

STRATUS PROPERTIES INC
Form 10-Q
August 14, 2014

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

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
or
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 000-19989

Stratus Properties Inc.

(Exact name of registrant as specified in its charter)

Delaware

72-1211572

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

212 Lavaca St., Suite 300

Austin, Texas

78701

(Address of principal executive offices)

(Zip Code)

(512) 478-5788

(Registrant's telephone number, including area code)

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

Yes No

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

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

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

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

On July 31, 2014, there were issued and outstanding 8,029,353 shares of the registrant's common stock, par value \$0.01 per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

STRATUS PROPERTIES INC.
CONSOLIDATED BALANCE SHEETS (Unaudited)
(In Thousands)

| | June 30, 2014 | December 31, 2013 | |
|--|------------------|----------------------|---|
| ASSETS | | | |
| Cash and cash equivalents | \$24,260 | \$21,307 | |
| Restricted cash | 4,550 | 5,077 | |
| Real estate held for sale | 20,233 | 18,133 | |
| Real estate under development | 93,973 | 76,891 | |
| Land available for development | 21,351 | 21,404 | |
| Real estate held for investment, net | 178,577 | 182,530 | |
| Investment in unconsolidated affiliates | 3,520 | 4,427 | |
| Other assets | 17,068 | 17,174 | |
| Total assets | \$363,532 | \$346,943 | |
| LIABILITIES AND EQUITY | | | |
| Accounts payable | \$6,133 | \$5,143 | |
| Accrued liabilities | 6,617 | 9,360 | |
| Debt | 168,937 | 151,332 | |
| Other liabilities and deferred gain | 12,996 | 11,792 | |
| Total liabilities | 194,683 | 177,627 | |
| Commitments and contingencies | | | |
| Equity: | | | |
| Stratus stockholders' equity: | | | |
| Common stock | 91 | 91 | |
| Capital in excess of par value of common stock | 203,944 | 203,724 | |
| Accumulated deficit | (59,408) | (60,724) |) |
| Accumulated other comprehensive loss | (326) | (22) |) |
| Common stock held in treasury | (20,275) | (19,448) |) |
| Total Stratus stockholders' equity | 124,026 | 123,621 | |
| Noncontrolling interests in subsidiaries | 44,823 | 45,695 | |
| Total equity | 168,849 | 169,316 | |
| Total liabilities and equity | \$363,532 | \$346,943 | |

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(In Thousands, Except Per Share Amounts)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | June 30, | | June 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Revenues: | | | | |
| Real estate operations | \$6,824 | \$28,043 | \$12,255 | \$46,905 |
| Hotel | 10,560 | 9,816 | 21,372 | 19,895 |
| Entertainment | 3,513 | 3,424 | 9,000 | 6,632 |
| Commercial leasing | 1,624 | 1,242 | 3,193 | 2,552 |
| Total revenues | 22,521 | 42,525 | 45,820 | 75,984 |
| Cost of sales: | | | | |
| Real estate operations | 4,682 | 23,833 | 8,500 | 39,785 |
| Hotel | 7,641 | 7,538 | 15,273 | 14,812 |
| Entertainment | 2,515 | 2,979 | 6,536 | 5,435 |
| Commercial leasing | 703 | 685 | 1,404 | 1,347 |
| Depreciation | 2,225 | 2,308 | 4,472 | 4,538 |
| Total cost of sales | 17,766 | 37,343 | 36,185 | 65,917 |
| Insurance settlement | (46 |) (1,785 |) (576 |) (1,785 |
| General and administrative expenses | 1,959 | 2,014 | 4,021 | 3,778 |
| Total costs and expenses | 19,679 | 37,572 | 39,630 | 67,910 |
| Operating income | 2,842 | 4,953 | 6,190 | 8,074 |
| Interest expense, net | (974 |) (2,008 |) (1,823 |) (4,307 |
| Loss on interest rate cap agreement | (170 |) — | (251 |) — |
| Other income, net | 3 | 95 | 22 | 1,345 |
| Income before income taxes and equity in unconsolidated affiliates' income (loss) | 1,701 | 3,040 | 4,138 | 5,112 |
| Equity in unconsolidated affiliates' (loss) income | (243 |) 149 | 438 | 111 |
| Provision for income taxes | (194 |) (222 |) (420 |) (425 |
| Net income | 1,264 | 2,967 | 4,156 | 4,798 |
| Net income attributable to noncontrolling interests in subsidiaries | (1,045 |) (2,335 |) (2,840 |) (3,013 |
| Net income attributable to Stratus common stock | \$219 | \$632 | \$1,316 | \$1,785 |
| Basic and diluted net income per share attributable to Stratus common stock | \$0.03 | \$0.08 | \$0.16 | \$0.22 |
| Weighted-average shares of common stock outstanding: | | | | |
| Basic | 8,030 | 8,099 | 8,040 | 8,102 |
| Diluted | 8,068 | 8,131 | 8,085 | 8,133 |

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(In Thousands)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$1,264 | \$2,967 | \$4,156 | \$4,798 |
| Other comprehensive loss, net of taxes: | | | | |
| Loss on interest rate swap agreement | (229 |) — | (435 |) — |
| Other comprehensive loss | (229 |) — | (435 |) — |
| Total comprehensive income | 1,035 | 2,967 | 3,721 | 4,798 |
| Total comprehensive income attributable to noncontrolling interests | (975 |) (2,335 |) (2,709 |) (3,013 |
| Total comprehensive income attributable to Stratus common stock | \$60 | \$632 | \$1,012 | \$1,785 |

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In Thousands)

| | Six Months Ended | |
|---|------------------|----------|
| | June 30, | |
| | 2014 | 2013 |
| Cash flow from operating activities: | | |
| Net income | \$4,156 | \$4,798 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation | 4,472 | 4,538 |
| Cost of real estate sold | 6,081 | 31,375 |
| Stock-based compensation | 220 | 157 |
| Equity in unconsolidated affiliates' income | (438) | (111) |
| Deposits | (101) | (113) |
| Purchases and development of real estate properties | (24,817) | (8,728) |
| Recovery of land previously sold | — | (485) |
| Municipal utility district reimbursement | — | 208 |
| Decrease (increase) in other assets | 1,093 | (12,631) |
| (Decrease) increase in accounts payable, accrued liabilities and other | (1,233) | 1,366 |
| Net cash (used in) provided by operating activities | (10,567) | 20,374 |
| Cash flow from investing activities: | | |
| Capital expenditures | (953) | (632) |
| Return of investment in (investment in) unconsolidated affiliates | 1,345 | (700) |
| Net cash provided by (used in) investing activities | 392 | (1,332) |
| Cash flow from financing activities: | | |
| Borrowings from credit facility | 23,500 | 9,000 |
| Payments on credit facility | (6,828) | (23,368) |
| Borrowings from project loans | 6,000 | 1,568 |
| Payments on project and term loans | (5,067) | (443) |
| Noncontrolling interests distributions | (3,581) | (103) |
| Repurchase of treasury stock | (637) | (623) |
| Net payments for stock-based awards | (190) | (72) |
| Financing costs | (69) | — |
| Net cash provided by (used in) financing activities | 13,128 | (14,041) |
| Net increase in cash and cash equivalents | 2,953 | 5,001 |
| Cash and cash equivalents at beginning of year | 21,307 | 12,784 |
| Cash and cash equivalents at end of period | \$24,260 | \$17,785 |

The accompanying Notes to Consolidated Financial Statements (Unaudited), which include information regarding noncash transactions, are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF EQUITY (Unaudited)
(In Thousands)

| | Stratus Stockholders' Equity | | | | | | | | | | |
|--|---|--------------------|--------------------------------------|-----------------------------|---|--|------------|---|---|-----------------|--|
| | Common Stock Number of Shares | At Par Value | Capital in Excess of Par Value | Accum- ulated Deficit | Accum- ulated Other Compre- hensive Loss | Common Stock Held in Treasury Number of Shares | At Cost | Total Stratus Stockholders' Equity | Noncontrolling Interests in Subsidiaries | Total Equity | |
| Balance at December 31, 2013 | 9,076 | \$91 | \$203,724 | \$(60,724) | \$(22) | 1,030 | \$(19,448) | \$123,621 | \$45,695 | \$169,316 | |
| Common stock repurchases | — | — | — | — | — | 37 | (637) | (637) | — | (637) | |
| Exercised and issued stock-based awards | 31 | — | — | — | — | — | — | — | — | — | |
| Stock-based compensation | — | — | 220 | — | — | — | — | 220 | — | 220 | |
| Tender of shares for stock-based awards | — | — | — | — | — | 11 | (190) | (190) | — | (190) | |
| Noncontrolling interests distributions | — | — | — | — | — | — | — | — | (3,581) | (3,581) | |
| Total comprehensive income (loss) | — | — | — | 1,316 | (304) | — | — | 1,012 | 2,709 | 3,721 | |
| Balance at June 30, 2014 | 9,107 | \$91 | \$203,944 | \$(59,408) | \$(326) | 1,078 | \$(20,275) | \$124,026 | \$44,823 | \$168,849 | |
| Balance at December 31, 2012 | 9,037 | \$90 | \$203,298 | \$(63,309) | \$— | 940 | \$(18,392) | \$121,687 | \$87,208 | \$208,895 | |
| Common stock repurchases | — | — | — | — | — | 52 | (623) | (623) | — | (623) | |
| Exercised and issued stock-based awards | 31 | 1 | 25 | — | — | — | — | 26 | — | 26 | |
| Stock-based compensation | — | — | 157 | — | — | — | — | 157 | — | 157 | |
| Tender of shares for stock-based awards | — | — | — | — | — | 8 | (99) | (99) | — | (99) | |
| Noncontrolling interests distributions | — | — | — | — | — | — | — | — | (14,328) | (14,328) | |
| | — | — | — | 1,785 | — | — | — | 1,785 | 3,013 | 4,798 | |

Total comprehensive
income

| | | | | | | | | | | |
|-----------------------------|-------|------|-----------|------------|-----|-------|------------|-----------|----------|-----------|
| Balance at June 30, 2013 | 9,068 | \$91 | \$203,480 | \$(61,524) | \$— | 1,000 | \$(19,114) | \$122,933 | \$75,893 | \$198,826 |
|-----------------------------|-------|------|-----------|------------|-----|-------|------------|-----------|----------|-----------|

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013, included in Stratus Properties Inc.'s (Stratus) Annual Report on Form 10-K (Stratus 2013 Form 10-K) filed with the Securities and Exchange Commission. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary for a fair statement of the results for the second-quarter periods. Operating results for the three-month and six-month periods ended June 30, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

2. EARNINGS PER SHARE

Stratus' basic net income per share of common stock was calculated by dividing the net income attributable to Stratus common stock by the weighted-average shares of common stock outstanding during the second-quarter and six-month periods. Following is a reconciliation of net income and weighted-average shares of common stock outstanding for purposes of calculating diluted net income per share (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income | \$1,264 | \$2,967 | \$4,156 | \$4,798 |
| Net income attributable to noncontrolling interests in subsidiaries | (1,045) | (2,335) | (2,840) | (3,013) |
| Net income attributable to Stratus common stock | \$219 | \$632 | \$1,316 | \$1,785 |
| Weighted-average shares of common stock outstanding | 8,030 | 8,099 | 8,040 | 8,102 |
| Add shares issuable upon exercise or vesting of: | | | | |
| Dilutive stock options | 15 | 8 | ^a 15 | 7 |
| Restricted stock units | 23 | 24 | 30 | 24 |
| Weighted-average shares of common stock outstanding for purposes of calculating diluted net income per share | 8,068 | 8,131 | 8,085 | 8,133 |
| Diluted net income per share attributable to Stratus common stock | \$0.03 | \$0.08 | \$0.16 | \$0.22 |

a. Excludes shares of common stock associated with outstanding stock options with exercise prices less than the average market price of Stratus' common stock that were anti-dilutive based on the treasury stock method totaling approximately 1,300 shares for second-quarter 2013 and 1,900 shares for the first six months of 2013.

Outstanding stock options with exercise prices greater than the average market price for Stratus' common stock during the period are excluded from the computation of diluted net income per share of common stock. Excluded were approximately 28,100 stock options with a weighted-average exercise price of \$27.20 for the second quarter and first six months of 2014, approximately 63,100 stock options with a weighted-average exercise price of \$21.00 per option for second-quarter 2013 and approximately 65,600 stock options with a weighted-average exercise price of \$20.69 for the first six months of 2013.

3. JOINT VENTURE WITH CANYON-JOHNSON URBAN FUND II, L.P.

Stratus and Canyon-Johnson Urban Fund II, L.P. (Canyon-Johnson) are participants in a joint venture, CJUF II Stratus Block 21, LLC (the Block 21 Joint Venture), for a 36-story mixed-use development in downtown Austin, Texas, anchored by a W Hotel & Residences (the W Austin Hotel & Residences project). Stratus is the manager of, and has an approximate 40 percent interest in, the Block 21 Joint Venture, and Canyon-Johnson has an approximate 60 percent interest in the Block 21 Joint Venture. As of June 30, 2014, cumulative capital contributions totaled \$71.9 million for Stratus and \$94.0 million for Canyon-Johnson. Distributions in second-quarter 2014 totaled \$1.9 million to Stratus and \$2.5 million to Canyon-Johnson. As of June 30, 2014, inception-to-date distributions totaled \$47.3 million for Stratus and \$54.2 million for Canyon-Johnson. The Block 21 Joint Venture is consolidated in Stratus' financial statements based on Stratus' assessment that the Block 21 Joint Venture is a variable interest

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entity (VIE) and that Stratus is the primary beneficiary. Stratus will continue to periodically evaluate which entity is the primary beneficiary of the Block 21 Joint Venture in accordance with applicable accounting guidance. See Note 2 of the Stratus 2013 Form 10-K for further discussion.

Stratus' consolidated balance sheets include the following assets and liabilities of the Block 21 Joint Venture (in thousands):

| | June 30, 2014 | December 31, 2013 |
|--------------------------------------|------------------|----------------------|
| Assets: | | |
| Cash and cash equivalents | \$16,544 | \$13,192 |
| Restricted cash | 4,547 | 5,069 |
| Real estate held for sale | 8,107 | 10,942 |
| Real estate held for investment, net | 153,984 | 157,541 |
| Other assets | 7,474 | 7,631 |
| Total assets | 190,656 | 194,375 |
| Liabilities: | | |
| Accounts payable | 2,801 | 3,428 |
| Accrued liabilities | 4,775 | 6,856 |
| Debt | 99,017 | 99,754 |
| Other liabilities | 6,021 | 4,761 |
| Total liabilities | 112,614 | 114,799 |
| Net assets | \$78,042 | \$79,576 |

Profits and losses among partners in a real estate venture are allocated based on how changes in net assets of the venture would affect cash payments to the partners over the life of the venture and on its liquidation. The amount of the ultimate profits earned by the W Austin Hotel & Residences project will affect the ultimate profit sharing ratios because of provisions in the joint venture agreement, which would require Stratus to return certain previously received distributions to Canyon-Johnson under certain circumstances. Because of the uncertainty of the ultimate profits and, therefore, profit-sharing ratios, the W Austin Hotel & Residences project's cumulative profits or losses are allocated based on a hypothetical liquidation of the Block 21 Joint Venture's net assets as of each balance sheet date. As of June 30, 2014, the cumulative earnings for the W Austin Hotel & Residences project were allocated based on 42 percent for Stratus and 58 percent for Canyon-Johnson.

4. JOINT VENTURE WITH LCHM HOLDINGS, LLC

In 2011, Stratus entered into a joint venture (the Parkside Village Joint Venture) with Moffett Holdings, LLC (Moffett Holdings) for the development of Parkside Village, a retail project in the Circle C Community. On March 3, 2014, Moffett Holdings redeemed and purchased the membership interest in Moffett Holdings held by LCHM Holdings, LLC (LCHM Holdings). In connection with the redemption, (1) LCHM Holdings received the 625,000 shares of Stratus common stock held by Moffett Holdings and (2) LCHM Holdings entered into an assignment and assumption agreement pursuant to which Moffett Holdings assigned to LCHM Holdings its rights and obligations under the Investor Rights Agreement between Moffett Holdings and Stratus dated as of March 15, 2012. See Note 3 of the Stratus 2013 Form 10-K for further discussion.

5. FAIR VALUE MEASUREMENTS

Fair value accounting guidance includes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

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The carrying value for certain Stratus financial instruments (i.e., cash and cash equivalents, restricted cash, accounts payable and accrued liabilities) approximates fair value because of their short-term nature and generally negligible credit losses. A summary of the carrying amount and fair value of Stratus' other financial instruments follows (in thousands):

| | June 30, 2014 | | December 31, 2013 | |
|------------------------------|----------------|------------|-------------------|------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets: | | | | |
| Interest rate cap agreement | \$ 100 | \$ 100 | \$ 351 | \$ 351 |
| Liabilities: | | | | |
| Interest rate swap agreement | 467 | 467 | 32 | 32 |
| Debt | 168,937 | 170,319 | 151,332 | 151,584 |

Interest Rate Cap Agreement. On September 30, 2013, the Block 21 Joint Venture paid \$0.5 million to enter into an interest rate cap agreement, which caps the one-month London Interbank Offered Rate (LIBOR), the variable rate in the Bank of America loan agreement (the BoA Loan) relating to the W Austin Hotel & Residences project, at 1 percent for the first year the BoA Loan is outstanding, 1.5 percent for the second year and 2 percent for the third year. Stratus uses an interest rate pricing model that relies on market observable inputs such as LIBOR to measure the fair value of the interest rate cap agreement. Stratus also evaluated the counterparty credit risk associated with the interest rate cap agreement, which is considered a Level 3 input, but did not consider such risk to be significant. Therefore, the interest rate cap agreement is classified within Level 2 of the fair value hierarchy.

Interest Rate Swap Agreement. On December 13, 2013, the Parkside Village Joint Venture entered into an interest rate swap agreement with Comerica Bank that effectively converts the Parkside Village loan's variable rate from one-month LIBOR to a fixed rate of 2.3 percent. With the interest rate swap agreement in place, the Parkside Village Joint Venture's interest cost on the Parkside Village loan will be 4.8 percent through the December 31, 2020, maturity date. Stratus also evaluated the counterparty credit risk associated with the interest rate swap agreement, which is considered a Level 3 input, but did not consider such risk to be significant. Therefore, the interest rate swap agreement is classified within Level 2 of the fair value hierarchy.

Debt. Stratus' debt is recorded at cost and is not actively traded. Fair value is estimated based on discounted future expected cash flows at estimated current market interest rates. Accordingly, Stratus' debt is classified within Level 2 of the fair value hierarchy. The fair value of debt does not represent the amounts that will ultimately be paid upon the maturities of the loans.

6. DEBT AND EQUITY TRANSACTIONS

Barton Creek Village Term Loan. On June 27, 2014, Stratus entered into a \$6 million term loan agreement with PlainsCapital Bank (the PlainsCapital loan). The PlainsCapital loan matures on June 27, 2024, and is secured by assets at Barton Creek Village. The interest rate is 4.19 percent and payments of principal and interest are due monthly. As required by the PlainsCapital loan, \$4.3 million of the proceeds were used to fully repay the existing Barton Creek Village loan, which was scheduled to mature on June 30, 2014.

Interest Expense and Capitalization. Interest expense (before capitalized interest) totaled \$1.9 million for second-quarter 2014, \$3.0 million for second-quarter 2013, \$3.6 million for the six months ended June 30, 2014, and \$6.0 million for the six months ended June 30, 2013. Stratus' capitalized interest costs totaled \$1.0 million for each of the second quarters of 2014 and 2013, \$1.8 million for the six months ended June 30, 2014, and \$1.7 million for the six months ended June 30, 2013. Capitalized interest costs for the 2014 and 2013 periods primarily related to development activities at properties in Barton Creek, Circle C and Lakeway, Texas.

Common Stock Repurchases. During the six months ended June 30, 2014, Stratus purchased 36,900 shares of its common stock for \$0.6 million (\$17.26 per share). Stratus obtained lender approval for these repurchases. See Note 9 of the Stratus 2013 Form 10-K for further discussion of common stock repurchases permitted under Stratus' debt agreements.

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7. INCOME TAXES

Stratus' accounting policy for and other information regarding its income taxes is further described in Notes 1 and 8 of the Stratus 2013 Form 10-K.

Stratus evaluated the recoverability of its deferred tax assets and considered available positive and negative evidence, giving greater weight to losses in recent years, the absence of taxable income in the carry-back period and uncertainty regarding projected future financial results. As a result, Stratus concluded that there was not sufficient positive evidence supporting the realizability of its deferred tax assets beyond an amount totaling \$0.3 million at June 30, 2014, and December 31, 2013.

Stratus' future results of operations may be negatively impacted by an inability to realize a tax benefit for future tax losses or for items that will generate additional deferred tax assets. Stratus' future results of operations may be favorably impacted by reversals of valuation allowances if Stratus is able to demonstrate sufficient positive evidence that its deferred tax assets will be realized.

The difference between Stratus' consolidated effective income tax rate for the six months of 2014 and 2013, and the U.S. federal statutory tax rate of 35 percent was primarily attributable to the realization of deferred tax assets.

8. BUSINESS SEGMENTS

Stratus currently has four operating segments: Real Estate Operations, Hotel, Entertainment and Commercial Leasing.

The Real Estate Operations segment is comprised of Stratus' real estate assets (developed, under development and undeveloped), which consists of its properties in the Barton Creek community, the Circle C Community, Lantana, and Lakeway, Texas, and the condominium units at the W Austin Hotel & Residences project.

The Hotel segment includes the W Austin Hotel located at the W Austin Hotel & Residences project.

The Entertainment segment includes ACL Live, a live music and entertainment venue and production studio at the W Austin Hotel & Residences project. In addition to hosting concerts and private events, this venue is the home of Austin City Limits, a television program showcasing popular music legends. The Entertainment segment also includes revenues and costs associated with events hosted at other venues, and the results of the Stageside Productions joint venture with Pedernales Entertainment LLC.

The Commercial Leasing segment includes the office and retail space at the W Austin Hotel & Residences project, a retail building and a bank building in Barton Creek Village, and 5700 Slaughter and Parkside Village in the Circle C Community.

Stratus uses operating income or loss to measure the performance of each segment. Stratus allocates parent company general and administrative expenses that do not directly relate to a particular operating segment between the Real Estate Operations and Commercial Leasing segments based on projected annual revenues for each segment. General and administrative expenses related to the W Austin Hotel & Residences project are allocated to the Real Estate Operations, Hotel, Entertainment and Commercial Leasing segments based on projected annual revenues for the W Austin Hotel & Residences project. The following segment information reflects management's determinations that may not be indicative of what actual financial performance of each segment would be if it were an independent entity.

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Segment data presented below was prepared on the same basis as Stratus' consolidated financial statements (in thousands).

| | Real Estate Operations ^a | Hotel | Entertainment | Commercial Leasing | Eliminations and Other ^b | Total |
|---------------------------------------|--|----------|---------------|-----------------------|--|-----------|
| Three Months Ended June 30, 2014: | | | | | | |
| Revenues: | | | | | | |
| Unaffiliated customers | \$6,824 | \$10,560 | \$3,513 | \$1,624 | \$— | \$22,521 |
| Intersegment | 24 | 99 | 11 | 132 | (266) |) — |
| Cost of sales, excluding depreciation | 4,696 | 7,642 | 2,598 | 727 | (122) |) 15,541 |
| Depreciation | 57 | 1,457 | 311 | 438 | (38) |) 2,225 |
| Insurance settlement | (46) |) — | — | — | — | (46) |
| General and administrative expenses | 1,465 | 143 | 52 | 445 | (146) |) 1,959 |
| Operating income | \$676 | \$1,417 | \$563 | \$146 | \$40 | \$2,842 |
| Capital expenditures ^c | \$16,826 | \$27 | \$— | \$438 | \$— | \$17,291 |
| Total assets at June 30, 2014 | 156,604 | 113,048 | 50,054 | 49,587 | (5,761) |) 363,532 |
| Three Months Ended June 30, 2013: | | | | | | |
| Revenues: | | | | | | |
| Unaffiliated customers | \$28,043 | \$9,816 | \$3,424 | \$1,242 | \$— | \$42,525 |
| Intersegment | 26 | 50 | 15 | 150 | (241) |) — |
| Cost of sales, excluding depreciation | 23,861 | 7,532 | 3,000 | 705 | (63) |) 35,035 |
| Depreciation | 59 | 1,558 | 310 | 418 | (37) |) 2,308 |
| Insurance settlement | (1,785) |) — | — | — | — | (1,785) |
| General and administrative expenses | 1,661 | 116 | 51 | 325 | (139) |) 2,014 |
| Operating income (loss) | \$4,273 | \$660 | \$78 | \$(56) |) \$(2) |) \$4,953 |
| Capital expenditures ^c | \$5,060 | \$2 | \$110 | \$450 | \$— | \$5,622 |
| Total assets at June 30, 2013 | 165,902 | 116,750 | 45,804 | 46,820 | (6,082) |) 369,194 |
| Six Months Ended June 30, 2014: | | | | | | |
| Revenues: | | | | | | |
| Unaffiliated customers | \$12,255 | \$21,372 | \$9,000 | \$3,193 | \$— | \$45,820 |
| Intersegment | 47 | 229 | 18 | 255 | (549) |) — |
| Cost of sales, excluding depreciation | 8,566 | 15,274 | 6,667 | 1,452 | (246) |) 31,713 |
| Depreciation | 113 | 2,930 | 630 | 873 | (74) |) 4,472 |
| Insurance settlement | (576) |) — | — | — | — | (576) |
| General and administrative expenses | 3,093 | 215 | 79 | 946 | (312) |) 4,021 |
| Operating income | \$1,106 | \$3,182 | \$1,642 | \$177 | \$83 | \$6,190 |
| Capital expenditures ^c | \$24,817 | \$76 | \$32 | \$845 | \$— | \$25,770 |
| Six Months Ended June 30, 2013: | | | | | | |
| Revenues: | | | | | | |
| Unaffiliated customers | \$46,905 | \$19,895 | \$6,632 | \$2,552 | \$— | \$75,984 |
| Intersegment | 40 | 132 | 23 | 281 | (476) |) — |
| Cost of sales, excluding depreciation | 39,841 | 14,812 | 5,489 | 1,387 | (150) |) 61,379 |
| Depreciation | 123 | 3,035 | 617 | 837 | (74) |) 4,538 |
| Insurance settlement | (1,785) |) — | — | — | — | (1,785) |
| General and administrative expenses | 3,164 | 190 | 74 | 627 | (277) |) 3,778 |
| Operating income (loss) | \$5,602 | \$1,990 | \$475 | \$(18) |) \$25 | \$8,074 |

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| | | | | | | |
|-----------------------------------|---------|-----|-------|-------|-----|---------|
| Capital expenditures ^c | \$8,728 | \$3 | \$119 | \$510 | \$— | \$9,360 |
|-----------------------------------|---------|-----|-------|-------|-----|---------|

a. Includes sales commissions and other revenues together with related expenses.

b. Includes eliminations of intersegment amounts, including the deferred development fee income between Stratus and the Block 21 Joint Venture (see Note 3).

c. Also includes purchases and development of residential real estate held for sale.

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9. NEW ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) which outlines a single comprehensive model and supersedes most of the current revenue recognition guidance. For public entities, this ASU is effective for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. Early adoption is not permitted. Stratus is evaluating this new guidance, but does not expect it to have a significant impact on its current revenue recognition policies.

In April 2014, FASB issued an ASU which revises the guidance for reporting discontinued operations. This ASU amends the definition of a discontinued operation and requires additional disclosures about disposal transactions that do not meet the definition of a discontinued operation. For public entities, this ASU is effective for annual periods beginning on or after December 15, 2014, and interim periods within that year. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. Stratus adopted this ASU in first-quarter 2014.

10. SUBSEQUENT EVENTS

Slaughter Term Loan. On July 18, 2014, Stratus entered into a \$7 million term loan agreement with United Heritage Credit Union (the United loan). The United loan matures on July 31, 2024, and is secured by 5700 Slaughter. The interest rate is 4.50 percent through July 31, 2019. Beginning August 1, 2019, and continuing through the maturity date, interest will accrue at the greater of the Prime Interest Rate plus 1.25 percent or 4.95 percent. As required by the United loan, \$5.0 million of the proceeds were used to fully repay the existing 5700 Slaughter term loan, which was scheduled to mature on January 31, 2015.

Stratus evaluated events after June 30, 2014, and through the date the financial statements were issued, and determined any events or transactions occurring during this period that would require recognition or disclosure are appropriately addressed in these financial statements.

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

OVERVIEW

In management's discussion and analysis of financial condition and results of operations, "we," "us," "our" and "Stratus" refer to Stratus Properties Inc. (Stratus) and all entities owned or controlled by Stratus. You should read the following discussion in conjunction with our financial statements, the related management's discussion and analysis of financial condition and results of operations and the discussion of our business and properties included in our Annual Report on Form 10-K for the year ended December 31, 2013 (2013 Form 10-K) filed with the Securities and Exchange Commission (refer to "Cautionary Statement" of this Form 10-Q for further discussion). The results of operations reported and summarized below are not necessarily indicative of future operating results, and future results could differ materially from those anticipated in forward-looking statements. All subsequent references to "Notes" refer to Notes to Consolidated Financial Statements (Unaudited) located in Part I, Item 1. "Financial Statements" of this Form 10-Q, unless otherwise stated.

We are a diversified real estate company engaged in the acquisition, development, management, operation and/or sale of commercial, hotel, entertainment, and multi- and single-family residential real estate properties located in Texas, primarily in the Austin and central-Texas areas. We generate revenues from sales of developed properties, from our hotel and entertainment operations and from rental income from our commercial properties. See Note 8 for further discussion of our operating segments.

Developed property sales can include condominium units at the W Austin Hotel & Residences project, an individual tract of land that has been developed and permitted for residential use or a developed lot with a home already built on it. We may, on occasion, sell properties under development, undeveloped properties or commercial properties, if opportunities arise that we believe will maximize overall asset values.

Our principal real estate holdings are in southwest Austin, Texas. The number of developed lots/units, under development acreage and undeveloped acreage as of June 30, 2014, that comprise our principal real estate development projects are presented in the following table.

| | Developed Lots/Units | Acreage | | | | | | Total Acreage | |
|---------------------|-------------------------|---------------------------------------|------------|-------|---------------------------------|--------------|------------|------------------|-------|
| | | Under Development Single Family | Commercial | Total | Undeveloped Single family | Multi-family | Commercial | | |
| Austin: | | | | | | | | | |
| Barton Creek | 21 | 166 | — | 166 | 512 | 327 | 418 | 1,257 | 1,423 |
| Circle C | 57 | — | 23 | 23 | — | 36 | 228 | 264 | 287 |
| Lantana | — | — | — | — | — | — | 43 | 43 | 43 |
| Lakeway | — | — | — | — | — | — | 40 | 40 | 40 |
| W Austin Residences | 6 | — | — | — | — | — | — | — | — |
| San Antonio: | | | | | | | | | |
| Camino Real | — | — | — | — | — | — | 2 | 2 | 2 |
| Total | 84 | 166 | 23 | 189 | 512 | 363 | 731 | 1,606 | 1,795 |

Our principal residential holdings at June 30, 2014, included developed lots at Barton Creek and the Circle C Community, and condominium units at the W Austin Hotel & Residences project. See "Development Activities - Residential" for further discussion. Our principal commercial holdings at June 30, 2014, in addition to the W Austin Hotel & Residences project, consisted of the first phase of Barton Creek Village, and the 5700 Slaughter retail complex and Parkside Village, which are both in the Circle C Community. See "Development Activities -

Commercial" for further discussion.

The W Austin Hotel & Residences project is located on a two-acre city block in downtown Austin and contains a 251-room luxury hotel, 159 residential condominium units, and office, retail and entertainment space. The hotel is managed by Starwood Hotels & Resorts Worldwide, Inc. The office space totals 39,328 square feet and the retail space totals 18,362 square feet. The entertainment space, occupied by Austin City Limits Live at the Moody Theater (ACL Live), includes a live music and entertainment venue and production studio.

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For second-quarter 2014, our revenues totaled \$22.5 million and our net income attributable to common stock totaled \$0.2 million, compared with revenues of \$42.5 million and net income attributable to common stock of \$0.6 million for second-quarter 2013. For the first six months of 2014, our revenues totaled \$45.8 million and our net income attributable to common stock totaled \$1.3 million, compared with revenues of \$76.0 million and net income attributable to common stock of \$1.8 million for the first six months of 2013. The decrease in revenues primarily relates to a decrease in condominium unit sales at the W Austin Residences as inventory has declined, as well as a decrease in Verano Drive lot sales. Only six condominium units remained available for sale at June 30, 2014. The results for second-quarter 2013 included income of \$1.8 million related to an insurance settlement. The results for the first six months of 2014 included income of \$0.6 million associated with an insurance settlement. The results for the first six months of 2013 included a gain of \$1.5 million associated with the sale of a 16-acre tract of land at Lantana and income of \$1.8 million related to an insurance settlement.

BUSINESS STRATEGY AND RELATED RISKS

Our business strategy is to create value for our shareholders by methodically developing high-quality residential and commercial projects using our existing assets and selectively pursuing new development opportunities. We believe that Austin, and other Texas markets, continue to be desirable. Many of our developments are in unique locations where development approvals have historically been subject to regulatory constraints, making it difficult to obtain entitlements. Our Austin assets, which are located in desirable areas with significant regulatory constraints, are highly entitled and, as a result, we believe that through strategic planning and development, we can maximize and fully exploit their value. Additionally, we believe the W Austin Hotel sets a high standard for contemporary luxury in downtown Austin and competes favorably with other hotels and resorts in our geographic market. Our entertainment operations provide quality live music experiences that create awareness for our ACL Live venue and brand, enhancing the overall value of the W Austin Hotel & Residences project. Our current focus is to proceed with the development of our properties, to seek new opportunities to acquire additional properties for potential mixed-use and retail development projects, including with strategic partners where beneficial, and to continue to effectively operate our hotel and entertainment businesses.

In years past, economic conditions, including the constrained capital and credit markets, negatively affected the execution of our business plan, primarily by decreasing the pace of development to match economic and market conditions. We responded to these conditions by successfully restructuring our existing debt, including reducing interest rates and extending maturities, which enabled us to preserve our development opportunities until market conditions improved. Economic conditions have improved and we believe we have the financial flexibility to fully exploit our development opportunities and resources. In the first six months of 2014, the joint venture for the W Austin Hotel & Residences project, CJUF II Stratus Block 21, LLC (the Block 21 Joint Venture), paid \$2.6 million in distributions to Stratus and \$3.6 million to Canyon-Johnson Urban Fund II, L.P. (Canyon Johnson), Stratus' joint venture partner. As of June 30, 2014, we had \$18.3 million of availability under our revolving line of credit with Comerica Bank and \$6.9 million in cash and cash equivalents available for use in our real estate operations, excluding cash balances held at our joint ventures, as shown below (in thousands):

| | |
|---|----------|
| Cash and cash equivalents | \$24,260 |
| Less: Block 21 Joint Venture cash | 16,544 |
| Less: Parkside Village Joint Venture cash | 838 |
| Net cash available | \$6,878 |

Although we have near-term debt maturities and significant recurring costs, including property taxes, maintenance and marketing, we believe we have sufficient liquidity to address our near term requirements. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors” in the Stratus 2013 Form 10-K for further discussion.

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DEVELOPMENT ACTIVITIES

Residential. As of June 30, 2014, the number of our residential developed lots/units, lots under development and lots for potential development by area are shown below (excluding lots associated with our unconsolidated joint venture with Trammell Crow Central Texas Development, Inc. relating to Crestview Station (the Crestview Station Joint Venture)):

| | Residential Lots/Units | | | Total |
|--------------------------------------|------------------------|-------------------|------------------------------------|-------|
| | Developed | Under Development | Potential Development ^a | |
| W Austin Hotel & Residences project: | | | | |
| Condominium units ^b | 6 | — | — | 6 |
| Barton Creek: | | | | |
| Amarra Drive: | | | | |
| Phase II Lots | 21 | — | — | 21 |
| Phase III Lots | — | 64 | — | 64 |
| Townhomes | — | — | 214 | 214 |
| Section N Multi-family | — | — | 1,860 | 1,860 |
| Other Barton Creek Sections | — | — | 155 | 155 |
| Circle C: | | | | |
| Meridian | 57 | — | — | 57 |
| Tract 101 Multi-family | — | — | 240 | 240 |
| Tract 102 Multi-family | — | — | 56 | 56 |
| Total Residential Lots/Units | 84 | 64 | 2,525 | 2,673 |

Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City of Austin (the City).

Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy^a with respect to those properties may change in the future. While we may be proceeding with approved infrastructure projects on some of these properties, they are not considered to be “under development” for disclosure in this table unless other development activities necessary to fully realize the properties’ intended final use are in progress or scheduled to commence in the near term.

b. Owned through a joint venture.

W Austin Hotel & Residences project. Delivery of the first condominium units at the W Austin Residences began in January 2011. As of June 30, 2014, sales of 153 of the 159 condominium units had closed for \$178.7 million (including one unit for \$2.7 million in second-quarter 2014). In July 2014, we sold one condominium unit for \$1.0 million and as of July 31, 2014, had five condominium units available for sale.

Barton Creek.

Calera. Calera is a residential subdivision with plat approval for 155 lots. Construction of the final phase, known as Verano Drive, was completed in July 2008 and includes 71 single-family lots. During second-quarter 2014, we sold the remaining six Verano Drive lots.

Amarra Drive. In 2008, we commenced development of Amarra Drive Phase II, which consists of 35 lots on 51 acres. Development was substantially completed in October 2008. During late 2013, we commenced development of Amarra

Phase III, which consists of 64 lots on 166 acres. During the first six months of 2014, we sold nine Phase II lots and as of June 30, 2014, 21 lots remain unsold. During July 2014, we sold one Phase II lot, and as of July 31, 2014, six Phase II lots were under contract.

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Circle C. We are developing the Circle C Community based on the entitlements secured in our Circle C settlement with the City. Our Circle C settlement, as amended in 2004, permits development of 1.16 million square feet of commercial space, 504 multi-family units and 830 single-family residential lots. Meridian is an 800-lot residential development at the Circle C Community. Development of the final phase of Meridian, which consists of 57 one-acre lots, was completed in first-quarter 2014. As of July 31, 2014, six Meridian lots were under contract.

Commercial. As of June 30, 2014, the number of square feet of our commercial property developed, under development and our remaining entitlements (i.e., potential development) is shown below:

| | Commercial Property | | | Total |
|--------------------------------------|---------------------|-------------------|------------------------------------|-----------|
| | Developed | Under Development | Potential Development ^a | |
| W Austin Hotel & Residences project: | | | | |
| Office ^b | 39,328 | — | — | 39,328 |
| Retail ^b | 18,362 | — | — | 18,362 |
| Barton Creek: | | | | |
| Treaty Oak Bank | 3,085 | — | — | 3,085 |
| Barton Creek Village Phase I | 22,366 | — | — | 22,366 |
| Barton Creek Village Phase II | — | — | 16,000 | 16,000 |
| Entry Corner | — | — | 5,000 | 5,000 |
| Amarra Retail/Office | — | — | 83,081 | 83,081 |
| Section N | — | — | 1,500,000 | 1,500,000 |
| Circle C: | | | | |
| Chase Bank Ground Lease | 4,450 | — | — | 4,450 |
| 5700 Slaughter | 21,248 | — | — | 21,248 |
| Parkside Village ^b | 77,641 | 12,543 | — | 90,184 |
| Tract 110 | — | — | 614,500 | 614,500 |
| Tract 114 | — | — | 78,357 | 78,357 |
| Lantana: | | | | |
| Tract GR1 | — | — | 325,000 | 325,000 |
| Tract G07 | — | — | 160,000 | 160,000 |
| Austin 290 Tract | — | — | 20,000 | 20,000 |
| Total Square Feet | 186,480 | 12,543 | 2,801,938 | 3,000,961 |

Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City. Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future. While we may be proceeding with approved infrastructure projects on some of these properties, they are not considered to be “under development” for disclosure in this table unless other development activities necessary to fully realize the properties’ intended final use are in progress or scheduled to commence in the near term.

a. Owned through a joint venture.

W Austin Hotel & Residences project. The project has 39,328 square feet of leasable office space, including 9,000 square feet for our corporate office. As of June 30, 2014, occupancy for the office space was 91 percent, with leasing activities for the remaining office space ongoing. The project also has 18,362 square feet of retail space, all of which became fully leased and occupied in first-quarter 2014.

Barton Creek. The first phase of the Barton Creek Village consists of a 22,366-square-foot retail complex, which includes a 3,085-square-foot bank building. As of June 30, 2014, occupancy was 100 percent for the retail complex, and the bank building is leased through January 2023.

Circle C. In 2008, we completed the construction of two retail buildings, totaling 21,248 square feet, at 5700 Slaughter in the Circle C Community (5700 Slaughter). This retail project also includes a 4,450-square-foot bank building on an existing ground lease, which expires in 2025. As of June 30, 2014, aggregate occupancy for the two retail buildings was approximately 91 percent.

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The Circle C Community also includes Parkside Village, a 90,184-square-foot retail project, which is currently under construction. This retail project consists of a 33,650-square-foot full-service movie theater and restaurant, a 13,890-square-foot medical clinic and five other retail buildings, including a 14,926-square-foot building, a 10,175-square-foot building, an 8,043-square-foot building, a 4,500-square-foot building and a stand-alone 5,000-square-foot building. In February 2011, we entered into the Parkside Village Joint Venture, obtained final permits and entitlements and began construction on the rental project. Construction of the final two buildings at Parkside Village is expected to be completed in October 2014. As of June 30, 2014, occupancy of the completed 77,641 square feet was 95 percent. The remaining buildings under development, the 8,043-square-foot building and the 4,500-square-foot building, are fully pre-leased.

Lantana. Lantana is a partially developed, mixed-use real estate development project. During first-quarter 2013, we sold a 16-acre tract for \$2.1 million, which had entitlements for approximately 70,000 square feet of office space. As of June 30, 2014, we had entitlements for approximately 485,000 square feet of office and retail space on the remaining 43 acres. Regional utility and road infrastructure is in place with capacity to serve Lantana at full build-out permitted under our existing entitlements.

Unconsolidated Affiliate.

Crestview Station. Crestview Station is a single-family, multi-family, retail and office development, which is located on the site of a commuter line. Crestview Station sold substantially all of its multi-family and commercial properties in 2007 and one commercial site in 2008, while retaining the single-family component. Crestview Station has entered into an agreement to sell the remaining residential land to DR Horton. The contract with DR Horton provides for the sale of 304 lots over four years for a total contract price of \$15.8 million. The results of the first three closings are shown below (in millions, except lots closed).

| Closing Date | Lots Closed | Sale Price | Gross Profit |
|--------------|-------------|------------|--------------|
| April 2012 | 73 | \$3.8 | \$0.4 |
| May 2013 | 59 | 3.4 | 0.7 |
| March 2014 | 59 | 3.5 | 0.8 |

We account for our 50 percent interest in the Crestview Station Joint Venture under the equity method.

RESULTS OF OPERATIONS

We are continually evaluating the development potential of our properties and will continue to consider opportunities to enter into transactions involving our properties. As a result, and because of numerous other factors affecting our business activities as described herein, our past operating results are not necessarily indicative of our future results.

The following table summarizes our results (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------|-----------------------------|-----------|---------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Operating income: | | | | |
| Real estate operations | \$676 | \$4,273 | \$1,106 | \$5,602 |
| Hotel | 1,417 | 660 | 3,182 | 1,990 |
| Entertainment | 563 | 78 | 1,642 | 475 |
| Commercial leasing | 146 | (56) | 177 | (18) |
| Eliminations and other | 40 | (2) | 83 | 25 |
| Operating income | \$2,842 | \$4,953 | \$6,190 | \$8,074 |
| Interest expense, net | \$(974) | \$(2,008) | \$(1,823) | \$(4,307) |
| Net income | \$1,264 | \$2,967 | \$4,156 | \$4,798 |

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| | | | | | | | | |
|---|----------|---|----------|---|----------|---|----------|---|
| Net income attributable to noncontrolling interests in subsidiaries | \$(1,045 |) | \$(2,335 |) | \$(2,840 |) | \$(3,013 |) |
| Net income attributable to Stratus common stock | \$219 | | \$632 | | \$1,316 | | \$1,785 | |

We have four operating segments: Real Estate Operations, Hotel, Entertainment and Commercial Leasing (see Note 8 for further discussion). The following is a discussion of our operating results by segment.

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Real Estate Operations

The following table summarizes our Real Estate Operations operating results (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|-----------------------------|----------|---------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues: | | | | |
| Developed property sales | \$6,777 | \$27,843 | \$12,126 | \$44,501 |
| Undeveloped property sales | — | — | — | 2,100 |
| Commissions and other | 71 | 226 | 176 | 344 |
| Total revenues | 6,848 | 28,069 | 12,302 | 46,945 |
| Cost of sales, including depreciation | 4,753 | 23,920 | 8,679 | 39,964 |
| Insurance settlement | (46 |) (1,785 |) (576 |) (1,785 |
| General and administrative expenses | 1,465 | 1,661 | 3,093 | 3,164 |
| Operating income | \$676 | \$4,273 | \$1,106 | \$5,602 |

Developed Property Sales. The following table summarizes our developed property sales (dollars in thousands):

| | Three Months Ended June 30, | | | 2013 | | |
|---|-----------------------------|----------|---------------------------|------------|----------|---------------------------|
| | 2014 | | | | | |
| | Units/Lots | Revenues | Average Cost per Unit/Lot | Units/Lots | Revenues | Average Cost Per Unit/Lot |
| W Austin Hotel & Residences Project Condominium Units | 1 | \$2,700 | \$2,295 | 16 | \$23,777 | \$1,236 |
| Barton Creek Calera: | | | | | | |
| Verano Drive | 6 | 2,370 | 179 | 8 | 2,486 | 180 |
| Calera Drive | — | — | — | 3 | 680 | 142 |
| Amarra Drive: | | | | | | |
| Phase I Lots | — | — | — | 1 | 300 | 259 |
| Phase II Lots | 4 | 1,707 | 163 | 1 | 600 | 264 |
| Total Residential | 11 | \$6,777 | | 29 | \$27,843 | |
| | Six Months Ended June 30, | | | 2013 | | |
| | 2014 | | | | | |
| | Units/Lots | Revenues | Average Cost per Unit/Lot | Units/Lots | Revenues | Average Cost per Unit/Lot |
| W Austin Hotel & Residences Project Condominium Units | 3 | \$4,420 | \$1,230 | 26 | \$37,763 | \$1,229 |
| Barton Creek Calera: | | | | | | |
| Verano Drive | 9 | 3,524 | 181 | 15 | 4,535 | 176 |
| Calera Drive | — | — | — | 4 | 898 | 139 |
| Amarra Drive: | | | | | | |
| Phase I Lots | — | — | — | 1 | 300 | 259 |

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| | | | | | | |
|-------------------|----|----------|-----|----|----------|-----|
| Phase II Lots | 9 | 4,182 | 185 | 1 | 600 | 264 |
| Mirador Estate | — | — | — | 1 | 405 | 264 |
| Total Residential | 21 | \$12,126 | | 48 | \$44,501 | |

The decrease in developed unit/lot sales and revenues in the 2014 periods primarily resulted from decreases in condominium unit sales at the W Austin Residences and lot sales at Verano Drive as inventories of both have declined, partly offset by increased Amarra Drive Phase II lot sales.

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Undeveloped Property Sales. During March 2013, we sold a 16-acre tract at Lantana for \$2.1 million, which had entitlements for approximately 70,000 square feet of office space.

Commissions and Other. Commissions and other primarily includes design fees and sales of our development fee credits to third parties and totaled \$0.1 million for second-quarter 2014, \$0.2 million for second-quarter 2013, \$0.2 million for the first six months of 2014 and \$0.3 million for the first six months of 2013. We received these development fee credits as part of the Circle C settlement (see Note 10 of the Stratus 2013 Form 10-K).

Cost of Sales. Cost of sales includes cost of property sold, project operating and marketing expenses and allocated overhead costs, partly offset by reductions for certain municipal utility district (MUD) reimbursements. Cost of sales totaled \$4.8 million for second-quarter 2014 and \$8.7 million for the first six months of 2014, compared with \$23.9 million for second-quarter 2013 and \$40.0 million for the first six months of 2013. The decrease in cost of sales for the 2014 periods, primarily reflects fewer condominium unit sales at the W Austin Residences. The first six months of 2014 also reflect a credit of \$0.5 million related to the recovery of building repair costs associated with damage caused by the June 2011 balcony glass breakage incidents at the W Austin Hotel & Residences project. Cost of sales for our real estate operations also includes significant, recurring costs (including property taxes, maintenance and marketing), which totaled \$0.9 million for second-quarter 2014 and \$1.9 million for the first six months of 2014, compared with \$1.5 million for second-quarter 2013 and \$3.0 million for the first six months of 2013. The decrease in these recurring costs for the 2014 periods primarily reflects lower property taxes as a result of lower condominium unit inventory at the W Austin Residences.

General and Administrative Expenses. Consolidated general and administrative expenses totaled approximately \$2.0 million in second-quarter 2014 and \$4.0 million for the first six months of 2014, compared with \$2.0 million in second-quarter 2013 and \$3.8 million for the first six months of 2013. General and administrative expenses allocated to real estate operations totaled \$1.5 million for second-quarter 2014 and \$3.1 million for the first six months of 2014, compared with \$1.7 million for second-quarter 2013 and \$3.2 million for the first six months of 2013. For more information about the allocation of general and administrative expenses to our operating segments, see Note 8.

Hotel

The following table summarizes our Hotel operating results (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|---------|---------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Hotel revenue | \$10,659 | \$9,866 | \$21,601 | \$20,027 |
| Hotel cost of sales, excluding depreciation | 7,642 | 7,532 | 15,274 | 14,812 |
| Depreciation | 1,457 | 1,558 | 2,930 | 3,035 |
| General and administrative expenses | 143 | 116 | 215 | 190 |
| Operating income | \$1,417 | \$660 | \$3,182 | \$1,990 |

Hotel Revenue. Hotel revenue reflects the results of operations for the W Austin Hotel, and primarily includes revenue from room reservations and food and beverage sales. Revenue per Available Room (REVPAR), which is calculated by dividing total room revenue by total rooms available, averaged \$284 for second-quarter 2014 and \$296 for the first six months of 2014, compared with \$250 for second-quarter 2013 and \$264 for the first six months of 2013. The increase in hotel revenue for the 2014 periods primarily reflects higher room rates and increased food and beverage sales.

Hotel Cost of Sales. Hotel operating costs totaled \$7.6 million in second-quarter 2014 and \$15.3 million for the first six months of 2014, compared with \$7.5 million in second-quarter 2013 and \$14.8 million for the first six months of 2013. The increase in hotel cost of sales in the 2014 periods primarily reflects increased variable costs, including labor

and marketing.

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Entertainment

The following table summarizes our Entertainment operating results (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|---------|---------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Entertainment revenue | \$3,524 | \$3,439 | \$9,018 | \$6,655 |
| Entertainment cost of sales, excluding depreciation | 2,598 | 3,000 | 6,667 | 5,489 |
| Depreciation | 311 | 310 | 630 | 617 |
| General and administrative expenses | 52 | 51 | 79 | 74 |
| Operating income | \$563 | \$78 | \$1,642 | \$475 |

Entertainment Revenue. Entertainment revenue primarily reflects the results of operations for ACL Live including the following: ticket sales; revenue from private events; sponsorships, personal seat license sales and suite sales; and sales of concessions and merchandise. Entertainment revenue also reflects revenues associated with outside events hosted at venues other than ACL Live and production of recorded content for artists performing at ACL Live, as well as the results of the joint venture with Pedernales Entertainment LLC relating to Stageside Productions (the Stageside Productions Joint Venture). Revenues from the Entertainment segment will vary from period to period as a result of factors such as the price of tickets and number of tickets sold, as well as the type of event. The increase in Entertainment revenue for the first six months of 2014, primarily resulted from higher private event revenue and higher ancillary revenue per attendee.

Certain key operating statistics relevant to the concert and event hosting industry are included below to provide additional information regarding the operating performance of ACL Live.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|---------|---------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Events: | | | | |
| Events hosted | 51 | 49 | 96 | 96 |
| Estimated attendance | 50,200 | 51,200 | 102,400 | 104,500 |
| Ancillary net revenue per attendee | \$42.69 | \$31.94 | \$48.08 | \$35.25 |
| Ticketing: | | | | |
| Number of tickets sold | 30,100 | 29,800 | 66,300 | 60,800 |
| Gross value of tickets sold (in thousands) | \$1,708 | \$2,011 | \$3,451 | \$3,612 |

Entertainment Cost of Sales. Entertainment operating costs totaled \$2.6 million in second-quarter 2014 and \$6.7 million for the first six months of 2014, compared with \$3.0 million in second-quarter 2013 and \$5.5 million for the first six months of 2013. Costs from the Entertainment segment will vary from period to period as a result of the types of events hosted.

Commercial Leasing

The following table summarizes our Commercial Leasing operating results (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|---------|---------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Rental revenue | \$1,756 | \$1,392 | \$3,448 | \$2,833 |
| Rental cost of sales, excluding depreciation | 727 | 705 | 1,452 | 1,387 |
| Depreciation | 438 | 418 | 873 | 837 |
| General and administrative expenses | 445 | 325 | 946 | 627 |
| Operating income (loss) | \$146 | \$(56) | \$177 | \$(18) |

Rental Revenue. Rental revenue primarily reflects revenue from the office and retail space at the W Austin Hotel & Residences project, Barton Creek Village, and Parkside Village and 5700 Slaughter, which are both in the Circle C Community. The increase in rental revenue in the 2014 periods primarily reflects increased occupancy at the W Austin Hotel & Residences project.

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Non-Operating Results

Interest Expense, net. Interest expense (before capitalized interest) totaled \$1.9 million in second-quarter 2014 and \$3.6 million for the first six months of 2014, compared with \$3.0 million in second-quarter 2013 and \$6.0 million for the first six months of 2013. The decrease in interest expense in the 2014 periods primarily reflects lower average interest rates associated with refinancing transactions. Capitalized interest totaled \$1.0 million in second-quarter 2014 and \$1.8 million for the first six months of 2014, compared with \$1.0 million in second-quarter 2013 and \$1.7 million for the first six months of 2013, and is primarily related to development activities at properties in Barton Creek, Circle C and Lakeway, Texas.

Other Income, net. We recorded other income of less than \$0.1 million for the second quarter and first six months of 2014, compared with \$0.1 million for second-quarter 2013 and \$1.3 million for the first six months of 2013. The decrease in other income in the 2014 periods primarily reflects interest received in connection with a Barton Creek MUD reimbursement and a gain on the recovery of land previously sold in the first six months of 2013.

Equity in Unconsolidated Affiliates' Income (Loss). We account for our interests in our unconsolidated affiliates, Crestview Station, Stump Fluff and Guapo Enterprises, using the equity method. Our equity in the net (loss) income of these entities totaled \$(0.2) million for second-quarter 2014 and \$0.4 million for the first six months of 2014, compared with \$0.1 million for the second quarter and first six months of 2013. The increase in the first six months of 2014 primarily reflects the third closing in the take-down agreement between Crestview Station and DR Horton and events hosted by Stump Fluff during the South by Southwest festival.

Provision for Income Taxes. We recorded a provision for income taxes of \$0.2 million for the second quarters of 2014 and 2013 and \$0.4 million for the first six months of 2014 and 2013. Our tax provision for both the 2014 and 2013 periods includes the Texas state margin tax. The difference between our consolidated effective income tax rate for each of the 2014 and 2013 periods, compared to the U.S. federal statutory tax rate of 35 percent, is primarily attributable to the realization of deferred tax assets.

Net Income Attributable to Noncontrolling Interests in Subsidiaries. Net income attributable to noncontrolling interests in subsidiaries totaled \$1.0 million for second-quarter 2014 and \$2.8 million for the first six months of 2014, compared with \$2.3 million for second-quarter 2013 and \$3.0 million for the first six months of 2013. The decrease in net income attributable to noncontrolling interests in subsidiaries for the 2014 periods primarily relates to fewer condominium unit sales at the W Austin Hotel & Residences project.

CAPITAL RESOURCES AND LIQUIDITY

Volatility in the real estate market, including the markets in which we operate, can impact sales of our properties. However, we believe that the unique nature and location of our assets will provide us positive cash flows. See "Business Strategy and Related Risks" for further discussion of our liquidity.

Comparison of Cash Flows for the Six Months Ended June 30, 2014 and 2013

Cash (used in) provided by operating activities totaled \$(10.6) million during the first six months of 2014, compared with \$20.4 million during the first six months of 2013. The decrease in operating cash flows is primarily related to a \$32.4 million decrease in developed property sales principally resulting from decreases in condominium unit sales at the W Austin Residences and lot sales at Verano Drive as inventories have declined. Expenditures for purchases and development of real estate properties totaled \$24.8 million during the first six months of 2014 and \$8.7 million during the first six months of 2013, and primarily included development costs for Lakeway Center and our Barton Creek properties.

Cash provided by (used in) investing activities totaled \$0.4 million during the first six months of 2014, compared with \$(1.3) million during the first six months of 2013. Stratus received distributions from Crestview Station totaling \$1.3 million during the first six months of 2014.

Cash provided by (used in) financing activities totaled \$13.1 million for the first six months of 2014, compared with \$(14.0) million for the first six months of 2013. During the first six months of 2014, net borrowings on the Comerica credit facility totaled \$16.7 million, compared with net payments of \$14.4 million for the first six months of 2013. Noncontrolling interest distributions for the Block 21 Joint Venture and the Parkside Village Joint Venture totaled \$3.6 million for the first six months of 2014, compared with distributions for the Parkside Village Joint Venture of \$0.1 million for the first six months of 2013. See "Credit Facility and Other Financing Arrangements" for a discussion of our outstanding debt at June 30, 2014.

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Credit Facility and Other Financing Arrangements

At June 30, 2014, we had total debt of \$168.9 million, compared with \$151.3 million at December 31, 2013. Our debt outstanding at June 30, 2014, consisted of the following:

\$99.0 million outstanding under the Bank of America (BoA) loan, which is secured by certain property and assets related to the W Austin Hotel & Residences project, excluding the remaining condominium units.

\$23.0 million outstanding under the five unsecured term loans with American Strategic Income Portfolio (ASIP), which include an \$8.0 million loan, a \$5.0 million loan, two \$3.5 million loans and a \$3.0 million loan.

\$17.7 million outstanding under a \$19.7 million construction loan, which is secured by the assets at Parkside Village.

\$16.7 million outstanding under the \$48 million Comerica credit facility, which is comprised of a \$35 million revolving loan, \$18.3 million of which was available at June 30, 2014; a \$3.0 million tranche for letters of credit, with no amounts outstanding (\$2.7 million of letters of credit committed); and a \$10 million construction loan, with no amounts outstanding (\$1.4 million of letters of credit committed). The Comerica credit facility is secured by substantially all of our assets except for properties that are encumbered by separate non-recourse permanent loan financing.

\$6.0 million outstanding under a term loan refinanced on June 27, 2014, which is secured by Barton Creek Village (see Note 6).

\$5.0 million outstanding under a term loan, which is secured by 5700 Slaughter.

\$1.6 million outstanding under a term loan, which is secured by land in Lakeway, Texas.

The Comerica credit facility and our ASIP unsecured term loans contain customary financial covenants, including a requirement that we maintain a minimum total stockholders' equity balance of \$110.0 million. As of June 30, 2014, Stratus' total stockholders' equity was \$124.0 million.

The following table summarizes our debt maturities as of June 30, 2014 (in thousands):

| | 2014 | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
|---------------------------------------|----------|----------|-----------|-------|-------|------------|-----------|
| BoA Loan ^a | \$750 | \$1,564 | \$96,703 | \$— | \$— | \$— | \$99,017 |
| ASIP Loans | — | 15,000 | 8,000 | — | — | — | 23,000 |
| Parkside Village Loan | — | 480 | 480 | 480 | 480 | 15,752 | 17,672 |
| Comerica Credit Facility ^b | 16,672 | — | — | — | — | — | 16,672 |
| Barton Creek Village Loan | 68 | 141 | 146 | 153 | 160 | 5,332 | 6,000 |
| 5700 Slaughter Loan ^c | 48 | 4,978 | — | — | — | — | 5,026 |
| Lakeway Center Loan | — | 1,550 | — | — | — | — | 1,550 |
| Total | \$17,538 | \$23,713 | \$105,329 | \$633 | \$640 | \$21,084 | \$168,937 |

a. The Block 21 Joint Venture has the option to extend the maturity date for up to three additional one-year terms.

b. The facility matures in November 2014.

c. On July 18, 2014, we refinanced the loan secured by 5700 Slaughter, increasing the principal balance to \$7.0 million and extending the maturity from January 31, 2015, to July 31, 2024 (see Note 10 for further discussion).

Stratus expects to repay or refinance its near-term debt maturities in the normal course of business.

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NEW ACCOUNTING STANDARDS

We do not expect the impact of recently issued accounting standards to have a significant impact on our future financial statements and disclosures.

CAUTIONARY STATEMENT

Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements in which we discuss factors we believe may affect our future performance. Forward-looking statements are all statements other than statements of historical facts, such as projections or expectations related to operational and financial performance, reimbursements for infrastructure costs, financing and regulatory matters, development plans and sales of land, units and lots, commercial leasing activities, timeframes for development, construction and completion of our projects, capital expenditures, liquidity and capital resources, results of our business strategy, and other plans and objectives of management for future operations and activities. The words "anticipates," "may," "can," "plans," "believes," "potential," "estimates," "expects," "projects," "intends," "likely," "will," "should," "to be" and any similar expressions that are not historical facts are intended to identify those assertions as forward-looking statements.

We caution readers that forward-looking statements are not guarantees of future performance, and our actual results may differ materially from those anticipated, projected or assumed in the forward-looking statements. Important factors that can cause our actual results to differ materially from those anticipated in the forward-looking statements include, but are not limited to, our ability to service our debt and the availability of financing, a decrease in the demand for real estate in the Austin, Texas market, changes in economic and business conditions, reduction in discretionary spending by consumers and corporations, competition from other real estate developers, hotel operators and/or entertainment venue operators and promoters, business opportunities that may be presented to and/or pursued by us, the failure of third parties to satisfy debt service obligations, the failure to complete agreements with strategic partners and/or appropriately manage relationships with strategic partners, the termination of sales contracts or letters of intent due to, among other factors, the failure of one or more closing conditions or market changes, the failure to attract customers for our developments or their failure to satisfy their purchase commitments, increases in interest rates, declines in the market value of our assets, increases in operating costs, including real estate taxes and the cost of construction materials, changes in external perception of the W Austin Hotel & Residences, changes in consumer preferences, changes in laws, regulations or the regulatory environment affecting the development of real estate, opposition from special interest groups with respect to development projects, weather-related risks and other factors described in more detail under "Risk Factors" in Part I, Item 1A. of our 2013 Form 10-K.

Investors are cautioned that many of the assumptions on which our forward-looking statements are based are subject to change after our forward-looking statements are made. Further, we may make changes to our business plans that could or will affect our results. We caution investors that we do not intend to update our forward-looking statements, notwithstanding any changes in our assumptions, business plans, actual experience, or other changes, and we undertake no obligation to update any forward-looking statements, except as required by law.

Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures. Our chief executive officer and chief financial officer, with the participation of management, have evaluated the effectiveness of our "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, they have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

(b) Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table sets forth shares of our common stock that we repurchased during the three months ended June 30, 2014.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ^a | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs ^a |
|---------------------|---|--|--|--|
| April 1 to 30, 2014 | 6,000 | \$16.90 | 6,000 | 994,755 |
| May 1 to 31, 2014 | — | — | — | 994,755 |
| June 1 to 30, 2014 | — | — | — | 994,755 |
| Total | 6,000 | 16.90 | 6,000 | |

In February 2001, our Board of Directors (the Board) approved an open market share purchase program for up to 0.7 million shares of our common stock. In November 2013, the Board approved an increase in the open market share purchase program from 0.7 million shares to 1.7 million shares of our common stock. The program does not have an expiration date.

Stratus' loan agreements with Comerica Bank and American Strategic Income Portfolio require approval for any common stock repurchases.

Item 6. Exhibits.

The exhibits to this report are listed in the Exhibit Index beginning on page E-1 hereof.

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SIGNATURE

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.

STRATUS PROPERTIES INC.

By: /s/ Erin D. Pickens

Erin D. Pickens
Senior Vice President and
Chief Financial Officer
(authorized signatory and
Principal Financial Officer)

Date: August 14, 2014

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EXHIBIT INDEX

| Exhibit Number | Exhibit Title | Filed with this Form 10-Q | Incorporated by Reference | | |
|----------------|---|---------------------------|---------------------------|-----------|------------|
| | | | Form | File No. | Date Filed |
| 3.1 | Composite Certificate of Incorporation of Stratus Properties Inc. | | 8-A/A | 000-19989 | 8/26/2010 |
| 3.2 | By-laws of Stratus Properties Inc., as amended as of November 6, 2007. | | 10-Q | 000-19989 | 8/11/2008 |
| 4.1 | Amended and Restated Rights Agreement, dated as of April 13, 2012, between Stratus Properties Inc. and Computershare Shareowner Services LLC, as Rights Agent, which includes the Form of Certificate of Designations of Series C Participating Cumulative Preferred Stock, the Form of Right Certificate, and the Summary of Stockholder Rights. | | 8-K | 000-19989 | 4/18/2012 |
| 4.2 | Investor Rights Agreement by and between Stratus Properties Inc. and Moffett Holdings, LLC, dated as of March 15, 2012. | | 8-K | 000-19989 | 3/20/2012 |
| 4.3 | Assignment and Assumption Agreement by and between Moffett Holdings, LLC and LCHM Holdings, LLC. | | 13D | 000-19989 | 3/5/2014 |
| <u>31.1</u> | Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a). | X | | | |
| <u>31.2</u> | Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a). | X | | | |
| <u>32.1</u> | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350. | X | | | |
| <u>32.2</u> | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350. | X | | | |
| 101.INS | XBRL Instance Document. | X | | | |
| 101.SCH | XBRL Taxonomy Extension Schema. | X | | | |
| 101.CAL | | X | | | |

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XBRL Taxonomy Extension Calculation
Linkbase.

| | | |
|---------|---|---|
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase. | X |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. | X |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase. | X |

E-1