

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

AMERICAN INDUSTRIAL PROPERTIES REIT INC

CIK: **778437** | IRS No.: **756335572** | State of Incorporation: **TX** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **001-09016** | Film No.: **96666497**
SIC: **6798** Real estate investment trusts

Mailing Address
6220 N BELTLINE ROAD
SUITE 205
IRVING TX 75063

Business Address
6220 N BELTLINE RD
STE 205
IRVING TX 75063
2145506053

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 1996

OR

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

For the transition period from _____ to _____

Commission file number 1-9016

AMERICAN INDUSTRIAL PROPERTIES REIT
(Exact name of registrant as specified in its charter)

Texas	75-6335572
(State or other	(I.R.S.
jurisdiction of	Employer
incorporation or	Identification
organization)	No.)

6220 North Beltline Road,	
Suite 205	75063-2656
Irving, Texas	
(Address of principal	(Zip Code)
executive offices)	

(972) 550-6053

(Registrant's telephone number, including area code)

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

9,075,400 Shares of Beneficial Interest were outstanding as of November 12, 1996.

American Industrial Properties REIT
Form 10-Q
For the Quarter Ended September 30, 1996

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American Industrial Properties REIT
 Consolidated Statements of Operations
 (unaudited, in thousands except share and per share data)
 <TABLE>

	Quarter Ended September 30,		Nine Months Ended September 30,	
<S>	1996 <C>	1,995 <C>	1996 <C>	1995 <C>
REVENUES				
Rents	\$ 2,150	2,164	\$ 6,568	\$ 6,467
Tenant reimbursements	643	634	2,071	2,080
Interest income	7	94	146	284
	2,800	2,892	8,785	8,831
REAL ESTATE EXPENSES				
Property operating expenses:				
Property taxes	368	355	1,110	1,056
Property management fees	107	100	324	315
Utilities	118	127	335	345
General operating	189	192	610	531
Repairs and maintenance	153	69	318	293
Other property operating expenses	75	87	220	221
Depreciation and amortization	769	663	2,177	2,109
Interest on 8.8% notes payable	1,001	1,334	3,350	3,373

Interest on mortgages payable	405	394	1,216	1,317
Administrative expenses:				
Trust administration and overhead	300	323	1,190	1,100
Litigation and proxy costs	116	146	1,004	521
	3,601	3,790	11,854	11,181
Loss from real estate operations	(801)	(898)	(3,069)	(2,350)
Loss on sales of real estate	-	-	-	(191)
Extraordinary loss on extinguishment of debt	-	-	-	(55)
Extraordinary gain on forgiveness of debt	-	-	1,367	-
NET LOSS	\$ (801)	(898)	\$ (1,702)	\$ (2,596)

PER SHARE DATA

Loss from real estate operations	\$ (0.09)	(0.10)	\$ (0.34)	\$ (0.26)
Loss on sales of real estate	-	-	-	(0.02)
Extraordinary loss on extinguishment of debt	-	-	-	(0.01)
Extraordinary gain on forgiveness of debt	-	-	0.15	-
Net Loss	\$ (0.09)	(0.10)	\$ (0.19)	\$ (0.29)
Distributions Paid	-	-	\$ 0.04	-
Number of shares outstanding	9,075,400	9,075,400	9,075,400	9,075,400

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

American Industrial Properties REIT
Consolidated Balance Sheets
(in thousands, except share and per share data)
<TABLE>

	September 30, 1996 (unaudited)	December 31, 1995
<S>	<C>	<C>
Real estate:		
Held for investment	\$81,181	\$97,091
Held for sale	21,476	4,806
	102,657	101,897
Accumulated depreciation	(25,374)	(23,441)
Net real estate	77,283	78,456
Cash and cash equivalents:		
Unrestricted	1,580	7,694
Restricted	604	659
Total cash and cash equivalents	2,184	8,353
Other assets, net	2,945	2,573
Total Assets	\$82,412	\$89,382
Liabilities:		
8.8% notes payable	\$45,239	\$45,239
Mortgage notes payable	17,406	17,576
Accrued interest	703	5,178
Accounts payable, accrued expenses and other		

liabilities	1,374	1,620
Tenant security deposits	507	521
Total Liabilities	65,229	70,134

Shareholders' Equity:

Shares of beneficial interest, \$0.10 par value authorized 10,000,000 Shares; issued and outstanding 9,075,400 Shares	908	908
Additional paid-in capital	124,605	124,605
Retained earnings (deficit)	(108,330)	(106,265)
Total Shareholders' Equity	17,183	19,248

Total Liabilities and Shareholders' Equity	\$82,412	\$89,382
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</TABLE>

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

American Industrial Properties REIT
Consolidated Statements of Cash Flows
(unaudited, in thousands)

<TABLE>

	Nine Months Ended	
	1996	1995
	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	\$ (1,702)	\$ (2,596)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,177	2,109
Loss on sales of real estate	-	191
Extraordinary loss on extinguishment of debt	-	55
Extraordinary loss on forgiveness of debt	(1,367)	-
Changes in operating assets and liabilities:		
(Increase) decrease in other assets	(451)	15
Decrease in accounts payable, accrued expenses and other liabilities and tenant security deposits	(260)	(295)
Net Cash Used In Operating Activities	(1,603)	(521)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of industrial distribution property	-	(1,309)
Capitalized improvements and leasing commissions	(925)	(793)
Net proceeds from sales of real estate	-	2,476
Net Cash (Used In) Provided By Investing Activities	(925)	374
CASH FLOWS FROM FINANCING ACTIVITIES:		
Distributions to shareholders	(363)	-
Principal repayments on mortgage notes payable	(170)	(2,742)
Prepayment penalty on		

extinguishment of debt	-	(55)
Increase (decrease) in accrued interest	(3,108)	3,341
Net Cash Used In Financing Activities	(3,641)	544
Net (Decrease) Increase in Cash and Cash Equivalents	(6,169)	397
Cash and Cash Equivalents at Beginning of Period	8,353	7,521
Cash and Cash Equivalents at End of Period	\$ 2,184	\$ 7,918
Cash Paid for Interest	\$ 7,674	\$ 1,349

</TABLE>

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

American Industrial Properties REIT
Notes to Consolidated Financial Statements
September 30, 1996
(unaudited)

Note 1 - Basis of Presentation

The accompanying consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures required by generally accepted accounting principles or those contained in the Trust's Annual Report on Form 10-K. Accordingly, these financial statements should be read in conjunction with the audited financial statements of the Trust for the year ended December 31, 1995, included in the Trust's Annual Report on Form 10-K.

The financial information included herein has been prepared in accordance with the Trust's customary accounting practices and has not been audited. In the opinion of management, the information presented reflects all adjustments necessary for a fair presentation of interim results. All such adjustments are of a normal and recurring nature.

Certain amounts in prior year financial statements have been reclassified to conform with the current year presentation.

Note 2 - Significant Accounting Policies

Principles of Consolidation. The consolidated financial statements of the Trust include the accounts of American Industrial Properties REIT and its wholly-owned subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ significantly from such estimates and assumptions.

Real Estate. The Trust carries its real estate at the lower of depreciated cost or net realizable value. In accordance with Statement of Financial Accounting Standards No. 121, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, the Trust records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the related carrying amounts. In addition, the Trust records impairment losses on assets held for sale when the estimated sales proceeds, after estimated selling costs, is less than the carrying value of the related asset. At September 30, 1996, ten properties were classified as held for investment and five properties were classified as held for sale, reflecting the Trust's intent to raise the capital necessary to purchase mortgage debt at a discount (see Note 4). Should unforeseen factors cause additional properties to be classified as held for sale, significant adjustments to reduce the net book value of such properties could be required.

Property improvements are capitalized while maintenance and repairs are expensed as incurred. Depreciation of buildings and capital improvements is computed using the straight-line method over forty years. Depreciation of tenant improvements is computed using the straight-line method over ten years.

American Industrial Properties REIT
Notes to Consolidated Financial Statements (continued)
September 30, 1996
(unaudited)

Other Assets. Other assets consists primarily of deferred rent receivable, prepaid leasing commissions and loan fees. Deferred rent receivable arises as the Trust recognizes rental income, including contractual rent increases or delayed rent starts, on a straight-line basis over the lease term. The Trust has recorded deferred rent receivable of \$682,000 and \$810,000 at September 30, 1996 and December 31, 1995, respectively. Leasing commissions are capitalized and amortized on a straight-line basis over the life of the lease. Loan fees are capitalized and amortized to interest expense on a level yield basis over the term of the related loan.

Income Taxes. The Trust operates as a real estate investment trust ("REIT") for federal income tax purposes. Under the REIT provisions, the Trust is required to distribute 95% of REIT taxable income and is allowed a deduction for dividends paid during the year. No provisions

for Federal income taxes have been required or recorded to date.

Note 3 - Zero Coupon Notes

In December 1993 and November 1994, the Trust partially in-substance defeased certain of its Zero Coupon Notes due 1997 totaling \$16,365,000 (face amount at maturity). At September 30, 1996, the accreted value of these Zero Coupon Notes was \$14,300,000.

Note 4 - Litigation

MLI Litigation. On May 1, 1995, the Trust initiated a lawsuit against the holder of its 8.8% unsecured notes payable ("MLI"), alleging, among other things, that MLI and others had engaged in acts of bad faith and conspiracy. This suit was subsequently amended to name additional defendants and to specify damages. Based on the facts surrounding this lawsuit, the Trust elected not to make a scheduled semi-annual interest payment on May 27, 1995. MLI thereafter declared the entire principal amount due and payable and began accruing interest, effective June 13, 1995, at the 11.7% default rate specified in the Note Purchase Agreement. The Trust entered into an agreement on May 22, 1996 (the "Settlement Agreement") whereby the Trust settled this litigation and obtained an option to repay the \$45,239,000 principal amount due and owing on these notes for \$36,800,000 (the "Option Price"). The Trust also paid \$5,200,000 to MLI in satisfaction of \$6,567,000 in outstanding accrued and unpaid interest (which included default rate interest of \$1,095,000) through April 12, 1996, resulting in an extraordinary gain of \$1,367,000.

In order to achieve the discount on the principal balance of the notes, the Trust will be required to pay at least \$25,000,000 by November 23, 1996, to be applied pro rata to the outstanding principal balance of the notes and dollar-for-dollar to the Option Price. The Trust must pay the remaining amount of the Option Price during extended option periods ending on March 31, 1997 or June 30, 1997, subject to the payment of additional principal payments in the amount of \$250,000 and \$150,000, respectively (which will be applied pro rata to the outstanding principal balance of the notes but not the Option Price). Interest also continues to accrue at the non-default rate of 8.8% per annum (and at the default rate upon an event of default), and monthly interest payments beginning June 3, 1996 must be made in order to receive the discount. Although interest will accrue against the outstanding principal balance of the notes, the interest payments will be calculated against the balance of the Option Price; the portion of the accrued interest which is not satisfied by the required monthly payments will be deferred and due only upon an event of default and will not be payable if the Trust performs its obligations pursuant to the Settlement Agreement.

The notes remain fully matured, due and payable, subject to a moratorium on any collection efforts by MLI through November 23, 1996, with possible extensions through June 30, 1997 as described above, as long as the Trust remains current in its obligations under the Settlement Agreement. If the Trust is unable to perform under the Settlement Agreement, it will be required to pay the outstanding principal balance of the notes plus the 8.8% interest thereon, net of interest payments paid on the Option Price as described above. If the Trust successfully completes the discounted payment of the notes, this transaction will result in a total gain to the Trust of approximately \$9,806,000, or \$1.08 per share (comprised of approximately \$8,439,000 of reduced principal payments and approximately \$1,367,000 of accrued and unpaid interest).

The Settlement Agreement also provides that the notes will now be secured by liens on twelve of the Trust's properties and by the Trust's interests in the partnerships which own two of the Trust's other properties. The Trust has agreed not to sell or encumber any of these properties or otherwise transfer its interests therein except in compliance with the Settlement Agreement, which requires application of certain proceeds to the Trust's obligations to MLI.

The Trust has received a financing commitment from the lending affiliate of an insurance company in the amount of \$27,990,000. This financing, which the Trust expects to close on or about November 15, 1996, will be secured by first liens on nine existing Trust properties and a tenth property which the Trust will acquire subsequent to the financing. The Trust anticipates that the net proceeds from this proposed financing will exceed the \$25,000,000 required to be paid to MLI on or before November 23, 1996.

Although management believes that the payment of these notes at a discount can be achieved, there can be no assurance that the Trust will be successful in its financing efforts (including the consummation of the financing described above) or property sale efforts and will ultimately be able to pay the Option Price required under the Settlement Agreement to achieve the discount.

Other Litigation. On January 8, 1996, the Trust filed a lawsuit in federal court in Dallas, Texas against a major shareholder of the Trust, alleging, among other things, violations of federal and state securities laws. On January 30, 1996, the defendants filed a counterclaim against the Trust, requesting that certain Bylaw amendments be stricken, that a receiver be appointed for the assets and business of the Trust and that the Trust recover certain funds from the Trust Managers. On March 26, 1996, the United States District Court for the Northern District of Texas denied the defendants' motion to appoint a receiver for the Trust. On September 9, 1996, the court granted defendants' motion for partial summary judgment, ruling that the provisions of Article IX of the Trust's bylaws limiting share ownership to 9.8% of the Trust's shares is invalid under the Texas REIT

Act. The court denied the Trust's motion for reconsideration of its September 9, 1996 ruling on October 28, 1996. Defendants also filed an application to preliminarily enjoin the Trust from enforcing Article IX and another bylaw provision (Article XIII) adopted by the Trust following the court's September 9, 1996 ruling. Article XIII also provides for share ownership limitations to ensure continued compliance with REIT requirements under the federal income tax laws and becomes effective if certain events occur that prevent the Trust from enforcing Article IX. On November 12, 1996, the court granted defendants' application for preliminary injunction. The Trust believes that the Court's ruling misconstrues the Texas REIT Act. Accordingly, the Trust intends to appeal this ruling. This counterclaim was joined with a class action and derivative complaint against the Trust and its Trust Managers filed by another shareholder on February 22, 1996. Although management believes the Trust will ultimately prevail in these suits, no assurance can be given regarding the ultimate outcome of this litigation.

The parties have entered into settlement discussions regarding the litigation described above. Although there can be no assurance that a settlement of the litigation will occur, due to the anticipated settlement of this litigation, the Trust Managers have determined that it is in the best interests of the Trust and its shareholders to cancel the Annual Meeting of Shareholders which was originally scheduled to be held on December 18, 1996. The new record date and date of the Annual Meeting of Shareholders will be announced at a later date.

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

Results of Operations

The table below provides a reconciliation of net loss, funds from operations ("FFO") and funds available for distribution ("FAD") for the quarter and nine months ended September 30, 1996 and 1995. Management believes that the presentation of FFO and FAD will enhance the reader's understanding of the Trust's financial condition as well as provide comparability to other real estate investment trusts. The determination of FFO is based on the definition adopted by the National Association of Real Estate Investment Trusts ("NAREIT") which is net income (loss) computed in accordance with generally accepted accounting principles, excluding gains or losses from debt restructuring and sales of property, plus real estate related depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures. In addition, NAREIT recommends that extraordinary items or significant non-recurring items that distort comparability should not be considered in arriving at FFO. FAD is generally more indicative of the Trust's ability to make distributions as it includes the effect of the Trust's capital expenditures. Neither FFO or FAD should be considered an alternative to net income as an indicator of the Trust's operating performance or to cash flows from operations as a measure of liquidity.

<TABLE>

(000)

(000)

	Quarter Ended		Nine Months Ended	
	September 30, 1996	September 30, 1995	September 30, 1996	September 30, 1995
<S>	<C>	<C>	<C>	<C>
Net loss	\$ (801)	\$ (898)	\$ (1,702)	\$ (2,596)
Loss on sales of real estate	-	-	-	191
Extraordinary loss - extinguishment of debt	-	-	-	55
Extraordinary gain - forgiveness of debt	-	-	(1,367)	-
Real estate depreciation and amortization	761	644	2,165	2,052
Default rate interest accrual	-	331	369	393
Funds from operation ("FFO")	(40)	77	(535)	95
Capitalized improvements and leasing commissions	(307)	(300)	(925)	(796)
GAAP straight line rent adjustment	19	24	128	116
Funds available for distribution ("FAD")	\$ (328)	\$ (199)	\$ (1,332)	\$ (585)

</TABLE>

Quarter Ended September 30, 1996 and 1995

The Trust had a net loss of \$801,000 for the quarter ended September 30, 1996 compared to a net loss of \$898,000 for the same quarter in 1995. This change was primarily related to a decrease in interest expense (due to the default rate interest accrued on the MLI notes in 1995), an increase in depreciation and amortization (due to higher depreciable balances in 1996), a decrease in interest income (due to the \$5.2 million paid to MLI in May 1996 in settlement of accrued interest) and a decrease in net operating income (due to a decrease in leased occupancy from 94.9% at September 30, 1995 to 92.0% at September 30, 1996).

The Trust's FFO, which excludes the effect of extraordinary gains or losses and the default rate interest accrued on the MLI notes, decreased by \$117,000 when comparing the quarter ended September 30, 1996 to the same quarter in 1995. This decrease is attributable to the aforementioned decrease in interest income and decrease in net operating income. FAD decreased by \$129,000 due primarily to the same factors affecting FFO.

Nine Months Ended September 30, 1996 and 1995

When comparing the nine months ended September 30, 1996 to the same period in 1995, the net loss of the Trust decreased from \$2,596,000 in 1995 to \$1,702,000 in 1996. This resulted primarily from an extraordinary gain on forgiveness of debt of \$1,367,000 recorded in the second quarter of 1996 as a result of the settlement of the MLI litigation, an increase of \$483,000 in litigation, refinancing and proxy costs (primarily due to the costs of defending against two shareholder lawsuits filed in 1996), a \$191,000 loss on the sale of the Trust's Quadrant property in February 1995, a \$138,000 decrease in interest income (due to the \$5.2 million paid to MLI in May 1996 in settlement of accrued interest), and a \$124,000 decrease in interest expense (due to the retirement of the Patapsco and Quadrant mortgage

loans in 1995 and a decrease in the interest rate on the Tamarac and Northview mortgage loans in July 1995).

The Trust's FFO, which excludes the effect of extraordinary gains or losses and default rate interest, decreased by \$630,000 when comparing the nine months ended September 30, 1996 to the same period in 1995. This is primarily attributable to the aforementioned increase in litigation, refinancing and proxy costs and the decrease in interest income.

FAD decreased by \$747,000 due to these same factors affecting FFO and the higher level of tenant improvements and leasing commissions in 1996. These expenditures are indicative of the Trust's higher level of leasing activity in 1996. During the first nine months of 1996, the Trust executed 411,000 square feet of new leases compared to 287,000 in 1995.

The overall occupancy of the Trust's portfolio on September 30, 1996 was 92.0%, compared to 94.9% on September 30, 1995. When comparing the nine months ended September 30, 1996 to the same period in 1995 on a same property basis, revenue was up 3.4% and net operating income was up 1.9% for the Trust's industrial properties whereas revenue was down 6.2% and net operating income was down 10.3% for the Trust's retail property. Occupancy at the Trust's retail property slipped from 88.3% at September 30, 1995 to 84.1% at September 30, 1996. The Trust is currently working toward the repositioning of the property and its tenants as a means of increasing occupancy.

Liquidity and Capital Resources

On May 22, 1996, the Trust entered into an agreement (the "Settlement Agreement") to repay the Trust's 8.8% unsecured notes to The Manufacturers Life Insurance Company ("MLI") and The Manufacturers Life Insurance Company (U.S.A.) ("MLI-USA") at a substantial discount in connection with the settlement of the Trust's litigation with MLI, MLI- USA, and Fidelity Management and Research Company, Fidelity Galileo Fund, L.P., Belmont Capital Partners II, L.P., Fidelity Puritan Trust and Fidelity Management Trust Co. (together, the "Fidelity Entities").

Pursuant to the Settlement Agreement and related documents, the Trust has been granted the option to repay the approximately \$45,239,000 principal amount due and owing on its outstanding notes for \$36,800,000 (the "Option Price"). As a condition to entering the Settlement Agreement, the Trust paid \$5,200,000 to MLI in satisfaction of \$6,567,000 in outstanding accrued and unpaid interest (which included default rate interest of \$1,095,000) through April 12, 1996, allowing the Trust to recognize an immediate gain of \$1,367,000. The Trust further paid approximately \$168,000 to MLI in satisfaction of accrued and unpaid interest through May 1, 1996.

In order to achieve the discount on the principal balance of the notes, the Trust will be required to pay at least \$25,000,000 to MLI and MLI-USA by November 23, 1996, to be applied pro rata to the outstanding principal balance of the notes and dollar-for-dollar to the Option Price. The Trust must pay the remaining amount of the Option Price during extended option periods ending on March 31, 1997 or June 30, 1997, subject to the payment of

additional principal payments in the amount of \$250,000 and \$150,000, respectively (which will be applied pro rata to the outstanding principal balance of the notes but not the Option Price). Interest also continues to accrue at the non-default rate of 8.8% per annum (and at the default rate upon an event of default), and monthly interest payments beginning June 3, 1996 must be made in order to receive the discount. Although interest will accrue against the outstanding principal balance of the notes, the interest payments will be calculated against the balance of the Option Price. The portion of the accrued interest which is not satisfied by the required monthly payments will be deferred and due only upon an event of default; such interest will be forgiven if the Trust performs its obligations pursuant to the Settlement Agreement.

The notes remain fully matured, due and payable, subject to a moratorium on any collection efforts by MLI and MLI-USA through November 23, 1996, with possible extensions through June 30, 1997 as described above, as long as the Trust remains current in its obligations under the Settlement Agreement. If the Trust is unable to perform under the Settlement Agreement, it will be required to pay the outstanding principal balance of the notes plus the 8.8% interest thereon, net of interest payments paid on the Option Price as described above. If the Trust successfully completes the discounted payment of the notes, this transaction will result in a total gain to the Trust of approximately \$9,806,000, or \$1.08 per share (comprised of approximately \$8,439,000 of reduced principal payments and approximately \$1,367,000 of accrued and unpaid interest). The Trust will also recognize a gain on the accrued interest which will be forgiven if the Trust performs its obligations under the Settlement Agreement (see above).

In addition, the Settlement Agreement provides that the notes will now be secured by liens on twelve of the Trust's properties and by the Trust's interests in the partnerships which own two other of the Trust's properties. The Trust has agreed not to sell or encumber any of its properties or otherwise transfer its interests therein except in compliance with the Settlement Agreement, which requires application of certain proceeds to the Trust's obligations to MLI and MLI-USA.

The Trust has received a financing commitment from the lending affiliate of an insurance company in the amount of \$27,990,000. This financing, which the Trust expects to close on or about November 15, 1996, will be secured by first liens on nine existing Trust properties and a tenth property which the Trust will acquire subsequent to the financing. The Trust anticipates that the net proceeds from this proposed financing will exceed the \$25,000,000 required to be paid to MLI on or before November 23, 1996. In addition, the Trust is currently marketing four properties for sale, and anticipates another transaction wherein the Trust will sell a property while purchasing another property from the buyer, as a means of raising capital to fund the remaining amount of the Option Price.

The Trust believes it can raise the funds necessary to complete the discounted payment of the MLI debt through property financing proceeds and the sale of real estate properties. However, the ultimate success of this transaction is dependent upon the financial and real estate markets existing at the time of such financing or property sales. Accordingly, there can be

no assurance that the Trust will ultimately be able to pay the Option Price as required under the Settlement Agreement to achieve the discount on the notes. Should the Trust be unable to perform under the Settlement Agreement, the lender has the right to immediately begin foreclosure proceedings against the collateral, which constitutes substantially all of the Trust's assets.

The Settlement Agreement also requires that the Trust not pay distributions to shareholders until the Trust has paid the Option Price in full. For this reason, the Trust Managers have determined that it is in the best interests of the Trust and its shareholders to suspend distributions to shareholders until such time as the Option Price has been paid and the discount on the notes fully achieved. Any future distributions to shareholders will be evaluated by the Trust Managers based on the liquidity of the Trust, performance of the Trust's portfolio, cash flow of the Trust and other circumstances existing upon payment of the Option Price.

The initial capitalization of the Trust in 1985 included \$179,698,000 (face amount at maturity) of Zero Coupon Notes due 1997. Pursuant to the retirement of these Zero Coupon Notes, the Trust partially in-substance defeased certain Zero Coupon Notes in December 1993 and November 1994. At September 30, 1996, the face amount at maturity and the accreted value of the defeased Notes were \$16,365,000 and \$14,300,000, respectively.

At September 30, 1996, the Trust had \$62,645,000 in mortgage debt outstanding, including the MLI debt of \$45,239,000. Of this amount, \$1,931,000 represented variable rate financing (with a weighted average interest rate of 10.25%) and \$60,714,000 represented fixed rate financing (with a weighted average interest rate of 8.80%).

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Manufacturers Life Insurance Company. As more fully described in Part I, Liquidity and Capital Resources, the Trust settled its litigation with The Manufacturers Life Insurance Company ("MLI") on May 22, 1996 and entered into a Settlement Agreement with respect to payment of the MLI notes.

Paul O. Koether and Pure World, Inc. On January 8, 1996, the Trust filed a lawsuit in federal court in Dallas, Texas, against Pure World, Inc. and Paul O. Koether. The suit alleges, among other things, violations under federal and state securities law for material misrepresentations and omissions made by the defendants in filings made with the Securities and Exchange Commission including the failure to disclose meetings and correspondence between the defendants and representatives of MLI, the Trust's largest unsecured creditor, regarding the proposed purchase at a discount of the Trust's unsecured notes held by MLI. The Trust seeks injunctive relief preventing future discussions with MLI regarding the purchase of the MLI notes, further attempts to gain control of the Trust by the defendants

and any further purchases of shares in the Trust by the defendants until proper disclosures are made. In addition, the Trust seeks a declaratory judgment regarding enforcement of the share ownership restrictions contained in the Trust's Bylaws and injunctive relief preventing the voting of shares accumulated in excess of the share ownership limitations contained in the Bylaws. The Trust also seeks recovery of distributions paid on shares accumulated in excess of these share ownership limitations.

On January 30, 1996, the defendants filed an answer, counterclaims and a third party complaint. The third party complaint was filed against the Trust Managers of the Trust. In their counterclaim and third party claims, the defendants are requesting that certain Bylaw amendments be stricken, that the court issue an injunction until an additional independent Trust Manager is appointed, that a receiver be appointed for the assets and business of the Trust, that the Trust recover certain funds from the Trust Managers, and that the defendants recover an unspecified amount of damages and attorneys' fees. The Trust filed a Motion to Dismiss, which the court granted in part, requiring the defendants to replead their counterclaim. On March 26, 1996, the court denied Pure World's motion for partial summary judgment to appoint a receiver for the Trust. The court ruled that the failure to elect new Trust Managers or re-elect the current Trust Managers at the last two annual shareholder meetings has not resulted in a shareholder deadlock and is insufficient grounds for the appointment of a receiver. On September 9, 1996, the court granted defendants' motion for partial summary judgment, ruling that the provisions of Article IX of the Trust's bylaws limiting share ownership to 9.8% of the Trust's shares is invalid under the Texas REIT Act. The court denied the Trust's motion for its reconsideration of its September 9, 1996 ruling on October 28, 1996. Defendants also filed an application to preliminarily enjoin the Trust from enforcing Article IX and another bylaw provision (Article XIII) adopted by the Trust following the court's September 9, 1996 ruling. Article XIII also limits share ownership to ensure the Trust continues to comply with REIT requirements under the federal income tax laws and becomes effective in the event that Article IX is finally adjudicated to be unenforceable or otherwise invalid, including any and all appeals or other appellate review, or the Trust is enjoined from enforcing Article IX. On November 12, 1996, the court granted defendants' application for preliminary injunction.

The Trust believes that the Court's ruling misconstrues the Texas REIT Act. Accordingly, the Trust intends to appeal the ruling. Although management believes the Trust will ultimately prevail in this suit, no assurance can be given regarding the ultimate outcome of this litigation and its financial effect upon the Trust.

Robert Strougo. On February 22, 1996, a class action and derivative complaint was filed against the Trust and its Trust Managers by an alleged shareholder of the Trust, Robert Strougo. The suit alleges, among other claims, interference with shareholders' franchise rights and breach of fiduciary duty and seeks recovery of unspecified damages and attorneys' fees. The court has since granted the Trust's and the Trust Managers' motion to dismiss the class action claim, ruling that such claim

was improper. In April 1996, this suit was consolidated with the Trust's litigation described in "Paul O. Koether and Pure World, Inc." above. Although management believes the Trust will ultimately prevail in this suit, no assurance can be given regarding the ultimate outcome of this litigation and its financial effect upon the Trust.

The costs of pursuing the above-described litigation and defending against the actions of the defendants are expected to be significant and could adversely affect the Trust's resources and liquidity.

The parties have entered into settlement discussions regarding the litigation described above. Although there can be no assurance that a settlement of the litigation will occur, due to the anticipated settlement of the litigation, the Trust Managers have determined that it is in the best interests of the Trust and its shareholders to cancel the Annual Meeting of Shareholders which was originally scheduled to be held on December 18, 1996. The new record date and date of the Annual Meeting of Shareholders will be announced at a later date.

Item 3.Defaults Upon Senior Securities.

As more fully described in Part I, Liquidity and Capital Resources, the Trust settled its litigation with The Manufacturers Life Insurance Company ("MLI") on May 22, 1996 and entered into a Settlement Agreement with respect to payment of the MLI notes.

Item 6.Exhibits and Reports on Form 8-K.

(a) Exhibits

Exhibit No.	Description
27.1 (filed herewith)	Financial Data Schedule

(b) Reports on Form 8-K

Current Report on Form 8-K dated September 24, 1996, reporting Item 5.

SIGNATURES

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

AMERICAN INDUSTRIAL PROPERTIES REIT
(Registrant)

Date: November 14, 1996 /s/ MARC A. SIMPSON
Marc A. Simpson,
Vice President and Chief Financial Officer

(principal accounting and financial
officer)

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