

INCOME OPPORTUNITY REALTY INVESTORS INC /TX/

Form 10-Q

May 15, 2008

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

or

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

For the transition period from to

Commission File Number 001-14784

**INCOME OPPORTUNITY REALTY INVESTORS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Nevada**  
**(State or Other Jurisdiction of**  
**Incorporation or Organization)**

**75-2615944**  
**(I.R.S. Employer**  
**Identification No.)**

**1800 Valley View Lane, Suite 300**

**Dallas, Texas 75234**

**(Address of principal executive offices)**

**(Zip Code)**

**(469) 522-4200**

**(Registrant's telephone number, including area code)**

**(Former name, former address and former fiscal year, if changed since last report)**

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a Smaller reporting company. See definitions of Large accelerated filer, accelerated filer, Non-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

(Do not check if a smaller reporting company)

Edgar Filing: INCOME OPPORTUNITY REALTY INVESTORS INC /TX/ - Form 10-Q

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE**

**PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No .

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

**Common Stock, \$.01 par value**  
(Class)

**4,162,574**  
(Outstanding at April 30, 2008)

**Table of Contents**

**INCOME OPPORTUNITY REALTY INVESTORS, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

Item 1. <u>Financial Statements</u>	
<u>Consolidated Balance Sheets at March 31, 2008 (unaudited) and December 31, 2007</u>	3
<u>Consolidated Statements of Operations for the three months ended March 31, 2008 and 2007 (unaudited)</u>	4
<u>Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2008 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2008 and 2007 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	17
Item 4. <u>Controls and Procedures</u>	17
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	18
Item 6. <u>Exhibits</u>	18
<u>SIGNATURE PAGE</u>	19
<u>CERTIFICATIONS</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****INCOME OPPORTUNITY REALTY INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS****(unaudited)**

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
	<b>(dollars in thousands)</b>	
<b>Assets</b>		
Real estate held for investment	\$ 43,027	\$ 43,027
Less accumulated depreciation	(2,544)	(2,456)
	40,483	40,571
Real estate held for sale		17,032
Notes and interest receivable from affiliates	27,441	27,441
Investment in real estate partnerships	110	532
Cash and cash equivalents	101	267
Receivables from affiliates	43,882	27,801
Other assets	1,177	2,663
	\$ 113,194	\$ 116,307
<b>Liabilities and Stockholders Equity</b>		
<b>Liabilities:</b>		
Notes and interest payable	\$ 44,439	\$ 44,354
Liabilities related to assets held for sale		25,152
Other liabilities (including \$1,888 in 2008 and \$0 in 2007 from affiliates and related parties)	4,723	2,057
	49,162	71,563
Commitments and contingencies		
Minority interest		677
<b>Stockholders equity:</b>		
Common Stock, \$.01 par value, authorized 10,000,000 shares; issued and outstanding 4,162,774 and 4,162,774 shares at 2008 and 2007, respectively.	42	42
Treasury stock	(37)	(37)
Paid-in capital	61,955	61,955
Accumulated earnings (deficit)	2,072	(17,893)
	64,032	44,067
	\$ 113,194	\$ 116,307

The notes are an integral part of the consolidated financial statements.



**Table of Contents****INCOME OPPORTUNITY REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

	<b>For the Three Months Ended March 31</b>	
	<b>2008</b>	<b>2007</b>
	<b>(dollars in thousands)</b>	
Property revenue		
Rents and other property revenues	\$ 556	\$ 579
Operating expenses:		
Property operations	1,053	496
Depreciation	88	87
General and administrative	115	135
Advisory fee to affiliate	227	211
Total operating expenses	1,483	929
Operating income (loss)	(927)	(350)
Other income (expense):		
Interest income (including \$698 in 2008 and \$514 in 2007 from affiliates and related parties)	698	1,099
Mortgage and loan interest	(904)	(836)
Net income fee		(5)
Total other income	(206)	258
Income (loss) before gain on land sales, equity in earnings of investees and minority interest	(1,133)	(92)
Minority interests		(38)
Income tax benefit	7,384	69
Net income (loss) from continuing operations	6,251	(61)
Discontinued operations	21,098	196
Income tax expense	(7,384)	(69)
Net income from discontinued operations	13,714	127
Net income applicable to common shares	\$ 19,965	\$ 66
Earnings per share		
Net income (loss) from continuing operations	1.50	(0.01)
Net income from discontinued operations	3.29	0.03
Net income applicable to common shares	\$ 4.79	\$ 0.02
Weighted average Common shares used in computing earnings per share	4,162,774	4,167,635

The notes are an integral part of the consolidated financial statements.





**Table of Contents**

**INCOME OPPORTUNITY REALTY INVESTORS, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

**For the Three Months Ended March 31, 2008**

(dollars in thousands)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Treasury Stock Shares	Treasury Stock Amount	Paid-in Capital	Accumulated Deficit	Stockholders Equity
<b>Balance, December 31, 2007</b>	4,168,035	\$ 42	5,261	\$ (37)	\$ 61,955	\$ (17,893)	\$ 44,067
Net Income						19,965	19,965
<b>Balance, March 31, 2008</b>	4,168,035	\$ 42	5,261	\$ (37)	\$ 61,955	\$ 2,072	\$ 64,032

The notes are an integral part of the consolidated financial statements.

**Table of Contents****INCOME OPPORTUNITY REALTY INVESTORS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	<b>For the Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(dollars in thousands)</b>	
<b>Cash Flows From Operating Activities</b>		
Net income applicable to common shareholders	\$ 19,965	\$ 66
Adjustments to reconcile net income applicable to common shares to net cash used in operating activities		
Gain on sale of income producing properties	(29,367)	
Depreciation and amortization	88	283
(Increase) decrease in assets		
Accrued interest receivable		(481)
Other assets	1,486	487
Increase (decrease) in liabilities		
Accrued interest payable		50
Minority interests	(677)	37
Other liabilities	2,666	(1,087)
<b>Net cash used in operating activities of continuing operations</b>	<b>(5,839)</b>	<b>(645)</b>
<b>Cash Flows From Investing Activities</b>		
Proceeds from sale of real estate	46,399	
Advances/deposits from (to) advisors and affiliates	(16,081)	714
<b>Net cash provided by investing activities</b>	<b>30,318</b>	<b>714</b>
<b>Cash Flows From Financing Activities</b>		
Payments on notes payable	(25,067)	(84)
Sale of investments	422	
<b>Net cash (used in) financing activities of continuing operations</b>	<b>(24,645)</b>	<b>(84)</b>
Net decrease in cash and cash equivalents	(166)	(15)
Cash and cash equivalents, beginning of year	267	80
Cash and cash equivalents, end of year	\$ 101	\$ 65
<b>Supplemental disclosure of noncash investing and financing activities</b>		
Cash paid for interest expense	3,461	1,284
Cash paid for income taxes		

The notes are an integral part of the consolidated financial statements

**Table of Contents****NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

Income Opportunity Realty Investors, Inc. ( IORI , we , us , our or the Company ) a Nevada corporation, is the successor to a California business trust organized on December 14, 1984. Syntek West, Inc. (SWI) owns approximately 54% of the outstanding shares of IORI. SWI is also our contractual advisor. We are an externally advised and managed real estate investment company. We have no employees.

*Properties*

At March 31, 2008, the Company owned or had interests in a portfolio of four properties; one apartment complex, and three commercial buildings consisting of an office building, a shopping center, and an Warehouse. The commercial properties have an aggregate 202,000 square feet of leasable space.

The accompanying interim financial statements are unaudited; however, the financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting solely of normal recurring matters) necessary for a fair statement of the financial statements for these interim periods have been included. The results of operations for the interim periods are not necessarily indicative of the results to be obtained for other interim periods or for the full fiscal year. The year end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosure required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the Company's financial statements and notes thereto contained in the Company's Annual Report in the Company's Form 10-K for its fiscal year ended December 31, 2007.

Dollar amounts in tables are in thousands, except per share amounts.

Certain balances from 2007 have been reclassified to conform to the 2008 presentation.

*Newly issued accounting standards*

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ( SFAS 141R ), *Business Combinations*. SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combinations. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. Accordingly, any business combinations the Company engages in will be recorded and disclosed following existing accounting principles until January 1, 2009. The Company expects SFAS 141R will affect the Company's consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, term and size of the acquisitions, if any, the Company consummates after the effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, effective for financial statements issued for fiscal years beginning after December 15, 2008. SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, and will impact the recording of minority interest. The Company is currently evaluating the effects the adoption of SFAS No. 160 will have on its financial position and results of operations.

**NOTE 2 REAL ESTATE ACTIVITY**

On January 25, 2008 we sold six apartment complexes which were all located in Midland, Texas in a single transaction. We sold the properties for an aggregate sales price of \$50.0 million, receiving \$20.7 million in cash after paying off \$25.1 million in existing debt. We recorded a \$29.4 million gain on sale as follows:

Property	Location	Number of Units	Sales price	Net Cash Received	Debt Discharged	Gain on Sale
----------	----------	--------------------	-------------	----------------------	--------------------	-----------------

Edgar Filing: INCOME OPPORTUNITY REALTY INVESTORS INC /TX/ - Form 10-Q

Brighton Court	Midland, TX	60 Units	\$ 5,886	\$ 230	\$ 2,727	\$ 2,862
Del Mar	Midland, TX	92 Units	7,235	4,852	2,613	4,303
Enclave	Midland, TX	68 Units	7,068	4,687	2,765	4,138
Meridian	Midland, TX	230 Units	17,197	5,872	10,800	10,350
Signature Place	Midland, TX	57 Units	5,563	3,210	1,477	3,160
Sinclair Place	Midland, TX	114 Units	6,614	1,805	4,611	4,554
			\$ 49,563	\$ 20,656	\$ 24,993	\$ 29,367

**Table of Contents****NOTE 3. DISCONTINUED OPERATIONS**

The Company applies the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 requires that long-lived assets that are to be disposed of by sale be measured at the lesser of (1) book value or (2) fair value less cost to sell. In addition, it requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions.

During the three months ended March 31, 2008, the Company sold the following properties which were all located in Midland, Texas:

Brighton Court, a 60 unit apartment complex.

Del Mar, a 92 unit apartment complex.

Enclave, a 68 unit apartment complex.

Meridian, a 230 unit apartment complex.

Signature Place, a 57 unit apartment complex.

Sinclair Place, a 114 unit apartment complex.

The following table summarizes income from discontinued operations and the related realized gains on sales of real estate from discontinued operations for the three months ended March 31, 2008.

	<b>For the Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenue</b>		
Rental	\$ 586	\$ 1,509
Property operations	427	610
	159	899
<b>Expenses</b>		
Interest	(2,517)	(584)
G&A	(1,002)	(8)
Depreciation		(111)
	(3,519)	(703)
Net loss from discontinued operations before gains on sale of real estate	(3,360)	196
Gain on sale of discontinued operations	29,367	
Net Sales fee to affiliate	(4,909)	
Income (loss) from discontinued operations	21,098	196
Tax benefit	(7,384)	(69)

## Edgar Filing: INCOME OPPORTUNITY REALTY INVESTORS INC /TX/ - Form 10-Q

Income (loss) from discontinued operations	\$ 13,714	\$ 127
--	-----------	--------

The Company's application of SFAS No. 144 results in the presentation of the net operating results of these qualifying properties sold or held for sale during 2008 as income from discontinued operations. The application of SFAS No. 144 does not have an impact on net income available to common shareholders. SFAS No. 144 only impacts the presentation of these properties within the Consolidated Statements of Operations.

**Table of Contents****NOTE 4. NOTES AND INTEREST RECEIVABLE**

The notes receivables consists of eight notes aggregating \$26.0 million. The notes accrue interest at 10.0% to 12.0% with maturity dates ranging from December 2008 to December 2013. The notes are primarily excess cash flow notes.

<b>Borrower</b>	<b>Maturity</b>	<b>Principal Balance</b>	<b>Interest Rate</b>
Housing for Seniors of Humble, LLC	12/27/09	\$ 2,000	11.50%
Housing for Seniors of Humble, LLC	12/27/09	6,363	11.50%
Unified Housing Foundation, Inc. (Marquis at VR)	12/10/13	2,734	12.00%
Unified Housing Foundation, Inc. (Echo Station)	12/26/13	1,668	12.00%
Unified Housing Foundation, Inc.	09/15/10	2,990	10.00%
Unified Housing Foundation, Inc. (Parkside Crossing)	12/29/13	1,936	12.00%
Unified Housing Foundation, Inc. (Timbers of Terrell)	12/18/08	1,323	12.00%
Centura Land Mortgage (due from Transcontinental Realty Investors, Inc - a related party)	08/22/08	7,000	Prime + 2%
Accrued Interest		1,427	
		\$ 27,441	

**NOTE 5. NOTES AND INTEREST PAYABLE**

The following table lists the mortgage notes payable as of March 31, 2008;

<b>Project</b>	<b>Maturity</b>	<b>Principal Balance</b>
Falcon Point *	08/31/08	\$ 950
2010 Valley View	10/03/08	2,131
Eagle Crest	11/01/11	2,419
Parkway Center	06/01/36	2,659
Centura Land	08/28/08	7,000
Travelers Land *	08/10/08	28,652
Accrued Interest		628
		\$ 44,439

\* Variable rate

**NOTE 6 ADVISORY AGREEMENT**

The Company has an Advisory Agreement with Syntek West, Inc. ( SWI ), wherein SWI is responsible for the Company's day-to-day operations. SWI must formulate and submit to IORI's Board of Directors for approval an annual budget and business plan containing a twelve month forecast of operations and cash flow with a general plan for asset sales and purchases, borrowing activity and other investments. SWI reports to the Board quarterly on IORI's performance against the business plan. The Advisory Agreement further places SWI in a fiduciary relationship to IORI's stockholders and contains a broad standard governing SWI's liability for any losses incurred by IORI.

SWI receives, as compensation for its management and advice, monthly advisory fees based on 6 1/2% of IORI's assets annually as well as specific fees for assisting IORI in obtaining financing and completing acquisitions. If IORI's operating expenses exceed limits specified in the Advisory Agreement SWI is obligated to refund a portion of the advisory fees.

## Edgar Filing: INCOME OPPORTUNITY REALTY INVESTORS INC /TX/ - Form 10-Q

Effective July 1, 2005, the Company and SWI entered into a Cash Management Agreement to further define the administration of the Company's day-to-day investment operations, relationship contacts, flow of funds and deposit and borrowing of funds. Under the Cash Management Agreement, all funds of the Company are delivered to SWI which has a deposit liability to the Company and is responsible for investment of all excess funds, which earn interest at the *Wall Street Journal* Prime Rate plus one percent per annum, set quarterly on the first day of each calendar quarter. Borrowings for the benefit of the Company bear the same interest rate. The Cash Management Agreement and the Advisory Agreement are automatically renewed each year unless terminated by SWI and IORI.



**Table of Contents**

SWI also receives a Net Income Fee calculated as 7.5% of IORI's net income.

<b>Revenue, fees, interest on cash advances and cost reimbursements to SWI</b>	<b>For Three Months Ended March 31</b>	
	<b>2008</b>	<b>2007</b>
Advisory fees to SWI	\$ 227	\$ 211
Net sales fee to SWI	\$ 3,100	\$
Net income fee to SWI	\$ 1,809	\$ 5
Interest income on cash advances to IORI	\$ (698)	\$ (335)

**NOTE 7. RECEIVABLE FROM AND PAYABLE TO AFFILIATES**

From time to time, IORI and its affiliates and related parties have made unsecured advances to each other. In addition, IORI and its affiliates have entered into transactions involving the purchase, sale, and financing of property. The table below reflects the various transactions between IORI, SWI, and TCI.

	<b>SWI</b>	<b>TCI</b>	<b>Total</b>
Balance, December 31, 2007	\$ 25,960	\$ 1,841	\$ 27,801
Cash received	(1,224)		(1,224)
Cash payments	19,547		19,547
Other additions	927	159	1,086
Other repayments	(3,328)		(3,328)
Balance, March 31, 2008	\$ 41,882	\$ 2,000	\$ 43,882

**NOTE 8. OPERATING SEGMENTS**

Significant differences among the accounting policies of the operating segments as compared to the Consolidated Financial Statements principally involve the calculation and allocation of administrative expenses. Management evaluates the performance of each of the operating segments and allocates resources to them based on their operating income and cash flow. There are no intersegment revenues and expenses and IORI conducted all of its business within the United States.

**Table of Contents**

Presented below is operating segment information for the three months ended March 31, 2008 and 2007 (dollars in thousands):

	Commercial Properties	Apartments	Land	Corporate	Total
<b>3/31/2008</b>					
Operating revenue	\$ 325	\$ 231	\$	\$	\$ 556
Operating expenses	358	278	319	98	1,053
Depreciation and amortization	59	29			88
Mortgage and loan interest	141	22	723	18	904
Interest income				698	698
Gain on land sales					
Segment operating income (loss)	\$ (233)	\$ (98)	\$ (1,042)	\$ 582	\$ (791)
<b>Capital expenditures</b>					
Assets	9,803	3,323	25,304	72,535	110,965
<b>Property Sales</b>					
Sales price	\$	\$ 49,563	\$	\$	\$ 49,563
Cost of sale		20,196			20,196
Deferred current gain					
Recognized prior deferred gain					
Gain on sale	\$	\$ 29,367	\$	\$	\$ 29,367
<b>3/31/2007</b>					
Operating revenue	\$ 336	\$ 243	\$	\$	\$ 579
Operating expenses	167	248	75	6	496
Depreciation and amortization	57	30			87
Mortgage and loan interest	136		700		836
Interest income				1,099	1,099
Gain on land sales					
Segment operating income (loss)	\$ (24)	\$ (35)	\$ (775)	\$ 1,093	\$ 259
<b>Capital expenditures</b>					
Assets	24				24
Assets	9,760	5,220	26,598	47,345	88,923
<b>Property Sales</b>					
Sales price	\$	\$	\$	\$	\$
Cost of sale					
Deferred current gain					
Recognized prior deferred gain					
Gain on sale	\$	\$	\$	\$	\$

**Table of Contents**

The tables below reconcile the segment information to the corresponding amounts in the Consolidated Statements of Operations:

	3/31/2008	3/31/2007
Segment operating income (loss)	\$ (791)	\$ 259
Other non-segment items of income/(expense)		
General and administrative	(115)	(135)
Advisory Fee	(227)	(211)
Net income fee to affiliate		(5)
Equity in earnings of investees		(38)
Deferred tax	7,384	69
Minority interest		
Income (loss) from continuing operations	\$ 6,251	\$ (61)

**SEGMENT ASSET RECONCILIATION TO TOTAL ASSETS**

	3/31/2008	3/31/2007
Segment assets	\$ 110,965	\$ 88,923
Investments in real estate partnerships	110	515
Other Assets and Receivables	2,119	1,423
Assets held for sale		17,032
Total assets	\$ 113,194	\$ 107,893

**NOTE 9. COMMITMENTS AND CONTINGENCIES**

*Litigation.* IORI is also involved in various lawsuits arising in the ordinary course of business. Management is of the opinion that the outcome of these lawsuits will have no material impact on the Company's financial condition, results of operations or liquidity.

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
WARNING CONCERNING FORWARD-LOOKING STATEMENTS**

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

This Report on Form 10-Q may contain forward-looking statements within the meaning of the federal securities laws, principally, but not only, under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations. We caution investors that any forward-looking statements in this report, or which management may make orally or in writing from time to time, are based on management's beliefs and on assumptions made by, and information currently available to, management. When used, the words anticipate, believe, expect, intend, may, might, plan, estimate, project, should, will, result and similar expressions which do not relate solely to historical matters are intended to identify forward-looking statements. These statements are subject to risks, uncertainties and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution you that, while forward-looking statements reflect our good faith beliefs when we make them, they are not guarantees of future performance and are impacted by actual events when they occur after we make such statements. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

## Edgar Filing: INCOME OPPORTUNITY REALTY INVESTORS INC /TX/ - Form 10-Q

Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the factors listed and described at Item 1A. Risk Factors in the Company's Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company's Form 10-K for the fiscal year ended December 31, 2007.

## **Table of Contents**

Other sections of this report may also include suggested factors that could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not possible for management to predict all such matters; nor can we assess the impact of all such matters on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Investors should also refer to our quarterly reports on Form 10-Q for future periods and current reports on Form 8-K as we file them with the Securities and Exchange Commission ( SEC ) and to other materials we may furnish to the public from time to time through Forms 8-K or otherwise.

### ***Overview***

IORI invests in equity interests in real estate through acquisitions, leases, partnerships and in mortgage loans. IORI is the successor to a California business trust organized on December 14, 1984, which commenced operations on April 10, 1985.

### ***Critical Accounting Policies***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or GAAP, requires management to use judgment in the application of accounting policies, including making estimates and assumptions. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of our financial statements. From time-to-time, we evaluate our estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. Below is a discussion of accounting policies that we consider critical in that they may require complex judgment in their application or require estimates about matters that are inherently uncertain.

### ***Real Estate Held for Investment***

Real estate held for investment is carried at cost. Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS No. 144 ), requires that a property be considered impaired if the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the property. If impairment exists, an impairment loss is recognized, by a charge against earnings, equal to the amount by which the carrying amount of the property exceeds the fair value less cost to sell the property. If impairment of a property is recognized, the carrying amount of the property is reduced by the amount of the impairment, and a new cost for the property is established. Such new cost is depreciated over the property's remaining useful life. Depreciation is provided by the straight-line method over estimated useful lives, which range from five to 40 years.

### ***Real Estate Held-for-Sale***

Foreclosed real estate is initially recorded at new cost, defined as the lower of original cost or fair value minus estimated costs of sale. SFAS No. 144 also requires that properties held-for-sale be reported at the lower of carrying amount or fair value less costs of sale. If a reduction in a held-for-sale property's carrying amount to fair value less costs of sale is required, a provision for loss is recognized by a charge against earnings. Subsequent revisions, either upward or downward, to a held-for-sale property's estimated fair value less costs of sale are recorded as an adjustment to the property's carrying amount, but not in excess of the property's carrying amount when originally classified as held-for-sale. A corresponding charge against or credit to earnings is recognized. Properties held for sale are not depreciated.

### ***Investments in Equity Investees***

IORI may be considered to have the ability to exercise significant influence over the operating and investment policies of certain of its investees. Those investees are accounted for using the equity method. Under the equity method, an initial investment, recorded at cost, is increased by a proportionate share of the investee's operating income and any additional investment and decreased by a proportionate share of the investee's operating losses and distributions received.

## **Table of Contents**

### ***Recognition of Rental Income***

Rental income for commercial property leases is recognized on a straight-line basis over the respective lease terms. Rental income for residential property leases is recorded when due from residents and is recognized monthly as earned, which is not materially different than on a straight-line basis as lease terms are generally for periods of one year or less.

### ***Revenue Recognition on the Sale of Real Estate***

Sales of real estate are recognized when and to the extent permitted by Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate* ( SFAS No. 66 ), as amended by SFAS No. 144. Until the requirements of SFAS No. 66 for full profit recognition have been met, transactions are accounted for using the deposit, installment, cost recovery or financing method, whichever is appropriate. When IORI provides seller financing, gain is not recognized at the time of sale unless the buyer's initial investment and continuing investment are deemed to be adequate as determined by SFAS No. 66 guidelines.

### ***Non-Performing Notes Receivable***

IORI considers a note receivable to be non-performing when the maturity date has passed without principal repayment and the borrower is not making interest payments. Any new note receivable that results from a modification or extension of a note considered non-performing will also be considered non-performing, without regard to the borrower's adherence to payment terms.

### ***Interest Recognition on Notes Receivable***

Interest income is not recognized on notes receivable that have been delinquent for 60 days or more. In addition, accrued but unpaid interest income is only recognized to the extent that the net realizable value of the underlying collateral exceeds the carrying value of the receivable.

### ***Allowance for Estimated Losses***

A valuation allowance is provided for estimated losses on notes receivable considered to be impaired. Impairment is considered to exist when it is probable that all amounts due under the terms of the note will not be collected. Valuation allowances are provided for estimated losses on notes receivable to the extent that the investment in the note exceeds management's estimate of the fair value of the collateral securing such note.

### ***Fair Value of Financial Instruments***

The following assumptions were used in estimating the fair value of its notes receivable, marketable equity securities, and notes payable. For performing notes receivable, the fair value was estimated by discounting future cash flows using current interest rates for similar loans. For non-performing notes receivable, the estimated fair value of IORI's interest in the collateral property was used. For marketable equity securities, fair value was based on the year-end closing market price of each security. For notes payable, the fair value was estimated using current rates for mortgages with similar terms and maturities.

### ***Liquidity and Capital Resources***

#### ***General***

Our principal liquidity needs are:

Meeting debt service requirements including balloon payments;

Funding normal recurring expenses;

Funding capital expenditures; and

Funding new property acquisitions.

Cash and equivalents totaled \$101,000 and \$267,000 at March 31, 2008 and December 31, 2007, respectively. Our primary source of cash is from the refinancing of existing mortgages, rents, receivables, and sale of assets. In 2008, we will refinance debt obligations as

## **Table of Contents**

they become due and generate excess cash from operations and sale of properties. However, if refinancing and excess cash from operations does not prove to be sufficient to satisfy all our obligations as they mature, we may sell income-producing real estate, refinance real estate, and incur additional borrowings secured by real estate to meet our cash requirements. We anticipate that our cash from the sale of properties in the first quarter will be sufficient to meet our liquidity needs.

### ***Cash flow summary***

The following summary discussion of our cash flows is based on the consolidated statement of cash flows from ITEM 1 Financial Statements and is not meant to be an all inclusive discussion of the changes in our cash flows for the periods presented.

Cash and cash equivalents were \$101,000 as of the three months ended March 31, 2008 as compared to \$65,000 as of the same period ended 2007. During the three month period ended March 31, 2008 our cash used in operating activities was (\$5.8 million), cash provided by investing activities was \$30.3 million and our cash used in financing activities was (\$24.6 million).

Cash used in operating activities of \$5.8 million was primarily due to the payment \$5.0 million in sales incentive fees which was in addition to our normal operating cash requirements. This fee relates to the sale of the six apartment complexes sold in January.

Cash provided by investing activities of \$30.3 million was due to receiving \$46.4 million on the sale of six apartment complexes in January 2008. We sold the Brighton, Enclave, Delmar, Sinclair, Meridian, and Signature apartments. The excess cash of \$16.1, after paying down our existing notes on those properties, closing cost and other operating expenses, was transferred to our advisor per the cash management agreement. Effective June 2005 the advisory agreement was amended to provide that we would receive or pay interest to or from the advisor for funds loaned to or borrowed from the advisor. The interest rate on the transfers is 1% plus prime.

Cash used in financing activities was \$24.6 million. The majority of this was used to pay down \$25.1 million of existing mortgages on the six properties that were sold in January.

We did not pay quarterly dividends in 2008 or 2007.

Management reviews the carrying values of IORI's properties at least annually or whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if, in the case of a property, the future cash flow from the property (undiscounted and without interest) is less than the carrying amount of the property. If impairment is found to exist, a provision for loss is recorded by a charge against earnings. The property review generally includes selective property inspections, discussions with the manager of the property, visits to selected properties in the area and a review of the following: (1) the property's current rents compared to market rents, (2) the property's expenses, (3) the property's maintenance requirements and (4) the property's cash flows.

### ***Results of Operations***

The following discussion is based on our consolidated financial statements for the three months ended March 31, 2008 and 2007. The following summary discussion is based on the consolidated statements of operations from ITEM 1 and is not meant to be an all inclusive discussion of the changes in our net income applicable to common shareholders.

Our net income applicable to common shares was \$20.0 million which includes income from discontinued operations of \$13.7 million for the three months ended March 31, 2008, as compared to net income applicable to common shares of \$66,000 which includes income from discontinued operations of \$127,000 for the same period ended 2007.

Rents and other property revenues were \$556,000 for the three months ended March 31, 2008 as compared to \$579,000 for the same period ended 2007, a decrease of \$23,000. This is relatively consistent and comparable to prior year as there have been no significant changes within our same property portfolio.

Property operations expenses were \$1.1 million for the three months ended March 31, 2008 as compared to \$496,000 for the same period ended 2007, an increase of \$557,000 this is primarily due to writing off \$500,000 in our investment in Nakash Income Associates.

Interest income was \$698,000 for the three months ended March 31, 2008 as compared to \$1.1 million for the same period ended 2007. In 2008, the Company has approximately \$27 million of notes receivable from an affiliated entity, Unified Housing Foundation. The terms of the notes provide that interest will only be paid from excess cash flow from the properties. Beginning in 2008, the Company discontinued accruing



interest on the notes receivable until cash is received.

**Table of Contents**

Mortgage and loan interest expenses were \$904,000 for the three months ended March 31, 2008 as compared to \$836,000 for the same period ended 2007, an increase of approximately \$68,000. This is relatively consistent with the prior period.

Income from discontinued operations was \$13.7 million which includes gain on sale of income producing properties of \$29.4 million, offset by mortgage interest expense of \$2.5 million, sales incentive fee of \$5.0 million and tax expense of \$7.4 million for the three months ended March 31, 2008 as compared to \$127,000 which includes interest expense of \$584,000, and tax expense of \$69,000 for the three months ended 2007. Discontinued operations included 6 apartment complexes that were all sold in January 2008.

	For the Three Months Ended March 31,	
	2008	2007
<b>Revenue</b>		
Rental	\$ 586	\$ 1,509
Property operations	427	610
	159	899
<b>Expenses</b>		
Interest	(2,517)	(584)
G&A	(1,002)	(8)
Depreciation		(111)
	(3,519)	(703)
Net loss from discontinued operations before gains on sale of real estate	(3,360)	196
Gain on sale of discontinued operations	29,367	
Net Sales fee to affiliate	(4,909)	
Income (loss) from discontinued operations	21,098	196
Tax expense	(7,384)	(69)
Income (loss) from discontinued operations	\$ 13,714	\$ 127

**Related Party Transactions**

Historically, IORI, ARI, Regis Realty I, LLC ( Regis I ), and TCI have each engaged in and may continue to engage in business transactions, including real estate partnerships with related parties. Management believes that all of the related party transactions represented the best investments available at the time and were at least as advantageous to IORI, ARI, Regis I and TCI as could have been obtained from unrelated third parties.

**Income Taxes**

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. IORI has alternative minimum tax credit carryforwards available for 2008 and has a loss for federal income tax purposes for the first three months of 2008; therefore, it recorded no provision for income taxes.

At March 31, 2008, IORI had a net deferred tax asset of approximately \$3.2 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that IORI will realize the benefit of the deferred tax asset, a 100% valuation allowance has been established.

**Inflation**

The effects of inflation on IORI's operations are not quantifiable. Revenues from apartment operations tend to fluctuate proportionately with inflationary increases and decreases in housing costs. Fluctuations in the rate of inflation also affect the sales value of properties and the ultimate gain to be realized from property sales. To the extent that inflation affects interest rates, earnings from short-term investments and the cost of new financings, as well as the cost of variable interest rate debt, will be affected.

**Table of Contents****Environmental Matters**

Under various federal, state and local environmental laws, ordinances and regulations, IORI may be potentially liable for removal or remediation costs, as well as certain other potential costs, relating to hazardous or toxic substances (including governmental fines and injuries to persons and property) where property-level managers have arranged for the removal, disposal or treatment of hazardous or toxic substances. In addition, certain environmental laws impose liability for release of asbestos-containing materials into the air and third parties may seek recovery for personal injury associated with such materials.

Management is not aware of any environmental liability relating to the above matters that would have a material adverse effect on IORI's business, assets or results of operations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES REGARDING MARKET RISK**

At March 31, 2008 IORI's exposure to a change in interest rates on its debt was as follows:

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
Notes payable:			
Variable rate	\$ 7,950,000	7.37%	\$ 79,500
Total decrease in IORI's annual net income			79,500
Per share			\$ .02

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, our management, with the participation of our Principal Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Principal Executive Officer and Interim Chief Financial Officer concluded that these 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. No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the first quarter of our fiscal year ending March 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the period of time covered by the Report, Income Opportunity Realty Investors, Inc. did not repurchase shares of its equity securities. The following table sets forth a summary for the quarter indicating the repurchases made and that at the end of the period covered by this Report, a specified number of shares may yet be purchased under the programs specified below:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>Maximum Number of Shares that May Yet be Purchased Under the Program<sup>(a)</sup></b>
Balance as of December 31, 2007			810,072	89,928
January 1-31, 2008			810,072	89,928
February 1-28, 2008			810,072	89,928
March 1-31, 2008			810,072	89,928
<b>Total</b>				

<sup>(a)</sup> On June 23, 2000, the IORI Board of Directors approved a share repurchase program for up to 900,000 shares of our common stock. This repurchase program has no termination date.

**ITEM 6. EXHIBITS**

The following documents are filed herewith as exhibits or incorporated by reference as indicated:

<b>Exhibit Number</b>	<b>Description</b>
3.0	Articles of Incorporation of Income Opportunity Realty Investors, Inc., (incorporated by reference to Appendix C to the Registrant's Registration Statement on Form S-4, dated February 12, 1996).
3.1	Bylaws of Income Opportunity Realty Investors, Inc. (incorporated by reference to Appendix D to the Registrant's Registration Statement on Forms S-4 dated February 12, 1996).
10.0	Advisory Agreement dated as of July 1, 2003 between Income Opportunity Realty Investors, Inc. and Syntek West, Inc. (incorporated by reference to Exhibit 10.0 to the registrant's current on Form 10-Q for event of July 1, 2003).
31.1*	Certification by President and Chief Operating Officer and Principal Executive Officer Pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
31.2*	Certification by Executive Vice President and Interim Chief Financial Officer Pursuant to Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended.
32.1*	Certification pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* filed herewith

**Table of Contents**

**SIGNATURE PAGE**

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.

INCOME OPPORTUNITY REALTY INVESTORS, INC.

Date: May 15, 2008

By: /s/ Daniel J. Moos  
Daniel J. Moos  
President and Chief Operating Officer

(Principal Executive Officer)

Date: May 15, 2008

By: /s/ Gene S. Bertcher  
Gene S. Bertcher  
Executive Vice President and Interim Chief Financial Officer