INCOME OPPORTUNITY REALTY INVESTORS INC /TX/
Form 10-K/A
September 07, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 5(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2003

OR

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

Commission File Number 001-14784

Income Opportunity Realty Investors, Inc.

(Exact name of registrant as specified in its charter)

Nevada	**75-2615944**
(State or other jurisdiction of Incorporation or organization)	(IRS Employer Identification Number)
1755 Wittington Place, Suite 340, Dallas, Texas	**75234**
(Address of principal executive offices)	(Zip Code)

Registrant s Telephone Number, including area code **214-750-5800**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
Common Stock, $0.01 par value	**American Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **None**

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** þ **No** o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). **Yes** o **No** þ

The aggregate market value of the shares of voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the closing sales price of the Common Stock on the American Stock Exchange as of June 30, 2003 (the last business day of the Registrant s most recently completed second fiscal quarter) was $4,198,758 based upon a total of 298,844 shares held as of June 30, 2003 by persons believed to be non-affiliates of the Registrant. The basis of the calculation does not constitute a determination by the Registrant as defined in Rule 405 of the Securities Act of 1933, as amended, such calculation, if made as of a date within sixty days of this filing, would yield a different value. As of March 19, 2004, there were 1,438,945 shares of common stock

outstanding.

Documents Incorporated by Reference:
NONE

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AMENDMENT NO. 1 TO
ANNUAL REPORT ON FORM 10-K FOR
INCOME OPPORTUNITY REALTY INVESTORS, INC.

The undersigned Registrant hereby amends the following items, exhibits, or other portions of its Annual Report on Form 10-K for the fiscal year ended December 31, 2003 as set forth below and as reflected in the substituted pages attached hereto which replace the same numbered pages in the original filing (this Amendment No. 1 is necessary by virtue of an identified accounting error in the financial statements related to formation of certain partnerships with Metra Capital LLC in April 2002, which error evolved in the establishment of the process relating to accounting for a deferral of operating income or expense from the properties in question until the sale of the applicable property; the error correction necessitates the changes described below):

Page 16 Item 6. Selected Financial Data. The table under this subcaption has been replaced based upon changes in the financial statements described below with respect to the years 2003 and 2002.

Pages 17-24 Item 7. Management s Discussion and Analysis of Results of Operations. This item has been amended to conform the appropriate references to the financial statement changes described below.

Pages 25-59 Item 8. Financial Statements and Supplementary Data. The Reports of Independent Registered Public Accounting Firms (pages 26-27) have been updated for a subsequent review. The consolidated balance sheets, consolidated statements of operations, consolidated statements of stockholders equity and consolidated statements of cash flows (pages 28-33) and Notes to Consolidated Financial Statements (pages 34-56) have been revised in the following respects:
Increase in interest expense by $458,000 from a reported $2,105,000 to $2,563,000.

Decrease in advisory fee by $1,000 from a reported $425,000 to $424,000.

Decrease in net income fee by $21,000 from a reported $130,000 to $109,000.

Increase in total other expense by $436,000 from a reported $5,486,000 to $5,922,000.

Decrease in net income by $436,000 from a reported $1,782,000 to $1,346,000.

Decrease in net income per share by $0.30 from a reported $1.24/sh to $0.94/sh.

Increase in receivable from affiliates by $22,000 from a reported $457,000 to $479,000.

Decrease in other assets by $73,000 from a reported $4,126,000 to $4,053,000.

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Decrease in total assets by $51,000 from a reported $101,144,000 to $101,093,000.

Increase in other liabilities by $385,000 from a reported $1,230,000 to $1,615,000.

Increase in accumulated deficit by $436,000 from a reported $23,699,000 to $24,135,000.

Such changes are necessitated on the basis of an accounting error relating to the Metra Transactions described in Notes 5 and 6 to the consolidated financial statements.

Page 60 Item 9A This item has been revised to disclose the identification of a control deficiency in internal controls over financial reporting as of April 2002 which continued through March 2005, which was an error in the recordation of an April 2002 transaction.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Amendment to be signed on its behalf by the undersigned, thereunto duly-authorized.
Date: September 7, 2005.

INCOME OPPORTUNITY REALTY INVESTORS, INC.

By: /s/ R. Neil Crouch, II

R. Neil Crouch, II, Executive Vice President and Chief Financial Officer and Acting Principal Executive Officer

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ITEM 6. *SELECTED FINANCIAL DATA*

	For the Years Ended December 31,				
	2003	2002	2001	2000	1999
	(dollars in thousands, except per share)				
	(Restated)				
EARNINGS DATA					
Rents	$ 7,814	$ 7,739	$ 7,322	$ 10,737	$ 15,968
Property expense	4,560	3,819	3,701	5,605	6,768
Operating income	3,254	3,920	3,621	5,132	9,200
Interest income	626	270	194	319	29
Gain on sale of real estate					1,525
Income (loss) from equity partnerships	(7)	862	(9)	(61)	148
Recovery of A/R written off	1,569				
Other expense	5,922	6,983	5,273	9,569	9,580
Net income (loss) from continuing operations	(480)	(1,931)	(1,467)	(4,179)	1,322
Discontinued operations	1,826	4,016	(1,995)	20,973	
Net income (loss)	$ 1,346	$ 2,085	$ (3,462)	$ 16,794	$ 1,322
PER SHARE DATA					
Net income (loss)	$ .94	$ 1.45	$ (2.32)	$ 11.03	$ .87
Dividends per share	$	$	$	$ .45	$ .60
Weighted average common shares outstanding	1,438,945	1,438,945	1,493,675	1,522,510	1,527,386

	As of December 31,				
	2003	2002	2001	2000	1999
	(dollars in thousands, except per share)				
	(Restated)				
BALANCE SHEET DATA					
Real estate held for investment, net	$ 50,365	$ 74,750	$ 87,315	$ 86,277	$ 86,542
Notes and interest receivable, net	45,531		505	1,500	
Total assets	101,093	90,185	91,833	96,519	91,185
Notes and interest payable	60,825	51,432	54,426	54,206	62,852
Stockholders equity	38,653	37,307	35,222	39,998	23,991

Book value per share	$ 26.86	$ 25.93	$ 24.48	$ 26.42	$ 15.69

IORI purchased four properties for a total of $21.0 million in 2003, nine properties for a total of $46.5 million in 2000, and one property for $5.4 million in 1999. IORI sold four properties for a total of $55.7 million in 2003, two properties for a total of $19.2 million in 2002, seven properties for a total of $66.6 million in 2000, and one property for $3.2 million in 1999. See ITEM 2. PROPERTIES Real Estate and ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

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

Critical accounting policies are those that are both important to the presentation of IORI s financial condition and results of operations and require management s most difficult, complex or subjective judgments. IORI s critical accounting policies relate to the evaluation of impairment of long-lived assets and the evaluation of the collectibility of accounts and notes receivable.

If events or changes in circumstances indicate that the carrying value of a rental property to be held and used or land held for development may be impaired, management performs a recoverability analysis based on estimated undiscounted cash flows to be generated from the property in the future. If the analysis indicates that the carrying value is not recoverable from future cash flows, the property is written down to estimated fair value and an impairment loss is recognized. If management decides to sell rental properties or land held for development, management evaluates the recoverability of the carrying amounts of the assets. If the evaluation indicates that the carrying value is not recoverable from estimated net sales proceeds, the property is written down to estimated fair value less costs to sell and an impairment loss is recognized within income from continuing operations. IORI s estimates of cash flow and fair values of the properties are based on current market conditions and considers matters such as rental rates and occupancies for comparable properties, recent sales data for comparable properties and, where applicable, contracts or the results of negotiations with purchasers or prospective purchasers. IORI s estimates are subject to revision as market conditions and IORI s assessments of them change.

IORI s allowance for doubtful accounts receivable and notes receivable is established based on analysis of the risk of loss on specific accounts. The analysis places particular emphasis on past due accounts. Management considers such information as the nature and age of the receivable, the payment history of the tenant or other debtor, the financial condition of the tenant or other debtor and IORI s assessment of its ability to meet its lease or interest obligations. IORI s estimate of the required allowance, which is reviewed on a quarterly basis, is subject to revision as these factors change and is sensitive to the effects of economic and market conditions.

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Obligations and Commitments

IORI has contractual obligations and commitments primarily with regards to the payment of mortgages.

The following table aggregates IORI s expected contractual obligations and commitments subsequent to December 31, 2003. (Dollars in thousands.)

	PAYMENTS DUE BY PERIOD (in thousands)						
	2004	2005	2006	2007	2008	Thereafter	Total
Variable interest rate notes							
Instrument s maturities	$ 6,272	$	$ 8,553	$	$	$	$ 14,825
Instrument s amortization	556	513	540				1,609
Interest	880	814	722				2,416
Fixed interest rate notes							
Instrument s maturities			1,228		2,078	35,910	39,216
Instrument s amortization	566	606	565	510	523	2,006	4,776
Interest	2,398	1,970	1,936	1,903	1,835	5,798	15,840
Principal payments	7,394	1,119	10,886	510	2,601	37,916	60,426

Liquidity and Capital Resources

Cash and cash equivalents totaled $58,000, $10,000 and $66,000 at December 31, 2003, 2002 and 2001. IORI s principal sources of cash have been and will continue to be property operations, proceeds from property sales and refinancings and partnership distributions. Management anticipates that IORI will generate excess cash from operations in 2004 due to increased rental rates and occupancy at its properties, however, if such excess does not prove to be sufficient to satisfy all IORI s obligations as they mature, when necessary, management also may selectively sell income producing real estate, refinance real estate and incur additional borrowings secured by real estate to meet cash requirements.

Net cash provided (used) by operating activities was $92,000 in 2003, ($2.5) million in 2002, and ($2.0) million in 2001. The primary factors affecting cash flow from operating activities are discussed in the following paragraphs.

Cash flow from property operations (rents collected less payments for property operating expenses) was $4.8 million in 2003, $3.4 million in 2002, and $6.0 million in 2001. In 2003, the increase of $1.4 million was primarily due to a decrease in property operating expenses. Of the decrease in 2002 from 2001, $1.7 million was due to the sale of two

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office buildings in 2002 and $900,000 was due to decreased occupancies at IORI s commercial properties.

Interest collected was $262,000 in 2003, $291,000 in 2002, and $148,000 in 2001. The decrease in 2003 was due to the reduction of two notes from 2002, offset by funding of a new note in 2003. The increase in 2002 from 2001 was due to the funding of two notes in 2002.

Interest paid on notes payable was $3.7 million in 2003, $4.3 million in 2002, and $5.5 million in 2001. Of the decrease in 2003 from 2002, $300,000 was due to the sale of three commercial properties and one land property in 2003 and the sale of two commercial properties in 2002, and $300,000 was the effects of Metra refinancing in 2002 and the payments to Metra for its return on capital. Of the decrease in 2002 from 2001, $600,000 was due to the sale of two commercial properties, $600,000 was due to the refinancing of Travelers land, $200,000 was due to decreased variable rates and principal reductions and a $200,000 increase was due to the refinancing of apartments.

Advisory and net income fee paid to affiliate was $451,000 in 2003, $868,000 in 2002, and $1.1 million in 2001. The decrease in 2003 from 2002 was due to a lower advisory fee charged by a new advisor (SWI) and a lower net income fee incurred. The decrease in 2002 from 2001 was due to a decrease in gross assets. See NOTE 8. ADVISORY AGREEMENT.

General and administrative expenses paid was $785,000 in 2003, $1.0 million in 2002, and $1.6 million in 2001. The decrease in 2003 from 2002 was primarily due to a decrease in director insurance expense. The decrease in 2002 from 2001 was due to decreases in franchise taxes paid.

IORI made improvements to its properties totaling $0 in 2003, $365,000 in 2002, and $3.5 million in 2001.

IORI received cash of $0 in 2003, $500,000 in 2002, and $1.0 million in 2001 from mortgage receivable principal payments, and net cash of $547,000 in 2003, $22.9 million in 2002, and $14.1 million from refinancings in 2001. In 2003, $603 million was expended in principal payments on mortgage debt, $26.3 million was expended in 2002, and $14.8 million was expended in 2001.

Liquidity and Capital Resources

Scheduled principal payments on notes payable of $7.4 million are due in 2004. For those mortgages that come due in 2003, it is management s intent to either seek an extension of the due dates by one or more years, or refinance the debt on a long-term basis, or pay off the debt at maturity, or selectively sell income producing real estate. Management believes it will continue to be successful in obtaining loan extensions and/or refinancings.

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Management expects that funds from existing cash resources, selective sales of income producing properties, refinancing of real estate, and additional borrowings against real estate will be sufficient to meet IORI s cash requirements associated with its current and anticipated level of operations, maturing debt obligations and existing commitments. To the extent that IORI s liquidity permits or financing sources are available, management intends to make new real estate investments.

IORI owned a 36.3% general partner interest in the Tri-City partnership. IORI received a distribution of $25,000 in 2002, $18,000 in 2001, and $25,000 in 2000 from Tri-City s operating cash flow. In 2002, IORI received $752,000 as a distribution from the sales proceeds. IORI owns a 40% general partner interest in the NIA partnership. In 2002 and 2001, IORI received no distributions from NIA and made a $24,000 contribution in 2001 to the partnership. IORI owns a 10% limited partnership interest in the TCI Eton Square partnership. IORI received no distributions and made no contributions to the partnership in 2003 or 2002. See NOTE 4. INVESTMENT IN EQUITY METHOD PARTNERSHIPS.

IORI paid no dividends in 2003 and 2002. In December 2000, the Board of Directors determined not to pay a fourth quarter dividend to holders of IORI s Common Stock. The non-payment decision was based on the Board determining that IORI needed to retain cash for acquisitions that were anticipated in 2001 and that IORI had no REIT taxable income that required a distribution. It is unlikely that IORI will pay any quarterly dividends for 2004.

In 2001, IORI repurchased 75,100 shares of Common Stock in a private block purchase for a total of $1.3 million.

Management reviews the carrying values of IORI s properties at least annually and whenever events or a change in circumstances indicate that impairment may exist. Impairment is considered to exist if the future cash flow from a 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 and visits to selected properties in the area and a review of (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

IORI reported net income of $1.3 million in 2003, a net income of $2.1 million in 2002 and net loss of $3.5 million in 2001. Fluctuations in these and the other components of revenue and expense are discussed in the following paragraphs.

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Rents were $7.8 million in 2003, $7.7 million in 2002 and $7.3 million in 2001. Rents in 2004 are expected to decrease if IORI selectively sells properties.

Property operations expense was $4.6 million in 2003, $3.8 million in 2002, and $3.7 million in 2001. The increase in 2003 from 2002 was due to an overall increase in various operating expenses including property taxes. Of the increase in 2002 from 2001, $100,000 was due to an increase in property taxes for IORI s land and $100,000 was due to increased utility and insurance expenses. Property operations expense is expected to decrease in 2004 as IORI selectively sells properties.

Interest income was $626,000 in 2003, $270,000 in 2002, and $194,000 in 2001. The increase in 2003 from 2002 was due to interest income earned from the payment of the notes receivable on Rosedale Towers. The increase in 2002 from 2001 was due to an increase in short term notes receivable which were paid off by the end of 2002.

Interest expense was $2.6 million in 2003, $2.3 million in 2002, and $2.1 million in 2001. The increase in 2003 from 2002 was due to the refinancing of Metra apartments. Of the increase in 2002 from 2001, $300,000 was due to the refinancing of apartments. Interest expense in 2003 is expected to remain constant or decrease as IORI selectively sells properties.

Depreciation expense was $1.2 million in 2003, $1.2 million in 2002, and $1.6 million in 2001. The decrease in 2003 from 2002 was due to sale of two commercial properties and fully depreciated tenant improvements. The decrease in 2002 from 2001 was due to fully depreciated tenant improvements.

Depreciation expense in 2004 is expected to approximate 2003.

Advisory fee to affiliate was $424,000 in 2003, $714,000 in 2002, and $817,000 in 2001. The change was due to changes in gross assets, the basis of the fee. See NOTE 8. ADVISORY AGREEMENT.

IORI paid a net income fee of $109,000 in 2003 as compared to $169,000 in 2002. IORI paid no net income fee in 2001. The net income fee is based on 7.5% of IORI s net income.

General and administrative expense was $779,000 in 2003, $1.0 million in 2002, and $739,000 in 2001. The decrease in 2003 resulted from reduced director and officers insurance.

Equity losses in partnership were $7,000 in 2003, equity gains were $862,000 in 2002, and equity losses were $9,000 in 2001. The Tri-City partnership was dissolved in 2002, which resulted in equity gain in that year.

IORI realized gains on the sale of real estate of $3.8 million in 2003 and $7.1 million in 2002. In 2003, the gains on sale of real estate

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represent the gain on the sale of Mowry and La Mesa, commercial properties. In 2002, the gains represent the gain on the sale of Daley Corporate Center.

IORI realized a loss on discontinued operations of $1.9 million, $3.1 million, and $1.9 million in 2003, 2002 and 2001. The loss relates to operating losses on two commercial properties that IORI sold during 2003. The following table summarizes revenue and expense information for the properties sold.

	2003	2002	2001
Revenue			
Rental Revenue	$ 1,991	$ 2,660	$ 5,679
Property operations	1,858	2,511	2,890
	133	149	2,789
Interest Income	462		
Expenses			
Interest	2,236	2,635	3,925
Depreciation	357	650	859
	2,593	3,285	4,784
Net loss from discontinued operations	(1,998)	(3,136)	(1,995)
Gain on sale of real estate	3,824	6,769	
Equity in gain on sale of real estate by equity investees		383	
Net income (loss) from discontinued operations	$ 1,826	$ 4,016	$ (1,995)

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.

Inflation

The effects of inflation on IORI s operations are not quantifiable. Revenues from property operations tend to fluctuate proportionately with inflationary increases and decreases in housing costs. Fluctuations in the rate of inflation also affect the sales values of properties and the ultimate gain to be realized from property sales. To the extent that inflation affects interest rates, earnings from short-term investment

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and the cost of new financings as well as the cost of variable interest rate debt will be affected.

Taxes

For the years 2002 and 2001, IORI elected and in the opinion of management qualified to be taxed as a REIT as defined under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended. To continue to qualify for federal taxation as a REIT, IORI was required to hold at least 75% of the value of its total assets in real estate assets, government securities, cash and cash equivalents at the close of each quarter of each taxable year. As a REIT, IORI was also required to distribute at least 90% (95% in 2000) of its REIT taxable income plus 90% (95% in 2000) of its net income from foreclosure property on an annual basis to stockholders.

Due to the completion of the tender offer by ARI on March 19, 2003, and the resulting concentration of ownership, IORI no longer met the requirement for tax treatment as a REIT as of January 1, 2003. IORI cannot re-qualify for tax treatment as a REIT for at least five years.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES REGARDING MARKET RISK*

IORI s future operations, cash flow and fair values of financial instruments are partially dependent upon the then existing market interest rates and market equity prices. Market risk is the changes in the market rates and prices and the affect of the changes on future operations. Market risk is managed by matching the property s anticipated net operating income to an appropriate financing.

IORI is exposed to interest rate risk associated with variable rate notes payable and maturing debt that has to be refinanced. IORI does not hold financial instruments for trading or other speculative purposes, but rather issues these financial instruments to finance its portfolio of real estate assets. IORI s interest rate sensitivity position is managed by IORI s finance department. Interest rate sensitivity is the relationship between changes in market interest rates and the fair value of market rate sensitive assets and liabilities. IORI s earnings are affected as changes in short-term interest rates impact its cost of variable rate debt and maturing fixed rate debt. A large portion of IORI s market risk is exposure to short-term interest rates from variable rate borrowings. The impact on IORI s financial statements of refinancing fixed debt that matured during 2003 was not material. If market interest rates for variable rate debt average 100 basis points more in 2004 than they did during 2003, IORI s interest expense would increase and income would decrease by $164,000. This amount is determined by considering the impact of hypothetical interest rates on IORI s borrowing cost. This analysis did not consider the effects of the reduced level of overall economic activity that could exist in such an environment. Further, in the event of a change of such magnitude, management would likely take actions to further mitigate its exposure to the change. However, due to the uncertainty of the specific actions that would be taken and their possible effects, the sensitivity

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analysis assumes no change in IORI s financial structure.

The following table contains only those exposures that existed at December 31, 2003. Anticipation of exposures or risk on positions that could possibly arise was not considered. IORI s ultimate interest rate risk and its affect on operations will depend on future capital market exposures, which cannot be anticipated with a probable assurance level. (Dollars in thousands.)

Liabilities

Notes payable

Variable interest rate-fair value							$ 14,576
	2004	2005	2006	2007	2008	Thereafter	Total
Instrument s maturities	$ 6,272	$	$ 8,553	$	$	$	$ 14,825
Instrument s amortization	556	513	540				1,609
Interest	880	814	722				2,416
Average rate	8.9%	9.1%	9.2%				
Fixed interest rate-fair value							$ 48,457
	2004	2005	2006	2007	2008	Thereafter	Total
Instrument s maturities			1,228		2,078	35,910	39,216
Instrument s amortization	566	606	565	510	523	2,006	4,776
Interest	2,398	1,970	1,936	1,903	1,835	5,798	15,840
Average rate	6.7%	7.1%	7.2%	7.2%	7.2%	7.1%	

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ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

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All other schedules are omitted because they are not required, are not applicable or the information required is included in the Financial Statements or the notes thereto.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors of
Income Opportunity Realty Investors, Inc.

We have audited the accompanying consolidated balance sheets of Income Opportunity Realty Investors, Inc. and Subsidiaries as of December 31, 2003, and the related consolidated statements of operations, stockholders equity and cash flows for year ended December 31, 2003. We have also audited the schedules listed in the accompanying index. These financial statements and the schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Income Opportunity Realty Investors, Inc. and Subsidiaries as of December 31, 2003 and the consolidated results of their operations and their cash flows for year ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedules referred to above presents fairly, in all material respects, the information set forth therein.

Farmer, Fuqua, & Huff, P.C.

March 12, 2004, except for the effects of the changes contained in Note 18, which is dated August 19, 2005

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors of
Income Opportunity Realty Investors, Inc.

We have audited the accompanying consolidated balance sheets of Income Opportunity Realty Investors, Inc. and Subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2002. We have also audited the schedules listed in the accompanying index. These financial statements and the schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe our audits provide a reasonable basis for our opinion.

As described in Note 17, Income Opportunity Realty Investors, Inc. s management has indicated its intent to both sell income producing properties and refinance or extend debt secured by real estate, to meet its liquidity needs.

As discussed in Note 1, IORI adopted the provisions of SFAS 144, *Accounting for Impairment of Long Lived Assets*, in 2001.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Income Opportunity Realty Investors, Inc. and Subsidiaries as of December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedules referred to above presents fairly, in all material respects, the information set forth therein.

BDO SEIDMAN, LLP
Dallas, Texas
March 21, 2003

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 2003	2002
	(dollars in thousands, except per share)	
	(Restated)	
Assets		
Real estate held for investment	$ 56,367	$ 82,252
Less accumulated depreciation	(6,002)	(7,502)
	50,365	74,750
Notes and interest receivable	45,531	
Investment in real estate partnerships	607	609
Cash and cash equivalents	58	10
Receivables from affiliates	479	10,497
Other assets	4,053	4,319
	$ 101,093	$ 90,185
Liabilities and Stockholders Equity		
Liabilities		
Notes and interest payable	$ 60,825	$ 51,432
Other liabilities	1,615	1,446
	62,440	52,878
Commitments and contingencies		
Stockholders equity		
Common Stock, $.01 par value; authorized 10,000,000 shares; issued and outstanding 1,438,945 shares in 2003 and 2002	14	14
Paid-in capital	62,774	62,774
Accumulated deficit	(24,135)	(25,481)
	38,653	37,307
	$ 101,093	$ 90,185

The accompanying notes are an integral part of these Consolidated Financial Statements.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2003	2002	2001
	(Restated)		
	(dollars in thousands, except per share)		
Property revenue			
Rents	$ 7,814	$ 7,739	$ 7,322
Property expense			
Property operations	4,560	3,819	3,701
Operating income	3,254	3,920	3,621
Other income			
Interest	626	270	194
Equity in income (loss) of equity partnerships	(7)	862	(9)
Recovery of loss provision on receivable from related party	1,569		
	2,188	1,132	185
Other expense			
Interest	2,563	2,279	2,149
Depreciation	1,199	1,216	1,568
Advisory fee to affiliate	424	714	817
Net income fee to affiliate	109	169	
Provision for loss on receivable from related party		1,568	
Provision for Asset Impairment	848		
General and administrative	779	1,037	739
	5,922	6,983	5,273
Net income (loss) from continuing operations	(480)	(1,931)	(1,467)
Discontinued operations:			
Income (loss) from operations	(1,998)	(3,136)	(1,995)
Gain on sale of real estate by equity investees		383	
Gain on sale of operations	3,824	6,769	
Net income (loss) from discontinued operations	1,826	4,016	(1,995)
Net income (loss)	$ 1,346	$ 2,085	$ (3,462)

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (cont.)

	For the Years Ended December 31,		
	2003 (Restated)	2002	2001
	(dollars in thousands, except per share)		
Earnings per share			
Net income (loss) from continuing operations	$ (0.33)	$ (1.34)	$ (0.98)
Discontinued operations	1.27	2.79	(1.34)
Net income (loss)	$ 0.94	$ 1.45	$ (2.32)
Weighted average shares of Common Stock used in computing earnings per share	1,438,945	1,438,945	1,493,675

The accompanying notes are an integral part of these Consolidated Financial Statements.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

	Common Stock Shares	Amount	Paid-in Capital	Accumulated Deficit	Stockholders Equity
		(dollars in thousands, except shares)			
Balance, January 1, 2001	1,514,045	15	64,087	(24,104)	39,998
Repurchase of Common Stock	(75,100)	(1)	(1,313)		(1,314)
Net (loss)				(3,462)	(3,462)
Balance, December 31, 2001	1,438,945	14	62,774	(27,566)	35,222
Net income				2,085	2,085
Balance, December 31, 2002	1,438,945	14	62,774	(25,481)	37,307
Net income (as Restated)				1,346	1,346
Balance, December 31, 2003	1,438,945	$ 14	$ 62,774	$ (24,135)	$ 38,653

(as Restated)

The accompanying notes are an integral part of these Consolidated Financial Statements.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2003	2002	2001
	(dollars in thousands)		
	(Restated)		
Cash Flows from Operating Activities			
Rents collected	$ 10,671	$ 10,554	$ 12,966
Payments for property operations	(5,903)	(7,131)	(6,981)
Interest collected	262	291	148
Interest paid	(3,702)	(4,339)	(5,528)
Advisory and net income fee paid to affiliate	(451)	(868)	(1,054)
General and administrative expenses paid	(785)	(1,029)	(1,618)
Distributions from equity partnerships operating cash flow		25	18
Other			20
Net cash provided by (used in) operating activities	92	(2,497)	(2,029)
Cash Flows from Investing Activities			
Funding of equity partnerships			(28)
Real estate improvements		(365)	(3,466)
Deposits on pending purchases and financings			(25)
Proceeds from sale of real estate	9,582	19,230	
Distributions from equity partnership s investing cash flow		752	
Funding of note receivable (including $5,109 in 2002 to related party)	(1,567)	(7,109)	
Collection of note receivable		500	1,000
Payments from (to) advisor and affiliates	(7,955)	(6,244)	4,635
Net cash provided by investing activities	60	6,764	2,116
Cash Flows from Financing Activities			
Proceeds from notes payable	917	23,152	14,900
Payments on notes payable	(603)	(26,308)	(14,783)
Deferred financing costs	(418)	(1,167)	(911)
Repurchase of Common Stock			(1,314)
Net cash used in financing activities	(104)	(4,323)	(2,108)
Net increase (decrease) in cash and cash equivalents	48	(56)	(2,021)
Cash and cash equivalents, beginning of year	10	66	2,087
Cash and cash equivalents, end of year	$ 58	$ 10	$ 66

The accompanying notes are an integral part of these Consolidated Financial Statements.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	For the Years Ended December 31,		
	2003	2002	2001
	(dollars in thousands)		
	(Restated)		
Reconciliation of net income (loss) to net cash used in operating activities			
Net income (loss)	$ 1,346	$ 2,085	$ (3,462)
Adjustments to reconcile net income (loss) to net cash used in operating activities Depreciation and amortization	2,165	1,867	2,930
Gain on sale of real estate	(3,824)	(7,152)	
Impairment of asset	848		
Equity in (income) loss of partnerships	2	(862)	9
Distributions from equity partnerships operating cash flow		25	18
Provision for loss		1,568	
Decrease in interest receivable	(368)	5	
(Increase) decrease in other assets	1	774	(1,554)
Decrease in interest payable	29	(9)	(103)
Increase (decrease) in other liabilities	(107)	(798)	133
Net cash provided by operating activities	$ 92	$ (2,497)	$ (2,029)
Schedule of noncash investing and financing activities			
Notes payable from purchase of real estate	$ 18,687	$	$
Notes payable assumed by buyer on sale of real estate	9,637		
Notes receivable collected by affiliates	8,760	5,541	

The accompanying notes are an integral part of these Consolidated Financial Statements.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying Consolidated Financial Statements of Income Opportunity Realty Investors, Inc. and consolidated entities were prepared in conformity with accounting principles generally accepted in the United States of America, the most significant of which are described in NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. The Notes to Consolidated Financial Statements are an integral part of these Consolidated Financial Statements. The data presented in the Notes to Consolidated Financial Statements are as of December 31 of each year and for the year then ended, unless otherwise indicated. Dollar amounts in tables are in thousands, except per share amounts.

Certain balances for 2002 and 2001 have been reclassified to conform to the 2003 presentation.

NOTE 1. *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*

Organization and business. Income Opportunity Realty Investors, Inc. (IORI) is the successor to a California business trust organized on December 14, 1984, which commenced operations on April 10, 1985. IORI invests in real estate through direct ownership, leases and partnerships and it also may invest in mortgage loans on real estate.

In October 2001, IORI announced a preliminary agreement for the acquisition of IORI by American Realty Investors, Inc. (ARI), a related party. See NOTE 17. COMMITMENTS AND CONTINGENCIES AND LIQUIDITY.

Basis of consolidation. The Consolidated Financial Statements include the accounts of IORI and controlled subsidiaries and partnerships. All significant intercompany transactions and balances have been eliminated.

Accounting estimates. In the preparation of the Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America, it is necessary for management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses for the year then ended. Actual results could differ from those estimates.

Recent accounting pronouncements. In April 2002, the FASB issued Statement 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction (SFAS No. 145). Statement 4, Reporting Gains and Losses from Extinguishment of Debt (SFAS No. 4), required that gains and losses from the extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary items. The provisions of

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1. *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES* (Continued)

SFAS No. 145 related to the rescission of SFAS No. 4 will require IORI to reclassify prior period items that do not meet the extraordinary classification. The provisions of SFAS No. 145 that relates to the rescission of SFAS No. 4 become effective in fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the consolidated financial position or results of operations of IORI.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3. IORI will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a company s commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure, an amendment of FASB Statement No. 123. SFAS No. 148 provides alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity s accounting policy decisions with respect to stock-based employee compensation. Finally, this Statement amends APB Opinion No. 28, Interim Financial Reporting, to require disclosure about those effects in interim financial information. Management currently believes that the adoption of SFAS No. 148 will not have a material impact on the financial statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which disclosures are effective for financial statements issued after December 15, 2002. While IORI has various guarantees included in contracts in the normal course of business, these guarantees do not represent significant commitments or contingent liabilities of the indebtedness of entities outside of the consolidated company.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1. *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES* (Continued)

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46) which requires the consolidation of variable interest entities, as defined. FIN 46 is applicable to financial statements to be issued by IORI after 2002, however, disclosures are required currently if IORI expects to consolidate any variable interest entities. IORI does not currently believe that any entities will be consolidated as a result of FIN 46.

Real estate held for investment and depreciation. Real estate held for investment is carried at cost. Statement of Financial Accounting Standards No. 144 (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 of 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 2 to 40 years.

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). Until the requirements of SFAS No. 66 for full profit recognition have been met, transactions are accounted for using either the deposit, the installment sale, the cost recovery or the financing method, whichever is appropriate. See NOTE 2. REAL ESTATE.

Investment in noncontrolled partnerships. The equity method is used to account for investments in partnerships which IORI does not control. Under the equity method, an initial investment, recorded at cost, is increased by a proportionate share of the partnership s operating income and any additional advances and decreased by a proportionate share of the partnership s operating losses and distributions received.

Operating segments. Management has determined reportable operating segments to be those that are used for internal reporting purposes which disaggregates operations by type of real estate.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 1. *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES* (Continued)

Fair value of financial instruments. The following assumptions were used in estimating the fair value of notes receivable and payable. For notes receivable the fair value was estimated by discounting future cash flows using current interest rates for similar loans. For notes payable the fair value was estimated using year end interest rates for mortgages with similar terms and maturities.

Cash equivalents. For purposes of the Consolidated Statements of Cash Flows, all highly liquid investments purchased with an original maturity of three months or less are considered cash equivalents.

Earnings per share. Income (loss) per share is presented in accordance with Statement of Financial Accounting Standards No. 128 Earnings Per Share. Income (loss) per share is computed based upon the weighted average number of shares of Common Stock outstanding during each year.

NOTE 2. *REAL ESTATE*

In 2003, IORI sold the following properties:

Property	Location	Sq.Ft.	Sales Price	Net Cash Received	Debt Discharged	Gain/(Loss) on Sale
Office Building Mowry Building	Newark, CA	58,758 Sq.Ft.	$ 5,000	$ 1,113	$ 4,057	
La Mesa Building	La Mesa, CA	90,105 Sq.Ft.	$ 13,500	$ 6,521	$ 5,468	$ 3,824
One Hickory Centre	Farmers Branch, TX	97,361 Sq.Ft.	$ 12,200	$ 227		
Land Travelers Land	Farmers Branch, TX	1.01 Acres	$ 25,000	$ 2,198		

The Mowry building, located at 5600 Mowry School Road, Newark, California, was sold on July 1, 2003 at the sales price of $5.0 million. Prior to the sale, IORI wrote down the carrying value of the property to its fair value, and an impairment loss of $848,000 was recognized.

Concentration of investment risk. IORI has a high concentration of investment risk on properties in the Southwest region of the United States. This risk includes, but is not limited to changes in local economic conditions, changes in real estate and zoning laws, increases in real estate taxes, floods, tornados and other acts of God and other factors beyond the control of management.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

Concentration of investment risk (continued). In the opinion of management, this investment risk is partially mitigated by the diversification of property types in other geographical regions of the United States, management s review of additional investments, acquisitions in other areas and by insurance.

NOTE 3. *NOTES AND INTEREST RECEIVABLE*

Junior Mortgage Loans. Junior mortgage loans are loans secured by mortgages that are subordinate to one or more prior liens either on the fee or a leasehold interest in real estate. Recourse on the loans ordinarily includes the real estate which secures the loan, other collateral and personal guarantees of the borrower.

In January 2002, IORI purchased 100% of the outstanding common shares of Rosedale Corporation (Rosedale), a wholly-owned subsidiary of American Realty Investors, Inc. (ARI), a related party, for $5.1 million cash. Rosedale owned the 83,331 sq. ft. Rosedale Towers Office Building in Roseville, Minnesota. ARI guaranteed that the asset would produce at least a 12% return annually of the purchase price for a period of three years from the purchase date. If the asset failed to produce the 12% return, ARI agreed to pay IORI any shortfall. Management recorded this related party transaction as a note receivable from ARI. In the first quarter of 2002, after reviewing the property s fair value after costs to sell, even though ARI has guaranteed the 12% return, IORI recognized a provision for loss on the note receivable of $767,000. In December 2002, the Rosedale Towers Office Building was sold for $7.2 million. ARI received $3.5 million of the proceeds after the payment of the first lien debt and various closing costs, and IORI recognized an additional loss of $801,000 on this note. The $3.5 million received by ARI is included within other assets in the accompanying Consolidated Balance Sheet. In the second quarter of 2003, IORI received a $2.0 million paydown from ARI on the receivable. In the third quarter of 2003, the remaining $1.5 million was collected.

In February 2002, IORI funded a $2.0 million mortgage loan as a participation agreement with Transcontinental Realty Investors, Inc. (TCI), a related party. The loan was secured by a second lien on a retail center in Montgomery County, Texas. The note receivable bore interest at 16.0% per annum, required monthly interest only payments of $47,000 and matured in February 2002. In February 2002, the loan was extended until April 2002. In April 2002, IORI extended the loan until July 2002, receiving $8,500 as an extension fee. In July 2002, the loan was extended until September 2002, with IORI receiving $8,500 as an extension fee. Of the $2.0 million in principal payments, $1.5 million was received by TCI and $500,000 was received by Basic Capital Management, Inc. (BCM), an affiliate and the advisor to IORI, until July 1, 2003. These amounts are included within receivables from affiliates in the accompanying Consolidated Balance Sheet.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 3. *NOTES AND INTEREST RECEIVABLE* (Continued)

On October 14, 2003, IORI sold and conveyed the office building known as One Hickory Centre and 202 acres of unimproved real property known as the Travelers Land in Dallas County, Texas to Encino Executive Plaza, Ltd. The sale price for One Hickory Centre was $12,200,000 and Encino Executive Plaza, Ltd. executed a wrap-around promissory note in the amount of $11,973,025 payable to the order of IORI secured by a Deed of Trust encumbering One Hickory Centre. The note bore interest at 6.7% per annum. As with the prior transaction, the difference between the purchase price and the promissory note represented adjustments for various prorations. The sale price for the Travelers Land was $25,000,000. At closing, Encino Executive Plaza, Ltd. executed an all inclusive wrap-around promissory note payable to the order of IORI in the principal amount of $22,801,987 secured by a Deed of Trust covering the Travelers Land sold and delivered cash to IORI in the amount of $1,946,715, the remaining difference of which was as a result of prorations and various expenses paid by IORI in connection with the closing of the transaction. The note bore interest at 6.7% per annum. Subsequently, IORI made a loan to Encino Executive Plaza, Ltd. in the amount of $1,567,232 payable upon demand or if no demand is made prior thereto on June 30, 2006 with a market rate of interest. Encino Executive Plaza, Ltd. executed and delivered a promissory note payable to the order of IORI in the stated principal amount of $1,567,232. The note bore interest at 6.7% per annum.

On December 30, 2003, a Promissory Note in the amount of $6,363,360 given by Housing for Seniors of Humble (Housing), LLC to NLP Lakeshore Villas, LLC (NLP) was assigned from ARI to IORI as a paydown of certain intercompany receivables.

On December 30, 2003, a Promissory Note in the amount of $2,000,000 given by Housing for Seniors of Humble (Housing), LLC to NLP Lakeshore Villas, LLC (NLP) was assigned from ARI to IORI as additional paydown of certain intercompany receivables.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 4. *INVESTMENT IN EQUITY METHOD PARTNERSHIPS*

Investments in equity method partnerships consisted of the following:

	2003	2002
Nakash Income Associates (NIA)	341	275
TCI Eton Square, L.P. (Eton Square)	266	334
	$ 607	$ 609

IORI owned a 36.3% general partner interest in Tri-City, which in turn owned a shopping center in Houston, Texas. TCI owned a 63.7% limited partner interest in Tri-City. In November 2002, the shopping center was sold for $4.2 million. Tri-City received net cash of $1.9 million after the payment of various closing costs. IORI received a distribution of $704,000 of the net proceeds and recognized a gain of $1.3 million on its investment in Tri-City. IORI also owns a 40% general partner interest in NIA. NIA s only asset is a wraparound mortgage note receivable secured by a shopping center in Maulden, Missouri. TCI owns the remaining 60% general partner interest in NIA. IORI further owns a 10% limited partner interest in Eton Square, which at December 31, 2003, owned the Eton Square Building in Tulsa, Oklahoma. TCI owns a 90% general partner interest in Eton Square.

Set forth below are summarized financial data for the partnerships accounted for using the equity method:

	2003	2002
Notes receivable	$ 902	$ 902
Real estate, net of accumulated depreciation ($1,631 in 2003 and $1,230 in 2002)	13,753	14,152
Other assets	(262)	
Notes payable	(10,206)	(10,362)
Other liabilities	(677)	(559)
Partners capital	$ 3,510	$ 4,133

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 4. *INVESTMENT IN EQUITY METHOD PARTNERSHIPS* (Continued)

	2003	2002	2001
Rents	$ 1,233	$ 2,981	$ 2,579
Interest income	156	156	80
Interest expense	(685)	(1,119)	(1,131)
Property operations expense	(802)	(1,453)	(1,230)
Depreciation	(400)	(628)	(586)
Loss before gains on sale of real estate	(498)	(63)	(288)
Gain on sale		1,054	
Net income (loss)	$ (498)	$ 991	$ (288)

IORI s equity share of:

	2003	2002	2001
Income (loss) before gains on sale of real estate	$ (7)	$ 862*	$ (9)
Gain on sale of real estate		383	
Net income (loss)	$ (7)	$ 1,245	$ (9)

* Includes the $1.3 million gain from the sale of IORI s investment in Tri-City.

NOTE 5. *NOTES AND INTEREST PAYABLE*

Notes and interest payable consisted of the following:

	2003		2002	
	Estimated Fair Value	Book Value	Estimated Fair Value	Book Value
Notes payable	$ 63,033	$ 60,427	$ 50,402	$ 51,063
Interest payable		398		369
		$ 60,825		$ 51,432

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 5. *NOTES AND INTEREST PAYABLE* (Continued)

Scheduled notes payable principal payments are due as follows:

2004	$ 7,394
2005	1,119
2006	10,886
2007	510
2008	2,601
Thereafter	37,916
	$ 60,426

Notes payable at December 31, 2003, bear interest at rates ranging from 4.47% to 10.5% and mature between 2003 and 2025. The mortgages are collateralized by deeds of trust on real estate with a net carrying value of $50.4 million. In April 2002, IORI sold all of its residential properties to partnerships controlled by Metra Capital, LLC (Metra). These properties include: the 60 unit Brighton Court, the 92 unit Del Mar, the 68 unit Enclave, the 280 unit Meridian, the 57 unit Signature, the 114 unit Sinclair, located in Midland, Texas, and the 106 unit Treehouse, located in San Antonio, Texas. Innovo Realty, Inc., a subsidiary of Innovo Group, Inc. (Innovo) is a limited partner in the partnerships that purchased the properties. Joseph Mizrachi, a director of ARI, a related party, controls approximately 11.67% of the outstanding common stock of Innovo. The sale constituted 23% of the total assets of IORI as of December 31, 2001. The sales price for the properties totaled $26.2 million. IORI received $5.4 million in cash after the payoff of $16.1 million in debt and various closing costs. Management has determined to account for this sale as a refinancing transaction, in accordance with SFAS No. 66, Accounting for Sales of Real Estate. IORI will continue to report the assets and the new debt incurred by the Metra partnerships on the IORI financial statements. The new debt on the properties totals $21.4 million, bears interest at 7.57% per annum, requires monthly interest only payments of $135,000 and matures in May 2012. IORI also received $5.2 million of 8% non-recourse, non-convertible Series A Preferred Stock (Preferred Shares) of Innovo.

The dividend on the Preferred Shares will be funded entirely and solely through member distributions from cash flows generated by the operation and subsequent sale of the sold properties. In the event the cash flows for the properties are insufficient to cover the 8% annual dividend, Innovo will have no obligation to cover any shortfall.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 5. *NOTES AND INTEREST PAYABLE* (Continued)

The Preferred Shares have a mandatory redemption feature and are redeemable from the cash proceeds received by Innovo from the operation and sale of the properties. All member distributions that are in excess of current and accrued 8% dividends must be used by Innovo to redeem the Preferred Shares. Since redemption of these shares is subject to the above future events, management has not recorded any basis in the Preferred Shares.

In 2003, IORI refinanced the following properties:

Property	Location	Sq.Ft./Acrs	Debt Incurred	Debt Discharged	Net Cash Received/ (Paid)	Interest Rate	Maturity Date
Office Building							
2010 Valley View	Farmers Branch,TX	40,066 Sq.Ft.	$ 2,436	1,778	547	6.25%	10/08
Travelers Land	Farmers Branch, TX	97,361 Sq.Ft.	$ 5,000	$ 4,225		6.00%(1)	12/06

(1) Variable rate.

NOTE 6. *RELATED PARTY TRANSACTIONS*

In January 2002, IORI purchased 100% of the outstanding common shares of Rosedale Corporation (Rosedale), a wholly-owned subsidiary of American Realty Investors, Inc. (ARI), a related party, for $5.1 million cash. Rosedale owned the 83,331 sq. ft. Rosedale Towers Office Building in Roseville, Minnesota. ARI guaranteed that the asset would produce at least a 12% return annually of the purchase price for a period of three years from the purchase date. If the asset failed to produce the 12% return, ARI agreed to pay IORI any shortfall. Management recorded this related party transaction as a note receivable from ARI. In the first quarter of 2002, after reviewing the property s fair value after costs to sell, even though ARI has guaranteed the 12% return, IORI recognized a provision for loss on the note receivable of $767,000. In December 2002, the Rosedale Towers Office Building was sold for $7.2 million. ARI received $3.5 million of the proceeds after the payment of the first lien debt and various closing costs, and IORI recognized an additional loss of $801,000 on this note. The $3.5 million received by ARI is included within other assets in the accompanying Consolidated Balance Sheet. In the second quarter of 2003, IORI received a $2.0 million paydown from ARI on the receivable. In the third quarter of 2003, the remaining $1.5 million was collected.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 6. *RELATED PARTY TRANSACTIONS* (Continued)

On December 30, 2003, a Promissory Note in the amount of $6.3 million given by Housing to NLP was assigned from ARI to IORI. On December 30, 2003, a Promissory Note in the amount of $2.0 million given by Housing to NLP was assigned from ARI to IORI. These assignments were payments aggregating $8.3 million plus accrued interest of $386,000 on certain intercompany receivables due to IORI.

On December 18, 2003, IORI purchased 100% of the outstanding common shares of Transcontinental Brewery Corporation (Brewery), a wholly-owned subsidiary of TCI, a related party, for $4.0 million for a reduction of intercompany debt in the same amount. Brewery owns the 19.96 acres of land and the 133,000 sq. ft. Eagle Crest Warehouse Building in Farmers Branch, Texas.

On December 18, 2003, IORI purchased 100% of the outstanding common shares of Transcontinental Treehouse Corporation (Treehouse-IR), a wholly-owned subsidiary of TCI, for $7.5 million for a reduction of intercompany debt in the amount of $2.4 million subject to mortgage lien in the amount of $5.1 million. Treehouse-IR owns the 153,072 sq. ft. Treehouse Apartments Building in Irving, Texas.

On December 18, 2003, IORI purchased 100% of the outstanding common shares of Transcontinental Parkway Corporation (Parkway), a wholly-owned subsidiary of TCI, for $4.0 million for reduction of intercompany debt in the amount of $2.4 million subject to mortgage lien in the amount of $1.6 million. Parkway owns the 28,374 sq. ft. Parkway Shopping Center in Dallas, Texas.

On September 19, 2002, IORI s Board of Directors authorized the Chief Financial Officer of the Company to advance funds either to or from the Company, through the advisor, in an amount up to $5.0 million on the condition that such advances shall be repaid in cash or transfers of assets within 90 days.

The following table reconciles the beginning and ending balances of Accounts Receivable from Affiliates as of December 31, 2003 (as Restated).

	SWI	BCM	ARI	TCI
Balance, December 31, 2002		$ 1,696	$ 3,541	$ 5,260
Cash transfers	15,209	5,017		
Cash repayments	(3,881)	(3,937)	(3,494)	(1,000)
Other additions	2,926	784	367	1
Other repayments	(13,930)	(3,560)	(47)	(4,000)
Balance, December 31, 2003	324	$	$ 367	$ 261

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 6. *RELATED PARTY TRANSACTIONS* (Continued)

Returns on Metra Properties. As described more fully in Note 5, IORI sold all of its residential properties during 2002 to partnerships controlled by Metra. The partnership agreement for each of these partnerships states that the Metra Partners, as defined, receive cash flow distributions at least quarterly in an amount sufficient to provide them with a fifteen percent cumulative compounded annual rate of return on their invested capital, as well as a cumulative annual amount of 0.50% of the average outstanding balance of the mortgage indebtedness secured by any of these residential properties. These distributions to the Metra Partners have priority over distributions to any of the other partners.

NOTE 7. *DIVIDENDS*

Dividends of $685,000 ($.45 per share) were paid in 2000.

It was reported to the Internal Revenue Service that 100% of the dividends paid in 2000 represented capital gains.

In December 2000, the Board of Directors determined not to pay a fourth quarter dividend to holders of IORI s Common Stock. The non-payment decision was based on the Board determining that IORI needed to retain cash for acquisitions that were anticipated in 2001 and that IORI had no REIT taxable income that required a distribution.

No dividends were declared or paid in 2003 or 2002. Management expects to pay no dividends in 2004.

NOTE 8. *RENTS UNDER OPERATING LEASES*

Operations include the leasing of office buildings. The leases thereon expire at various dates through 2011. The following is a schedule of minimum future rents on non-cancelable operating leases as of December 31, 2003:

2004	$ 2,354
2005	2,298
2006	1,762
2007	1,389
2008	1,182
Thereafter	1,888
	$ 10,873

NOTE 9. *ADVISORY AGREEMENT*

SWI is 100% owned by Gene E. Phillips. Mr. Phillips is a Chairman, a President, a Chief Executive Officer, and a Director, and is involved in daily consultation with the officers of SWI and has significant influence over the conduct of SWI s business, including the rendering of advisory services and the making of investment decisions for itself and for IORI.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 9. *ADVISORY AGREEMENT* (Continued)

Under the Advisory Agreement, SWI is required to annually formulate and submit for Board approval a budget and business plan containing a twelve-month forecast of operations and cash flow, a general plan for asset sales and purchases, borrowing activity and other investments. SWI is required to report quarterly to the Board on IORI s performance against the business plan. In addition, all transactions require prior Board approval, unless they are explicitly provided for in the approved business plan or are made pursuant to authority expressly delegated to SWI by the Board.

The Advisory Agreement also requires prior Board approval for the retention of all consultants and third party professionals other than legal counsel. The Advisory Agreement provides that SWI shall be deemed to be in a fiduciary relationship to the stockholders and contains a broad standard governing SWI s liability for losses incurred by IORI.

The Advisory Agreement provides for SWI to be responsible for IORI s day-to-day operations and to receive an advisory fee comprised of a gross asset fee of .0625% per month (.75% per annum) of the average of the gross asset value (total assets less allowance for amortization, depreciation or depletion and valuation reserves) and an annual net income fee equal to 7.5% per annum of net income.

The Advisory Agreement also provides for SWI to receive an annual incentive sales fee. SWI or an affiliate of SWI is to receive an acquisition commission for supervising the purchase or long-term lease of real estate. SWI or an affiliate of SWI is to receive a mortgage or loan acquisition fee with respect to the purchase of any existing mortgage loan. SWI or an affiliate of SWI also is to receive a mortgage brokerage and equity refinancing fee for obtaining loans or refinancing of IORI s properties. In addition, SWI receives reimbursement of certain expenses incurred by it, in the performance of advisory services for IORI.

The Advisory Agreement requires SWI or any affiliate of SWI to pay to IORI one-half of any compensation received from third parties with respect to the origination, placement or brokerage of any loan made by IORI.

Under the Advisory Agreement all or a portion of the annual advisory fee must be refunded by SWI if the Operating Expenses of IORI (as defined in the Advisory Agreement) exceed certain limits specified in the Advisory Agreement. The effect of this limitation was to require SWI to refund $227,000 of the 2003 annual advisory fee, $68,000 of the 2002 annual advisory fee, and $256,000 of the 2001 annual advisory fee.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 9. *ADVISORY AGREEMENT* (Continued)

Additionally, if management was to request that SWI render services other than those required by the Advisory Agreement, SWI or an affiliate of BCM would be separately compensated for such additional services on terms to be agreed upon from time to time. As discussed in NOTE 9. PROPERTY MANAGEMENT, Triad Realty Services, Ltd. (Triad), an affiliate of SWI, provides property management services and, as discussed in NOTE 11. REAL ESTATE BROKERAGE, Regis Realty, Inc. (Regis), a related party, provided, on a non-exclusive basis, brokerage services. SWI may assign the Advisory Agreement only with the prior consent of IORI.

NOTE 10. *PROPERTY MANAGEMENT*

Triad provides property management services for a fee of 5% or less of the monthly gross rents collected on residential properties and 3% or
less of the monthly gross rents collected on commercial properties under its management. Triad subcontracts with other entities for property-level management services at various rates. The general partner of Triad is BCM. The limited partner of Triad is Highland Realty Services, Inc. (Highland), a related party. Triad subcontracted to Regis, which is owned by Highland, the property-level management and leasing of IORI s five office buildings and the commercial property owned by Eton Square, until December 2002. Since January 1, 2003, Regis Realty I, LLC, which is owned by Highland, provided property management services. Regis was and Regis Realty I, LLC is entitled to receive property and construction management fees and leasing commissions in accordance with the terms of its property-level management agreement with Triad.

NOTE 11. *REAL ESTATE BROKERAGE*

Regis also provided brokerage services on a non-exclusive basis until December 2003. Regis was and Regis Realty I, LLC is entitled to receive a commission for property purchases and sales in accordance with a sliding scale of total brokerage fees to be paid by IORI.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 12. *ADVISORY FEES, PROPERTY MANAGEMENT FEES, ETC.*

Fees and cost reimbursements to SWI/BCM and its affiliates:

	2003	2002	2001
Fees	(Restated)		
Advisory	$ 424	$ 714	$ 817
Net income	109	169	
Property acquisition			
Mortgage brokerage and equity refinancing	547	262	99
Property & Construction Mgt. & Leasing Comm	323	0	0
	$ 1,403	$ 1,145	$ 916
Cost reimbursements	$ 173	$ 246	$ 323

NOTE 13. *INCOME TAXES*

For the years 2002 and 2001, IORI elected and qualified to be treated as a Real Estate Investment Trust (REIT), as defined in Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code), and as such, was not taxed for federal income tax purposes on that portion of its taxable income which is distributed to stockholders. Due to the completion of the tender offer by ARI, an affiliate, and the resulting concentration of ownership, IORI no longer met the requirements for tax treatment as a REIT under the Code as of January 1, 2003, and is prohibited for re-qualifying for REIT status for at least five years.

IORI had net income for federal income tax purposes before the application of operating loss carryforwards in 2003 and 2002 and had a net loss for federal income tax purposes in 2001. Therefore, IORI recorded no provision for income taxes. IORI s tax basis in its net assets differs from the amount at which its net assets are reported for financial statement purposes, principally due to the accounting for gains and losses on property sales, depreciation on owned properties and investments in joint venture partnerships. At December 31, 2003, IORI s tax basis in its net assets was exceeded by their net basis for financial statement purposes by approximately $14.4 million and IORI s tax basis in its net mortgage liabilities was exceeded by their net basis for financial statement purposes by approximately $21.3 million. As a result, aggregate future income for income tax purposes will be less than such amount for financial statement purposes by approximately $6.9 million. Additionally, at December 31, 2003, IORI has current and prior tax net operating loss carryforwards of $2.3 million expiring through the year 2021.

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As a result of IORI s election to be treated as a REIT for income tax purposes for years 2002 and 2001 and its then intention to distribute its REIT taxable income, if any, in future years, no deferred tax asset, liability or valuation allowance was recorded. At December 31, 2003, IORI had a net deferred tax asset of $3.5 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.

NOTE 14. *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 general and administrative expenses. Management evaluates the performance of the operating segments and allocates resources to each of them based on their operating income and cash flow. Items of income that are not reflected in the segments are interest, and equity in partnerships totaling $619,000, $1.1 million, $185,000 for 2003, 2002 and 2001, respectively. Expenses/(Gains) that are not reflected in the segments are general and administrative expenses, advisory and net income fees, provision for loss, and provision for asset impairment totaling $2.2 million, $3.5 million, and $1.6 million for 2003, 2002 and 2001, respectively. Excluded from operating segment assets are assets of $50.8 million at December 31, 2003, $15.4 million at December 31, 2002, and $4.4 million at December 31, 2001, which are not identifiable with an operating segment. There are no intersegment revenues and expenses and all business is conducted in the United States.

Presented below is the operating income of each operating segment.

2003 (as restated)	Land	Commercial Properties	Apartments	Total
Rents	$	$ 2,456	$ 5,358	$ 7,814
Property operating expenses		1,091	3,471	4,560
Operating income (loss)	$	$ 1,365	$ 1,887	$ 3,254
Depreciation	$	$ 794	$ 405	$ 1,199
Interest		623	1,940	2,563
Real estate improvements		494		494
Assets	44	22,105	28,216	50,365

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 14. *OPERATING SEGMENTS* (Continued)

	Commercial Properties	Total
Property Sales		
Sales price	$ 55,700	$ 55,700
Cost of sale	51,874	51,874
Gain on sale	$ 3,824	$ 3,824

	Land	Commercial Properties	Apartments	Total
2002				
Rents	$	$ 2,394	$ 5,345	$ 7,739
Property operating expenses		1,030	2,789	3,819
Operating income	$	$ 1,364	$ 2,556	$ 3,920
Depreciation	$	$ 739	$ 477	$ 1,216
Interest		605	1,674	2,279
Real estate improvements		240		240
Assets	24,929	28,688	21,133	74,750

	Commercial Properties	Total
Property Sales		
Sales price	$ 19,230	$ 19,230
Cost of sale	12,461	12,461
Gain on sale	$ 6,769	$ 6,769

	Land	Commercial Properties	Apartments	Total
2001				
Rents	$	$ 2,277	$ 5,045	$ 7,322
Property operating expenses		1,034	2,667	3,701
Operating income	$	$ 1,243	$ 2,378	$ 3,621

Depreciation	$	$ 1,056	$ 512	$ 1,568
Interest		788	1,361	2,149
Real estate improvements	2,404	1,062		3,466
Assets	24,492	41,213	21,610	87,315

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 15. *DISCONTINUED OPERATIONS*

Effective January 1, 2002, IORI adopted Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which established a single accounting model for the impairment or disposal of long-lived assets, including discontinued operations. This statement requires that the operations related to properties that have been sold or properties that are intended to be sold be presented as discontinued operations in the statement of operations for all periods presented, and properties intended to be sold are to be designated as held-for-sale on the balance sheet.

For 2003, 2002, and 2001, income (loss) from discontinued operations relates to two properties that IORI sold during 2002 and four properties sold during 2003. The following table summarizes revenue and expense information for these properties sold.

	2003	2002	2001
Revenue			
Rental	$ 1,991	$ 2,660	$ 5,679
Property operations	1,858	2,511	2,890
	133	149	2,789
Interest Income	462		
Expenses			
Interest	2,236	2,635	3,925
Depreciation	357	650	859
	2,593	3,285	4,784
Net income (loss) from discontinued operations	(1,998)	(3,136)	(1,995)
Gain on sale of real estate	3,824	6,769	
Equity in gain on sale of real estate by equity investees		383	
Net income (loss) from discontinued operations	$ 1,826	$ 4,016	$ (1,995)

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 16. *QUARTERLY DATA*

The following is a tabulation of quarterly results of operations for the years 2003, 2002 and 2001 (unaudited).

	Three Months Ended			
2003 (as restated)	March 31	June 30	September 30	December 31
Rents	$ 1,942	$ 1,958	$ 1,970	$ 1,944
Property expense	966	1,012	1,182	1,400
Operating income	976	946	788	544
Interest income		614	12	
Income (loss) in equity partnerships	(15)		(13)	21
Recovery of A/R written off		1,569		
Other expense	1,300	1,982	1,325	1,315
Net income (loss) from continuing operations	(339)	1,147	(538)	(750)
Discontinued operations	(588)	(491)	(541)	3,446
Net income (loss)	$ (927)	$ 656	$ (1,079)	$ 2,696
Earnings per share				
Net income (loss)	$ (0.64)	$ 0.46	$ (.75)	$ 1.87

	Three Months Ended			
2002	March 31	June 30	September 30	December 31
Rents	$ 1,892	$ 1,888	$ 2,061	$ 1,898
Property expense	801	896	1,137	985
Operating income	1,091	992	924	913
Interest income	37	310	185	(262)
Income (loss) in equity partnerships	(17)	48	60	771
Other expense	2,393	1,519	1,055	2,016
Net loss from continuing operations	(1,282)	(169)	114	(594)
Discontinued operations	6,355	(718)	(1,355)	(266)
Net income (loss)	$ 5,073	$ (887)	$ (1,241)	$ (860)

Earnings per share				
Net income (loss)	$ 3.53	$ (.62)	$ (.86)	$ (.60)

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 16. *QUARTERLY DATA* (Continued)

	Three Months Ended			
2001	March 31	June 30	September 30	December 31
Rents	$ 1,814	$ 1,806	$ 1,802	$ 1,900
Property expense	907	889	1,013	892
Operating income	907	917	789	1,008
Interest income	72	62	8	52
Income (loss) in equity partnerships	9	(6)	(30)	18
Other expense	1,328	1,327	1,406	1,212
Net income (loss) from continuing operations	(340)	(354)	(639)	(134)
Discontinued operations	(377)	(378)	(1,110)	(130)
Net income (loss)	$ (717)	$ (732)	$ (1,749)	$ (264)
Earnings per share				
Net income (loss)	$ (.47)	$ (.49)	$ (1.16)	$ (.18)

In the third quarter of 2003, the Mowry Building was sold, and an impairment loss on sale of real estate of 848,000 was recognized. In the fourth quarter of 2003, La Mesa Village, Travelers Land, and One Hickory Centre were sold. $3.8 million gain was recognized on the sale of La Mesa Village. Travelers Land had $59,000 deferred capital loss on sale.

NOTE 17. *COMMITMENTS AND CONTINGENCIES AND LIQUIDITY*

Olive Litigation. In February 1990, IORI, together with National Income Realty Trust, Continental Mortgage and Equity Trust (CMET) and TCI, three real estate entities with, at the time, the same officers, directors or trustees and advisor as IORI, entered into a settlement (the Settlement) of a class and derivative action entitled *Olive et al. v. National Income Realty Trust et al.* (the Olive Litigation), relating to the operation and management of each of the entities. On April 23, 1990, the Court granted final approval of the terms of the Settlement. The Settlement was modified in 1994 (the Modification), which was amended on January 27, 1997 by Amendment to the Modification effective January 9, 1994 (the First Amendment).

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 17. *COMMITMENTS AND CONTINGENCIES AND LIQUIDITY* (Continued)

In October 2000, plaintiffs counsel asserted that the stock option agreement to purchase TCI shares, which was entered into by IORI and an affiliate of IORI, American Realty Investors, Inc. (ARI), in October 2000 with an investment fund, breached a provision of the Modification. As a result of this assertion, IORI assigned all of its rights to purchase the TCI shares under this stock option agreement to ARI.

The Board believes that all provisions of the Settlement, the Modification and First Amendment terminated on April 28, 1999. However, in September 2000, the Court ruled that certain provisions of the Modification continue to be effective after the termination date. This ruling was appealed to the United States Court of Appeals for the Ninth Circuit by IORI and TCI.

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 17. *COMMITMENTS AND CONTINGENCIES AND LIQUIDITY* (Continued)

On October 23, 2001, IORI, TCI and ARI jointly announced a preliminary agreement with the plaintiff s legal counsel for complete settlement of all disputes in the lawsuit. In February 2002, the court granted final approval of the proposed settlement (the Second Amendment). Under the Second Amendment, the appeal was dismissed and ARI agreed to either (i) acquire all of the outstanding shares of IORI and TCI not currently owned by ARI for a cash payment or shares of ARI preferred stock or (ii) make a tender offer for all of the outstanding common shares of IORI and TCI not currently owned by ARI. At the time, IORI had the same board as TCI and the same advisor as TCI and ARI. Earl D. Cecil and Ted P. Stokely who served as Directors of IORI and TCI, were also directors of ARI.

On November 15, 2002, ARI commenced, through subsidiaries, a tender offer for shares of common stock of TCI and IORI. The price per share was $17.50 for TCI shares and $19.00 for IORI shares. The tender offers were completed on March 19, 2003. ARI acquired 265,036 shares of IORI and 1,213,226 TCI shares. The completion of the tender offer fulfilled the obligations under the Second Amendment and the Olive Litigation was dismissed with prejudice.

Liquidity. Management anticipates that IORI will generate excess cash from operations in 2003 due to increased rental rates and occupancy

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

NOTE 17. *COMMITMENTS AND CONTINGENCIES AND LIQUIDITY* (Continued)

at its properties, however, such excess may not be sufficient to discharge all of IORI s debt obligations as they mature. Management intends to selectively sell income producing real estate, refinance real estate and incur additional borrowings against real estate to meet its cash requirements.

Other Litigation. IORI is also involved in various other 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.

NOTE 18. CORRECTION OF PREVIOUSLY FILED FINANCIAL STATEMENTS

The Company identified an accounting error in the financial statements related to the total Metra transactions. The error involved the establishment of an incorrect process involving the deferral of operating income or expense from the Metra properties until the sale of the property. The result is the Company concluded that changes should be made to its financial statements for the year ending December 31, 2003. The resulting impact in these financial statements was to decrease net income for the year ended December 31, 2003 by $436,000 from a reported $1,782,000 to $1,346,000, and a decrease of net income on a per share basis from a reported $1.24 per share to $0.94 per share. This decrease resulted from an increase in interest expense of approximately $458,000, decrease of net income fee to affiliate of $21,000, and a decrease of advisory fee to affiliate of $1,000. Total assets decreased by approximately $51,000 due to an increase of receivable from affiliate for $22,000 and an decrease in other assets of $73,000, and total liabilities increase by $385,000 due to a decrease in other liabilities of $385,000.

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SCHEDULE III
INCOME OPPORTUNITY REALTY INVESTORS, INC.
REAL ESTATE AND ACCUMULATED DEPRECIATION
December 31, 2003

Property/Location	Encum-brances	Initial Cost		Cost Capitalized Subsequent to Acquisition	Gross Amount Carried at End of Year [1]			Accumu-lated Depreci-ation	Date of Construc-tion	Date Acquired	Life on Which Depreciation in Latest Statement of Operation is Computed
		Land	Building & Improvements		Land	Building & Improvements	Total				
		(dollars in thousands)									
Properties Held For Investment Apartments											
Brighton Court, Midland, TX	$ 2,843	$ 339	$ 3,051	$	$ 339	$ 3,051	$ 3,390	$ 267	1983	06/00	40 years
Del Mar, Midland, TX	2,725	324	2,919		324	2,919	3,243	255	1983	06/00	40 years
Enclave, Midland, TX	2,882	324	2,919		324	2,919	3,243	255	1983	06/00	40 years
Meridian, Midland, TX	4,502	1,138	4,552		1,138	4,552	5,690	455	1983	12/99	40 years
Signature Place, Midland, TX	2,410	265	2,388		265	2,388	2,653	174	1983	06/00	40 years
Sinclair Place, Midland, TX	2,054	221	1,990		221	1,990	2,211	209	1983	06/00	40 years
Treehouse, San Antonio, TX	3,752	375	2,124	259	375	2,383	2,758	844	1975	09/89	5-40 years
Treehouse, Irving, TX	5,083	716	6,771		716	6,771	7,487		1974	12/03	5-40 years
Office Buildings											
2010 Valley View, Farmers Branch, TX	2,425	120	479	2,979	120	3,458	3,578	1,264	1998	09/97	5-40 years
Akard Plaza, Dallas, TX	1,966	734	2,936	454	734	3,390	4,124	785	1984	12/97	5-40 years
Chuck Yeager, Chantilly, VA	4,336	1,080	4,321	1,566	1,080	5,887	6,967	1,494	1991	01/97	5-40 years
Parkway Ctr, Farmers Branch, TX	1,631	333	3,511		333	3,511	3,844		1979	12/03	5-40 years

Industrial Warehouse Eagle Crest, Farmers Branch, TX	2,129	1,906		2,129	1,906	4,035		5-40 12/03 years
Land Frankel, Midland County, TX	44			44		44		06/00
3 HickoryCtr, FarmersBranch, TX	2,804		296	3,100		3,100		
	$ 36,609	$ 10,946	$ 39,867	$ 5,554	$ 11,242	$ 45,125	$ 56,367	$ 6,002

(1) The aggregate cost for Federal income tax purposes is $34.7 million.

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SCHEDULE III
(Continued)

INCOME OPPORTUNITY REALTY INVESTORS, INC.
REAL ESTATE AND ACCUMULATED DEPRECIATION

	2003	2002	2001
	(dollars in thousands)		
Reconciliation of Real Estate			
Balance at January 1,	$ 82,252	$ 95,190	$ 91,837
Additions			
Acquisitions and Improvements	15,365	677	3,466
Deductions			
Retirements		(462)	(113)
Sale of real estate	(41,250)	(13,153)	
Balance at December 31,	$ 56,367	$ 82,252	$ 95,190
Reconciliation of Accumulated Depreciation			
Balance at January 1,	$ 7,502	$ 7,875	$ 5,560
Additions			
Depreciation	1,552	1,867	2,427
Deductions			
Retirements			(112)
Sale of real estate	(3,052)	(2,240)	
Balance at December 31,	$ 6,002	$ 7,502	$ 7,875

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SCHEDULE IV
(Continued)

INCOME OPPORTUNITY REALTY INVESTORS, INC.
MORTGAGE LOANS ON REAL ESTATE

	2003	2002	2001
		(dollars in thousands)	
Balance at January 1,	$	$ 500	$ 1,500
Additions			
New mortgage loans	45,531	7,109	
Deductions			
Amounts charged off		(1,568)	
Collections of principal by IORI		(500)	
Collections of principal by affiliates		(5,541)	(1,000)
Balance at December 31,	$ 45,531	$	$ 500

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Effective July 1, 2003, the Board of Directors of Income Opportunity Realty Investors, Inc. (IORI) engaged the Plano, Texas firm of Farmer, Fuqua & Huff, P.C. as the independent accountant to audit IORI s financial statements. During the Registrant s two most recent fiscal years, and as any subsequent interim period, IORI did not consult with Farmer, Fuqua & Huff, P.C. or any of its members about the application of accounting principles to any specified transaction or any other matter.

The engagement effective July 1, 2003, of Farmer, Fuqua & Huff, P.C. as a new independent accountant for IORI necessarily results in the termination or dismissal of the principal accountant which audited IORI s financial statements in the past two fiscal years ended December 31, 2001 and 2002, BDO Seidman. During the Registrant s two most recent fiscal years and any subsequent interim period, BDO Seidman s report on IORI s financial statements for those two years did not contain an adverse opinion or disclaimer of opinion, nor was such opinion qualified or modified as to uncertainty, audit scope or accounting principles, and no disagreement existed between the Registrant and BDO Seidman concerning any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure. The decision to change accountants was approved by the Audit Committee of the Board of Directors of IORI consisting of Messrs. Ted P. Stokely, Earl D. Cecil and Martin L. White.

ITEM 9A. CONTROLS AND PROCEDURES

IORI, under the supervision and with the participation of its management, including IORI s Acting Principal Executive Officer and Principal Accounting Officer, evaluated the effectiveness of the design and operation of IORI s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Act) as of the end of the period covered by this report. Based on that evaluation, as of the time of filing IORI s original Form 10-K for the fiscal year ended December 31, 2003, IORI s Acting Principal Executive Officer concluded that IORI s disclosure controls and procedures are effective at December 31, 2003 in timely making known to him material information relating to IORI and its consolidated subsidiaries required to be disclosed in IORI s reports filed or submitted under the Exchange Act. There has been no change in IORI s internal control over financial reporting during the quarter ended December 31, 2003, that was believed to have materially affected or was then reasonably likely to materially affect IORI s internal control over financial reporting.

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However, subsequent to the filing of the original Form 10-K for the fiscal year ended December 31, 2003, IORI and its accountants identified a control deficiency in its internal controls over financial reporting as of April 2003 (which was not material in 2002) which continued undetected through March 2005, which constituted a material weakness (starting in 2003) within the meaning of the Public Company Accounting Oversight Board Auditing Standard No. 2. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of an annual or interim financial statement will not be prevented or detected. The material weakness related to IORI s accounting for the Metra transaction in April 2002 which included a deferral of operating income and/or expense until the time of ultimate sale of a property to an independent third party purchaser. As a result, an error was discovered that affected the consolidated balance sheet, consolidated statement of operations, consolidated statements of stockholders equity and consolidated statements of cash flows for 2002 and subsequent periods. The amounts for 2002 were not material, but the amounts for 2003 were material which caused the need for correction of the 2003 financial statements. That correction caused IORI to file an amendment on Form 10-K/A for the years ended December 31, 2003 and December 31, 2004, and a subsequent Form 10-Q/A for the quarter ended March 31, 2005 in order to restate such 2003 annual financial statements in its prior filings and to carry forward such changes in current filings. The error also caused IORI s acting principal executive officer and principal financial officer to re-evaluate and reconsider the effect on the adequacy of IORI s disclosure controls and procedures as of the end of the period covered by the original Form 10-K for the period ended December 31, 2004. Based upon such error, IORI s disclosure controls and procedures involving review of all material historical transactions and supporting documents could have an impact on any current reporting periods were not effective to detect such error. Beginning after the second quarter of 2005, IORI concluded that Management will review all material historical transactions and supporting documents that could have a continuing impact upon any current reporting periods, will review quarterly on a sampling basis all non-material historical transactions that are included in financial statements for any current reporting period, and will continue the process of reviewing all current transactions included in current reporting period financial statements. Management also believes that the transaction involving the error was uniquely complex and is not likely to be repeated, but Management is working with its outside consultant for guidance about other possible control procedures to ensure that in the future errors will be detected and material misstatement of annual or interim financial statements will be prevented.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND ADVISOR OF THE REGISTRANT

Directors

The affairs of IORI are managed by a Board of Directors. The Directors are elected at the annual meeting of stockholders or appointed by the incumbent Board and serve until the next annual meeting of stockholders or until a successor has been elected or approved.

After December 31, 2003, a number of changes occurred in the composition of the Board of Directors of IORI, the creation of certain Board committees, the adoption of Committee charters, the adoption of a Code of Ethics for Senior Financial Officers, and the adoption of Guidelines for Director Independence. Also, the composition of the members of the Board of Directors changed with the resignations of Henry A. Butler (July 1, 2003), Earl D. Cecil (on February 29, 2004) and Martin L. White (March 15, 2004), as

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well as the election of Ken L. Joines as a director in July 2003, and independent directors, David E. Allard and Peter L. Larsen on February 20, 2004, and Robert A. Jakuszewski on March 16, 2004.

It is the Board s objective that a majority of the Board consists of independent directors. For a director to be considered independent, the Board must determine that the Director does not have any direct or indirect material relationship with IORI. The Board has established

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