apartment property to a third party. Effective April 30, 2006, the Company's management agreement with Chastleton Associates LP was also terminated upon the sale of the apartment property to a third party. These properties were previously owned by an affiliate. Management fees generated by each of these properties accounted for less than 1% of the Company's total revenue.

We receive an additional fee from the properties that we manage for their use of the property management computer system that we purchased at the end of 2001 and a fee for vehicles purchased by the Company for use on behalf of the properties. The cost of the computer system and vehicles are reflected within depreciation expense.

The Company manages the project development of the joint venture with Lennar for a market rate fee pursuant to a management agreement. These fees are based on the cost of the project and a prorated share is earned when each lot is sold.

For the six and three months ended June 30, 2007, management fees decreased \$61,000 and \$30,000, respectively as compared to the six and three months ended June 30, 2006. These amounts only include the fees earned from the non-controlled properties; the fees earned from the controlled properties are eliminated in consolidation.

### **General, Administrative, Selling and Marketing Expense – U.S. Operations:**

The costs associated with the oversight of our U.S. operations, accounting, human resources, office management and technology, as well as corporate and other executive office costs are included in this section. ARMC employs the centralized office management approach for its property management services for our properties located in St. Charles, Maryland, our properties located in the Baltimore, Maryland area and the property in Virginia and, to a lesser extent, the other properties that we manage. Our unconsolidated and managed-only apartment properties reimburse ARMC for certain costs incurred at the central office that are attributable to the operations of those properties. In accordance with EITF Topic 01-14, "Income Statement Characterization of Reimbursements Received for Out of Pocket Expenses Incurred," the cost and reimbursement of these costs are not included in general and administrative expenses, but rather they are reflected as separate line items on the consolidated income statement.

General, administrative, selling and marketing costs incurred within our U.S. operations increased \$745,000 to \$3,923,000 for the six months of 2007 compared to \$3,178,000 for the same period of 2006. The 23% increase is primarily attributable to increases in our consulting and legal fees related to strategic planning including fees associated with an evaluation of a recapitalization of the company, and consulting services provided for our FIN 48 implementation during the first quarter of 2007, as well as other increases in salaries and benefits related to the quarterly accrual in 2007 of estimated management bonuses. The increases were offset in part by decreases in audit and accounting expenses as a result of the non-recurring work in the first quarter of 2006 related to the closing agreement reached with the IRS, as well as decreases in our share appreciation rights expense and corporate donations.

General, administrative, selling and marketing costs incurred within our U.S. operations increased \$680,000 to \$2,176,000 for the three months ended June 30, 2007, compared to \$1,496,000 for the same period of 2006. The 45% increase is primarily attributable to increases in our consulting and legal services related to strategic planning including an evaluation of a recapitalization of the company, as well as other increases in salaries and benefits related to the quarterly accrual in 2007 of estimated management bonuses. The Company also experienced an increase in share appreciation rights expense for the quarter to date period as a result of a decrease in fair value recorded in the second quarter of 2006. The increases were offset in part by decreases corporate donations.

We anticipate additional costs will be incurred as part of the company's strategic planning activities noted above. These costs include, but are not limited to, legal fees, consulting fees, and fees paid to the Special Committee to the Board of Trustees.

**Table of Contents****Depreciation Expense – U.S. Operations:**

Depreciation expense increased \$470,000 to \$2,745,000 for the first six months of 2007 compared to \$2,275,000 for the same period in 2006. The depreciation expense also increased \$275,000 to \$1,474,000 compared to \$1,199,000 for the three months ended June 30, 2006. The year to date and quarter to date increases in depreciation are primarily the result of depreciation related to the acquisitions of Milford Station I and Milford Station II and the depreciation related to Sheffield Greens Apartments, all of which accounted for \$308,000 and \$221,000 of the variances, respectively. The balance of the increases relate to the recent refinancings of several properties at the end of 2006 and beginning of 2007. The Company used part of the proceeds to make significant investments in capital improvements at these properties resulting in increased depreciation expense for both the year to date and quarter to date.

**Interest Income – U.S. Operations:**

Interest income increased \$532,000 to \$591,000 for the six months ended June 30, 2007, as compared to \$59,000 for the six months ended June 30, 2006. The increase was primarily attributable to \$299,000 of interest income accrued on the undistributed bond proceeds held in escrow by Charles County for the six months ended June 30, 2007. The Company reached a written agreement with the County regarding interest earned on amounts held in escrow by the County, but not yet drawn by the Company, whereby the Company is now able to accrue investment income on the related receivables. In addition, the Company earned \$230,000 on investments of cash received from the various apartment partnership refinancings at the end of last year and the beginning of this year and has earned interest accordingly.

Interest income increased \$260,000 to \$294,000 for the three months ended June 30, 2007, as compared to \$34,000 for the three months ended June 30, 2006. The increase was primarily attributable to \$147,000 of interest income accrued on the undistributed bond proceeds held in escrow by Charles County for the three months ended June 30, 2007. The Company reached a written agreement with the County regarding interest earned on amounts held in escrow by the County, but not yet drawn by the Company, whereby the Company is now able to accrue investment income on the related receivables. In addition, the Company earned \$115,000 on investments of cash received from the various apartment partnership refinancings at the end of last year and the beginning of this year and has earned interest accordingly.

**Interest Expense – U.S. Operations:**

The Company considers interest expense on all U.S. debt available for capitalization to the extent of average qualifying assets for the period. Interest specific to the construction of qualifying assets, represented primarily by our recourse debt, is first considered for capitalization. To the extent qualifying assets exceed debt specifically identified, a weighted average rate including all other debt of the U.S. segment is applied. Any excess interest is reflected as interest expense. For 2007 and 2006, the excess interest primarily relates to the interest incurred on the non-recourse debt from our investment properties.

Interest expense increased \$2,578,000 for the first six months of 2007 to \$6,626,000, as compared to \$4,048,000 for the same period of 2006. Interest expense increased \$1,045,000 for the second quarter of 2007 to \$3,160,000 as compared to \$2,115,000 for the same period of 2006. The year to date and quarter to date increases were primarily attributable to interest expense incurred at new properties, including Sheffield Greens Apartments, Milford Station I and Milford Station II all of which accounted for \$890,000 and \$400,000 of the increase, respectively. In addition, the refinancing of several apartment mortgages during the fourth quarter of 2006 and early first quarter 2007 increased interest expense at Fox Chase Apartments, LLC, New Forest Apartments, LLC, Coachman's Apartments LLC and Village Lake Apartments, LLC. Additionally, interest expense increased as a result of accrued interest on uncertain tax positions associated with our implementation of FIN 48 in the first quarter 2007.

For the six and three months ended June 30, 2007, \$601,000 and \$319,000 of interest cost was capitalized. During the same period in 2006, \$732,000 and \$443,000 of interest cost was capitalized.

**Provision for Income Taxes – U.S. Operations:**

The effective tax rates for the six and three months ended June 30, 2007, and June 30, 2006, were 33% and 46% and 43% and 44%, respectively. The statutory rate is 40%. The effective tax rate for 2007 differs from the statutory rate due to the relatively small net losses for the six and three months ended June 30, 2007, the related benefit for which, was partially offset by accrued penalties on uncertain tax positions as part of the implementation of FIN 48. The effective tax rates for 2006 differ from the statutory rate due to certain permanent differences and state taxes.

**Results of Operations – Puerto Rico Operations:**

For the six months ended June 30, 2007, our Puerto Rico segment generated \$3,915,000 of operating income compared to \$4,968,000 of operating income generated by the segment for the same period in 2006. For the three months ended June 30, 2007, our Puerto Rico segment generated \$1,815,000 of operating income compared to \$2,890,000 of operating income for the same period of 2006. Additional information and analysis of the Puerto Rico operations can be found below.

**Rental Property Revenues and Operating Expenses – Puerto Rico Operations:**

Our rental property revenues and expenses are generated primarily from the 12 multifamily apartment properties located in the San Juan metropolitan area. In addition, the Company operates a commercial rental property in the community of Parque Escorial, known as Escorial Building One (“EBO”), in which it holds a 100% ownership interest. EBO is a three-story building with approximately

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56,000 square feet of offices space for lease. The Company moved the Puerto Rico Corporate Office to the new facilities in the third quarter of 2005, and leases approximately 20% of the building.

### *Six Months*

Rental property revenues increased \$594,000 or 6% to \$11,126,000 for the six months ended June 30, 2007 compared to \$10,532,000 for the same period of 2006. The year to date increase in our rental property revenues was primarily the result of an overall rent increases of 3% from HUD on our multifamily apartment properties. The multifamily apartment properties also experienced a 20% increase in other revenues. In addition, rents for our commercial rental property, EOB, increased 89% for the year to date period as tenants occupied the new office building.

Rental property operating expenses increased \$195,000 or 4% to \$5,638,000 for the six months ended June 30, 2007 compared to \$5,443,000 for the same period of 2006. The year to date increase was the result of a 2% increase to our multifamily apartment properties operating expenses driven by overall inflationary adjustments as well as specific above inflation increases noted in utilities and repairs. In addition, operating expenses for our commercial rental property, EOB, increased 27% for the year to date period as a result of increased occupancy.

### *Three Months*

Rental property revenues increased \$333,000 or 6% to \$5,621,000 for the three months ended June 30, 2007 compared to \$5,288,000 for the same period of 2006. The quarter to date increase in our rental property revenues was primarily the result of an overall rent increases of 3% from HUD on our multifamily apartment properties. The multifamily apartment properties also experienced a 20% increase in other revenues. In addition, rents for our commercial rental property, EOB, increased 96% for the three-month period as a result of lease up efforts and new tenants.

Rental operating expenses increased \$113,000 or 4% to \$2,907,000 for the three months ended June 30, 2007 compared to \$2,794,000 for the same period in 2006. The quarter to date increase was the result of a 3% increase to our multifamily apartment properties operating expenses driven by overall inflationary adjustments as well as specific above inflation increases noted in utilities and repairs. In addition, operating expenses for our commercial rental property, EOB, increased 24% for the three-month period as a result of increased occupancy.

### **Community Development – Puerto Rico Operations:**

Total land sales revenue in any one period is affected by commercial sales which are cyclical in nature and usually have a noticeable positive impact on our earnings in the period in which settlement is made.

There were no community development land sales during the six and three months ended June 30, 2007 and 2006. There were no commercial contracts for commercial sales in backlog at June 30, 2007.

### **Homebuilding – Puerto Rico Operations:**

The Company organizes corporations as needed to operate each individual homebuilding project. In April 2004, the Company commenced the construction of a new 160-unit mid-rise condominium complex known as Torres del Escorial (“Torres”). The condominium units were offered to buyers in the market in January 2005 and delivery of the units commenced in the fourth quarter of 2005. The condominium units are sold individually from an onsite sales office to pre-qualified homebuyers.

For the six months ended June 30, 2007, homebuilding revenues decreased \$6,045,000 or 54% to \$5,214,000 as compared to \$11,259,000 for the six months ended June 30, 2006. The decrease in year to date revenues was primarily driven by a decrease in the number of units sold in the respective periods, offset in part by an increase in the per unit selling prices. For the six months ended June 30, 2007, the company sold 20 units at an average selling price of \$261,000 as compared to 45 units at an average selling price of \$250,000 per unit for the same period of 2006.

For the three months ended June 30, 2007, homebuilding revenues decreased \$5,108,000 or 71% to \$2,126,000 as compared to \$7,234,000 for the three months ended June 30, 2006. The decrease in quarter to date revenues was also primarily driven by a decrease in the number of units sold in the respective periods, offset in part by an increase in the per unit selling prices. For the three months ended June 30, 2007, the company sold 8 units at an average selling price of \$266,000 as compared to 29 units at an average selling price of \$249,000 per unit for the same period of 2006.

The gross margin for the six and three months ended June 30, 2007 were 27% and 28%, respectively, while for the six and three months of 2006 were 24% for both periods. The increases in the gross profit margin are attributable to an increase in the sales prices of the units in the third and fourth buildings.

As of June 30, 2007, 3 units of Torres were under contract at an average selling price of \$300,000 per unit. Each sales contract is backed by a \$6,000 deposit. For the six months ended June 30, 2007, the Company had 13 new contracts and 5 canceled contracts. For the same period in 2006, the Company had 33 new contracts and 27 canceled contracts. The Puerto Rico real estate market has slowed substantially since the second quarter of 2006. The reduction of new contracts and the reduced pace of sales has impacted the Company somewhat, but not to the same extent as the overall Puerto Rico market decline. The Company currently anticipates that the remaining 30 units in Torres will sell during the balance of 2007 and into the first quarter of 2008 and that its current pricing remains competitive.



**Table of Contents****Management and Other fees – Puerto Rico Operations:**

We earn monthly fees from our management of four non-owned apartment properties and four property-owner associations operating in Parque Escorial. This section includes only the fees earned from the non-owned managed entities. The fees earned from the controlled properties are eliminated in consolidation.

Management fees increased 6% or \$17,000 to \$313,000 for the six months ended June 30, 2007, as compared to \$296,000 for the same period of 2006. During the three months ended June 30, 2007 management fees increased 9% or \$13,000 to \$160,000 as compared to \$147,000 for the same period of 2006. The year to date and quarter to date increases in our management fees resulted from increases in the annual rents in the non-owned apartment properties and from increases in the managed fees received from Parque Escorial Association during the respective periods.

**General, Administrative, Selling and Marketing Expenses – Puerto Rico Operations:**

The costs associated with the oversight of our operations, accounting, human resources, office management and technology are included within our general, administrative, selling and marketing expenses. The apartment properties reimburse IGP for certain costs incurred at IGP's office that are attributable to the operations of those properties. In accordance with EITF 01-14 the costs and reimbursement of these costs are not included within this section but rather, they are reflected as separate line items on the consolidated income statement. Due to the fact that our corporate office is in our office building, EBO, rent expense and parking expenses are eliminated in consolidation.

General, administrative, selling and marketing expenses increased 7% or \$92,000 to \$1,448,000 during the six months ended June 30, 2007, as compared to \$1,356,000 for the same period of 2006. The increase is primarily attributable to increases in salaries and benefits related to the accrual in 2007 of quarterly management bonuses.

During the quarter ended June 30, 2007, general, administrative, selling and marketing increased 21% or \$126,000 to \$732,000 as compared to \$606,000 for the same period of 2006. The increase is primarily attributable to increases in salaries and benefits related to the accrual in 2007 of quarterly management bonuses and an increase in share appreciation rights expense for the quarter to date period as a result of a decrease in fair value recorded in the second quarter of 2006.

**Depreciation Expense – Puerto Rico Operatio**

Depreciation expense for the six months ended June 30, 2007 increased \$37,000 or 2% to \$1,836,000 as compared to \$1,799,000 for the six months ended June 30, 2006. Depreciation expense for the three months ended June 30, 2007 increased \$21,000 or 2% to \$923,000 as compared to \$902,000 for the six months ended June 30, 2006. The nominal increases in the year to date and quarter to date amounts relate to depreciation expense due to the replacement of elevators in select apartment properties. In addition, the depreciation expense increased due to the relocation of our offices primarily related to our corporate office furniture and leasehold improvements.

**Interest Income – Puerto Rico Operations:**

Interest income for the six months ended June 30, 2007 increased \$166,000 to \$226,000 as compared to \$60,000 for the same period of 2006. The increase in year to date interest income was primarily attributable to the recognition of interest income on the El Monte note receivable. The note originated as part of the sale of the complex in December 2004, at which point the Company determined that the cost recovery method of accounting was appropriate for gain recognition. Accordingly, the interest income on this note was also deferred until the interest payment was received, which occurred in January 2007. Interest income for the three months ended June 30, 2007 decreased \$4,000 to \$11,000 as compared to \$15,000 for the same period of 2006.

**Equity in Earnings from Unconsolidated Entities – Puerto Rico Operations:**

We account for our limited partner investment in the commercial rental property owned by ELI and El Monte under the equity method of accounting. The earnings from our investment in commercial rental property are reflected within this section. The recognition of earnings depends on our investment basis in the property, and where the partnership is in the earnings stream.

Equity in earnings from unconsolidated entities for the six and three months ended June 30, 2007 was \$1,846,000 and \$173,000, respectively, compared to \$343,000 and \$173,000 for the same periods of 2006. The year to date increase of \$1,503,000 was related to the payment in full of the \$1,500,000 note receivable held by El Monte in January 2007. The note was received as part of the sale of the El Monte facility, at which point the Company determined that the cost recovery method of accounting was appropriate for gain recognition. Accordingly, revenue was deferred until collection of the note receivable, which occurred in January 2007.

**Interest Expense – Puerto Rico Operations:**

The Company considers interest expense on all Puerto Rico debt available for capitalization to the extent of average qualifying assets for the period. Interest specific to the construction of qualifying assets is first considered for capitalization. To the extent qualifying assets exceed debt specifically identified a weighted average rate including all other debt of the Puerto Rico segment is applied. Any excess interest is reflected as interest expense. For 2007 and 2006, the excess interest primarily relates to the interest incurred on the non-recourse debt from our investment properties.

For the six months ended June 30, 2007, interest expense decreased \$4,000 or less than 1% to \$3,166,000 as compared to \$3,170,000 for the same period of 2006. For the three months ended June 30, 2007, interest expense decreased \$17,000 or 1% to

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\$1,585,000 as compared to \$1,602,000 for the same period of 2006. The year to date and quarter to date decreases are nominal and resulted from self amortizing mortgages on our multifamily apartment partnerships offset in part by decreased interest capitalized as a function of amounts available for interest capitalization between the respective periods.

For the six and three months ended June 30, 2007, \$78,000 and \$39,000 of interest cost was capitalized. During the same periods in 2006, \$496,000 and \$224,000 of interest cost was capitalized. The decrease in amounts of interest capitalized was due to the substantial completion of our Torres project at the end of 2006 as completed units are not considered qualifying assets for the purposes of interest capitalization.

**Minority Interest in Consolidated Entities – Puerto Rico Operations:**

The Company records minority interest expense related to the minority partners' share of the consolidated apartment partnerships earnings and distributions to minority partners in excess of their basis in the consolidated partnership. Losses charged to the minority interest are limited to the minority partners' basis in the partnership. Because the minority interest holders in most of our partnerships have received distributions in excess of their basis, we anticipate volatility in minority interest expense. Although this allows us to recognize 100 percent of the income of the partnerships up to distributions and losses in excess of basis previously required to be recognized as our expense, we will be required to expense 100 percent of future distributions to minority partners and any subsequent losses.

Minority interest for the six and three months period ended June 30, 2007 were \$1,384,000 and \$12,000, respectively. Minority interest for the six and three months period ended June 30, 2006 were \$2,354,000 and \$1,297,000, respectively. The \$970,000 decrease in minority interest expense for the six months ended June 30, 2007 as compared to the six month period ended June 30, 2006 was primarily the result of regular distributions from the surplus cash and refinancing to the minority owners in excess of their basis from our consolidated apartment partnerships. In the first quarter of 2007, the company made refinancing distributions of \$400,000 to the limited partners of Carolina Associates related to the mortgage refinancing of the related properties. In the second quarter of 2006, the Company made distributions of \$1,100,000 to the limited partners of Colinas de San Juan related the mortgage refinancing of the related properties. The Colinas distribution also represents the primary component of the \$1,285,000 decrease in minority interest expense for the three months ended June 30, 2007 as compared to the three month period ended June 30, 2006.

**Provision for Income Taxes – Puerto Rico Operations:**

The effective tax rate for the six and three months ended June 30, 2007 and 2006 were 49% and 37% and 39% and 28%, respectively. The statutory rate is 29%. The difference in the statutory tax rate and the effective tax rate for the six months ended June 30, 2007 is primarily due to the double taxation on the earnings of our wholly owned corporate subsidiary, ICP. As a result of a non-recurring gain recorded in the first quarter 2007 related to its investment in El Monte, ICP's current taxes payable and ACPT's related deferred tax liability on the ICP undistributed earnings experienced a considerable increase for the six months ended June 30, 2007. In addition, the effective tax rate for the three months ended June 30, 2007 was affected by the true-up of certain permanent differences. For the six month period ended June 30, 2006, the effective tax rate was greater than the statutory rate due to a relatively small net loss for the period, which was disproportionately impacted by non-taxable items, such as the tax exempt income received from our commercial partnership ELI, SE, offset in part by deferred taxes on items for which no current benefit may be recognized. The effective rate for the three months ended June 30, 2006 did not differ substantially from the statutory rate.

**LIQUIDITY AND CAPITAL RESOURCES***Summary of Cash Flows*

As of June 30, 2007, the Company had cash and cash equivalents totaling \$22,303,000 and restricted cash totaling \$22,601,000. The following table sets forth the changes in the Company's cash flows (\$ in thousands):

	Six Months Ended	
	June 30,	
	2007	2006
Operating		
Activities	\$ (7,072)	\$ 2,315
Investing		
Activities	(5,489)	(23,085)
Financing		
Activities	7,405	13,079
Net		
Decrease		
in Cash	\$ (5,156)	\$ (7,691)

For the six months ended June 30, 2007, operating activities used \$7,072,000 of cash flows compared to \$2,315,000 of cash flows provided by operating activities for the six months ended June 30, 2006. The \$9,387,000 decrease in cash flows from operating activities for the second quarter of 2007 compared to the same period in 2006 is primarily related to the \$6,045,000 decrease in homebuilding sales in the second quarter 2007 as compared to 2006. Operating cash flows were also impacted by the additions to our community development assets for the six months ended June 30, 2007, which were \$4,186,000 in excess of the additions during the same period of 2006. The Company continues to invest a significant amount

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into infrastructure within St. Charles. In addition, the company significantly reduced accounts payable and accrued liabilities during the six months ended June 30, 2007 related to payments on outstanding development expenditures and other payables at year end. These uses of cash were offset by a decrease of \$3,961,000 in our homebuilding expenditures for the six months ended June 30, 2007, as compared to the same period in 2006. As of June 30, 2007, the Torres project was substantially complete, whereas it was undergoing significant construction during the first half of 2006. In addition, the company received a \$2,000,000 fee during the second quarter 2007 related to a right of way agreement. From period to period, cash flow from operating activities is also impacted by changes in our net income, as discussed more fully above under "Results of Operations," as well as other changes in our receivables and payables. For the six months ended June 30, 2007, net cash used in investing activities was \$5,489,000 compared to \$23,085,000 for the same period of 2006. Cash provided by or used in investing activities generally relates to increases in our investment portfolio through acquisition, development or construction of rental properties and land held for future use, net of returns on our investments. The change in cash related to investing activities was primarily the result of acquiring the Milford I and Milford II properties during the six months ended June 30, 2006. In addition, we completed the construction of Sheffield Greens Apartments during the first quarter of 2007, whereas during the first half of 2006 we invested \$7,747,000 in construction. These differences were partially offset by the 11 additional properties added to our consolidation as of January 1, 2006, under the new provisions of EITF-04-05, at which point we added \$4,723,000 to the consolidated cash balance.

For the six months ended June 30, 2007, net cash provided by financing activities was \$7,405,000 as compared to \$13,079,000 for the six months ended June 30, 2006. The decrease in cash provided by financing activities was primarily the result of reduced proceeds from debt financing, related to the mortgages for the Milford I and Milford II acquisition. In addition, cash flows from financing activities were decreased by the timing of distribution payments made to minority interests as well as decreased dividends to shareholders. Distributions to limited partners decreased as a result of reduced refinancing distributions between periods. Dividends to shareholders were reduced as a result of a non-recurring special dividend distribution made in the first half of 2006. Partially offsetting these decreases was an increase in draws on the Charles County bond escrow as construction of infrastructure within St. Charles continues.

***Contractual Financial Obligations***

The following chart reflects our contractual financial obligations as of June 30, 2007:

	<b>Payments Due By Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Recourse debt-community development and homebuilding	\$ 26,255	\$ 1,390	\$ 4,752	\$ 3,229	\$ 16,884
Capital lease obligations	128	27	59	35	7
<b>Total Recourse Debt</b>	<b>26,383</b>	<b>1,417</b>	<b>4,811</b>	<b>3,264</b>	<b>16,891</b>
Non-recourse debt-community development	500	500	-	-	-
Non-recourse debt-investment properties	280,168	3,750	14,749	9,089	252,580
<b>Total Non-Recourse Debt</b>	<b>280,668</b>	<b>4,250</b>	<b>14,749</b>	<b>9,089</b>	<b>252,580</b>
Operating lease obligations	942	298	540	104	-
Purchase obligations	30,148	16,050	13,923	50	125

Total contractual financial obligations	\$ 338,141	\$ 22,015	\$ 34,023	\$ 12,507	\$ 269,596
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Recourse Debt - U.S. Operations

On April 14, 2006, the Company closed a three-year \$14,000,000 revolving line of credit loan (“the Revolver”) secured by a first lien deed of trust on property located in St. Charles, MD. The maximum amount of the loan at any one time is \$14,000,000. The facility includes various sub-limits on a revolving basis for amounts to finance apartment project acquisitions and land development in St. Charles. The terms require certain financial covenants to be calculated annually as of December 31, including a tangible net worth to senior debt ratio for ALD and a minimum net worth test for ACPT. The Company was in compliance with these financial covenants as of June 30, 2007. As of June 30, 2007, no amounts were outstanding on the Revolver. Management currently expects to fund development operations from current cash balances and operating cash flows rather than borrowings from the line of credit.

Pursuant to an agreement reached between ACPT and the Charles County Commissioners in 2002, the Company agreed to accelerate the construction of two major roadway links to the Charles County (the "County") road system. As part of the agreement, the County agreed to issue general obligation public improvement Bonds (the “Bonds”) to finance \$20,000,000 of this construction

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guaranteed by letters of credit provided by Lennar as part of a residential lot sales contract for 1,950 lots in Fairway Village. The Bonds were issued in three installments with the final \$6,000,000 installment issued in March 2006. The Bonds bear interest rates ranging from 4% to 8%, for a blended lifetime rate for total Bonds issued to date of 5.1%, and call for semi-annual interest payments and annual principal payments and mature in fifteen years. Under the terms of bond repayment agreements between the Company and the County, the Company is obligated to pay interest and principal on the full amount of the Bonds; as such, the Company recorded the full amount of the debt and a receivable from the County representing the undisbursed Bond proceeds to be advanced to the Company as major infrastructure development within the project occurs. As part of the agreement, the Company will pay the County a monthly payment equal to one-sixth of the semi-annual interest payments and one-twelfth of the annual principal payment due on the Bonds. The County also requires ACPT to fund an escrow account from lot sales that will be used to repay this obligation.

In August 2005, the Company signed a memorandum of understanding ("MOU") with the Charles County Commissioners regarding a land donation that is anticipated to house a planned minor league baseball stadium and entertainment complex. Under the terms of the MOU, the Company donated 42 acres of land in St. Charles to the County on December 31, 2005. The Company also agreed to expedite off-site utilities, storm-water management and road construction improvements that will serve the entertainment complex and future portions of St. Charles so that the improvements will be completed concurrently with the entertainment complex. The County will be responsible for infrastructure improvements on the site of the complex. In return, the County agreed to issue \$7,000,000 of general obligation bonds to finance the infrastructure improvements. In March 2006, \$4,000,000 of bonds were issued for this project, with an additional \$3,000,000 issued in March 2007. The funds provided by the County for this project will be repaid by ACPT over a 15-year period. In addition, the County agreed to issue an additional 100 school allocations a year to St. Charles commencing with the issuance of bonds.

In December 2006, the Company reached an agreement with Charles County whereby the Company receives interest payments on any undistributed bond proceeds held in escrow by the County. The agreement covers the period from July 1, 2005, through the last draw made by the Company. For the six and three months ended June 30, 2007, the Company recognized \$299,000 and \$147,000 of interest income on these escrowed funds.

**Recourse Debt - Puerto Rico Operations**

Substantially all of the Company's 490 acres of community development land assets in Parque El Comandante within the Puerto Rico segment are encumbered by recourse debt. The homebuilding and land assets in Parque Escorial are unencumbered as of June 30, 2007. On September 1, 2006, LDA secured a revolving line of credit facility of \$15,000,000 to be utilized as follows: (i) to repay its outstanding loan of \$800,000; and (ii) to fund development costs of a project in which the Company plans to develop a planned community in Canovanas, Puerto Rico, to fund acquisitions and/or investments mainly in estate ventures, to fund transaction costs and expenses, to fund future payments of interest under the line of credit and to fund any future working capital needs of the Company. The line of credit bears interest at a fluctuating rate equivalent to the LIBOR Rate plus 200 basis points (7.35% at June 30, 2007) and matures on August 31, 2008. The outstanding balance of this facility on June 30, 2007, was \$1,800,000.

**Non-Recourse Debt - U.S. Operations**

As more fully described in Note 4 to our Consolidated Financial Statements included in this Form 10-Q, the non-recourse apartment properties' debt is collateralized by apartment projects. As of June 30, 2007, approximately 38% of this debt is secured by the Federal Housing Administration ("FHA") or the Maryland Housing Fund. Non-recourse debt within our U.S. operations also includes a construction loan for a new apartment project in St. Charles. On August 11, 2005, Sheffield Greens Apartments, LLC ("Sheffield Greens"), a wholly owned subsidiary of the Company, obtained a non-recourse construction loan of \$27,008,000 to fund the construction costs for a new apartment property in St. Charles' Fairway Village. The construction loan will mature in September 2007 and at such time will convert into a 40-year non-recourse permanent mortgage. The loan has a fixed interest rate of 5.47%, and requires interest-only payments during the construction phase followed by principal and interest payments until

maturity. The loan is subject to a HUD regulatory agreement. The loan documents provide for covenants and events of default that are customary for mortgage loans insured by the Federal Housing Authority.

On January 31, 2007, Coachman's Apartments, LLC ("Coachman's"), a majority-owned subsidiary of the Company, secured a non-recourse mortgage of \$11,000,000. The ten-year loan, amortized over 30 years, has a fixed interest rate of 5.555%, requires principal and interest payments through maturity and a balloon payment at the maturity date, February 1, 2017. The prior mortgage of \$6,020,000 was repaid and the net proceeds from the refinancing will be used for overall apartment property improvements, the repayment of recourse debt, future development efforts and potential acquisitions.

On February 1, 2007, Village Lake Apartments, LLC ("Village Lake"), a majority-owned subsidiary of the Company, secured a non-recourse mortgage of \$9,300,000. The ten-year loan, amortized over 30 years, has a fixed interest rate of 5.72%, requires principal and interest payments through maturity and a balloon payment at the maturity date, February 1, 2017. The prior mortgage of \$6,981,000 was repaid and the net proceeds from the refinancing will be used for overall apartment property improvements, the repayment of recourse debt, future development efforts and potential acquisitions.

In the fourth quarter of 2005, the Company purchased 22 residential acres adjacent to the Sheffield Neighborhood in St. Charles for \$1,000,000. The Company paid \$500,000 in cash and signed a two-year, non-interest bearing, non-recourse note, for \$500,000 due in November 2007.



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### Non-Recourse Debt - Puerto Rico Operations

As more fully described in Note 4 to our Consolidated Financial Statements included in this Form 10-Q, the non-recourse debt is collateralized by the respective multifamily apartment project or commercial building. As of June 30, 2007, approximately 1% of this debt is secured by the Federal Housing Administration ("FHA"). There were no significant changes to our non-recourse debt obligations during the six months ended June 30, 2007.

### Purchase Obligations and Other Contractual Obligations

In addition to our contractual obligations described above, we have other purchase obligations consisting primarily of contractual commitments for normal operating expenses at our apartment properties, recurring corporate expenditures including employment, consulting and compensation agreements and audit fees, non-recurring corporate expenditures such as improvements at our investment properties, the construction of the new apartment projects in St. Charles, costs associated with our land development contracts for the County's road projects and the development of our land in the U.S. and Puerto Rico. Our U.S. and Puerto Rico land development and construction contracts are subject to increases in cost of materials and labor and other project overruns. Our overall capital requirements will depend upon acquisition opportunities, the level of improvements on existing properties and the cost of future phases of residential and commercial land development.

### Liquidity Requirements

Our short-term liquidity requirements consist primarily of obligations under capital and operating leases, normal recurring operating expenses, regular debt service requirements, non-recurring expenditures and dividends to common shareholders. The Company has historically met its liquidity requirements from cash flow generated from residential and commercial land sales, home sales, property management fees, and rental property revenue. However, the Company has noted a current reduction in the demand for residential real estate in the St. Charles and Parque Escorial markets. Should this reduced demand result in a significant decline in the prices of real estate in the St. Charles and Parque Escorial markets or defaults on our sales contracts, it could adversely impact our cash flows. In addition, reduced demand for our commercial property could result in significantly reduced prices of our commercial real estate and adversely impact our cash flows. Currently, anticipated cash flow from operations, existing loans, refinanced or extended loans, and new financing are expected to meet our financial commitments for the year. However, there are no assurances that these funds will be generated.

We are actively seeking additions to our multifamily apartment property portfolio and our real estate holdings. We are currently pursuing various opportunities to purchase additional multifamily apartment properties in the Baltimore, Maryland and Washington, D.C. areas. For the remainder of 2007 and into 2008, the Company plans to explore opportunities in Florida while continuing its development activity within the master planned communities in St. Charles and Puerto Rico and may commit to future contractual obligations as needed. Future acquisitions may be financed through a combination of Company equity, third-party equity and market rate mortgages. For the remainder of 2007 and into 2008, we may seek additional development loans and permanent mortgages for continued development and expansion of St. Charles and Parque Escorial and other potential rental property opportunities. The Company will evaluate and determine on a continuing basis, depending upon market conditions and the outcome of events described under the section titled "Forward-Looking Statements," the most efficient use of the Company's capital, including acquisitions and dispositions, purchasing, refinancing, exchanging or retiring certain of the Company's outstanding debt obligations, distributions to shareholders and its existing contractual obligations.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is exposed to certain financial market risks, the most predominant being fluctuations in interest rates. Interest rate fluctuations are monitored by the Company's management as an integral part of the Company's overall risk management program, which recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effect on the Company's results of operations.

As of June 30, 2007, there have been no material changes in the Company's financial market risk since December 31, 2006, as discussed in the Company's Annual Report on Form 10-K.

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### **Evaluation of Disclosure Controls and Procedures**

In connection with the preparation of this Form 10-Q, as of June 30, 2007, an evaluation was performed under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Exchange Act. In performing this evaluation, management reviewed the selection, application and monitoring of our historical accounting policies. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures, because of the material weakness in internal control discussed below, were not effective in ensuring that the information required to be disclosed in our reports filed with the SEC is recorded, processed, summarized and reported on a timely basis.

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During the preparation of the Company's 2004 tax returns in the fourth quarter 2005, the Company became aware that certain intercompany interest income was subject to U.S. withholding tax when the interest was paid and certain income from its Puerto Rico operations could be treated as income of ACPT even though it was not distributed to ACPT. The Company determined that neither the obligation to pay the withholding tax or exposure related to the tax status had been previously accrued. Accordingly, the Company announced on November 15, 2005, that the Company would restate financial statements for the periods covered in its Form 10-K for the fiscal year ended December 31, 2004, and the Forms 10-Q for the first two quarters of fiscal 2005 to correct previously reported amounts related to these income tax matters.

The Company determined the accounting errors referenced above indicated a material weakness in internal controls with respect to accounting for income taxes. A material weakness in internal control is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements would not be prevented or detected on a timely basis by the Company. The Company has implemented controls and procedures designed to remediate this material weakness. These controls and procedures include hiring a new Director of Tax who will help manage the tax compliance and tax accounting process, retaining international tax advisors to provide the Company with updates related to changes in international tax laws impacting the Company, providing in-house tax professionals and senior financial management with additional training to enhance their awareness of potential international tax matters and implementation of other additional control procedures related to accounting for income taxes. In order to remediate the material weakness, management must ensure that these new controls and procedures are operating effectively and fully address the risks giving rise to the material weakness. Management believes that once sufficient evidence of the operating effectiveness of these controls exists, the material weakness will be fully remediated.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

See the information under the heading "Legal Matters" in Note 5 to the consolidated financial statements in this Form 10-Q for information regarding legal proceedings, which information is incorporated by reference in this Item 1.

**ITEM 1A. RISK FACTORS**

There has been no material change in the Company's risk factors from those outlined in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

ACPT held its 2007 Annual Meeting of Shareholders on June 6, 2007. At the Meeting, shareholders elected two individuals to serve as trustees for a three year timer to expire at the Annual Meeting in 2010.

The results of the voting were as follows:

	<u>Trustee</u>	<u>Votes</u>	
		<u>Votes For</u>	<u>Withheld</u>
Michael Wilson	J.	4,247,236	200
J. Shafer	Thomas	4,246,986	450

The terms of Edwin L. Kelly, Thomas S. Condit, Antonio Ginorio, and T. Michael Scott continued after the meeting and each continue to serve as a trustee.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(A) Exhibits

10.1 Summary of Non-Employee Trustee Compensation

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chairman and Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.1 Section 1350 Certification of Chairman and Chief Executive Officer

32.2 Section 1350 Certification of Chief Financial Officer

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**SIGNATURES**

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

AMERICAN COMMUNITY PROPERTIES TRUST

(Registrant)

Dated: August 13, 2007      By: /s/ J. Michael Wilson  
J. Michael Wilson  
Chairman and Chief Executive Officer

Dated: August 13, 2007      By: /s/ Cynthia L. Hedrick  
Cynthia L. Hedrick  
Chief Financial Officer

Dated: August 13, 2007      By: /s/ Matthew M. Martin  
Matthew M. Martin  
Chief Accounting Officer