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, 2004

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, 2004 (the last business day of the Registrant s most recently completed second fiscal quarter) was $4,034,394 based upon a total of 298,844 shares held as of June 30, 2004 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 18, 2005, there were 1,389,345 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

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AMENDMENT NO. 3 TO
ANNUAL REPORT ON FORM 10-K FOR
INCOME OPPORTUNITY REALTY INVESTORS, INC.

The undersigned Registrant hereby further amends the following items, exhibits, or other portions of its Annual Report on Form 10-K for the fiscal year ended December 31, 2004 as set forth below and as reflected in the substituted pages attached hereto which replace the same numbered pages in the original filing as previously amended by Amendment Nos. 1 and 2 (this Amendment No. 3 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 20 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 2004 and 2003.

- Pages 21-27 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 29-62 Item 8. Financial Statements and Supplementary Data. The Reports of Independent Registered Public Accounting Firms (Pages 30-32) 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 33-38) and Notes to Consolidated Financial Statements (Pages 39-59) have been revised in the following respects:

  Increase in interest expense by $79,000 from a reported $3,491,000 to $3,570,000.

  Decrease in advisory fee by $2,000 from a reported $743,000 to $741,000.

  Decrease in net income fee by $13,000 from a reported $453,000 to $440,000.

  Increase in total other expense by $64,000 from a reported $5,990,000 to $6,054,000.

  Decrease in net income by $64,000 from a reported $5,492,000 to $5,428,000.

  Decrease in net income per share by $0.04 from a reported $3.95/sh to $3.91/sh.

  Decrease in other assets by $563,000 from a reported $3,658,000 to $3,095,000 (includes $73,000 decrease in 2003).

  Decrease in total assets by $563,000 from a reported $91,201,000 to $90,638,000 (includes $73,000 decrease in 2003).

  Decrease in payable to affiliates by $38,000 from a reported $1,288,000 to $1,248,000 (includes $22,000 decrease in 2003).

  Decrease in other liabilities by $24,000 from a reported $1,553,000 to $1,529,000 (includes $385,000 increase in 2003).

  Increase in accumulated deficit by $501,000 from a reported $18,206,000 to $18,707,000 (includes $436,000 increase in 2003).

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 64 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 undetected error in the recordation of an April 2002 transaction.

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SIGNATURE

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/ Robert N. Crouch II Robert N. Crouch II Executive Vice President, Chief Financial Officer, and Acting Principal Executive Officer

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ITEM 6. *SELECTED FINANCIAL DATA*

	For the Years Ended December 31,				
	2004	2003	2002	2001	2000
	(dollars in thousands, except per share)				
	(Restated)	(Restated)			
EARNINGS DATA					
Rents	$ 5,905	$ 5,224	$ 5,298	$ 4,956	$ 8,761
Property expense	3,129	3,331	2,748	2,637	4,652
Operating income	2,776	1,893	2,550	2,319	4,109
Interest income	3,325	626	270	194	319
Income (loss) from equity partnerships	(3)	(7)	862	(9)	(61)
Recovery of A/R written off		1,569			
Other expense	6,054	4,788	5,694	3,868	9,580
Net income (loss) from continuing operations	44	(707)	(2,012)	(1,364)	(4,086)
Discontinued operations	5,384	2,053	4,097	(2,098)	20,880
Net income (loss)	$ 5,428	$ 1,346	$ 2,085	$ (3,462)	$ 16,794
PER SHARE DATA					
Net income (loss)	$ 3.91	$ 0.94	$ 1.45	$ (2.32)	$ 11.03
Dividends per share	$	$	$	$	$ .45
Weighted average common shares outstanding	1,389,345	1,438,945	1,438,945	1,493,675	1,522,510

Earnings data reflects the retroactive changes in the discontinued operations from 2000 to 2004.

	As of December 31,				
	2004	2003	2002	2001	2000
	(dollars in thousands, except per share)				
	(Restated)	(Restated)			
BALANCE SHEET DATA					
Real estate held for investment, net	$ 31,368	$ 50,365	$ 74,750	$ 87,315	$ 86,277
Notes and interest receivable, net	54,911	45,531		505	1,500
Total assets	90,638	101,093	90,185	91,833	96,519
Notes and interest payable	44,571	60,825	51,432	54,426	54,206

Stockholders equity	43,290	38,653	37,307	35,222	39,998
Book value per share	$ 31.16	$ 26.86	$ 25.93	$ 24.48	$ 26.42

IORI purchased four properties for a total of $21.0 million in 2003, and nine properties for a total of $46.5 million in 2000. IORI sold five properties for a total of $ 24.5 million in 2004, four properties for a total of $55.7 million in 2003, two properties for a total of $19.2 million in 2002, and seven properties for a total of $66.6 million in 2000. 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, 2004. (Dollars in thousands) See ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK-Liabilities and NOTE 5. NOTES AND INTEREST PAYABLE .

	PAYMENTS DUE BY PERIOD (in thousands)						
	2005	2006	2007	2008	2009	Thereafter	Total
Variable interest rate notes							
Instrument s maturities	$5,175	$3,542	$	$	$	$	$ 8,717
Instrument s amortization	500	458					958
Interest	493	243					736
Fixed interest rate notes							
Instrument s maturities		1,371		2,083		25,536	28,990
Instrument s amortization	771	730	717	750	742	1,966	5,676
Interest	2,337	2,204	2,093	2,006	1,852	3,947	14,439
Principal payments	6,446	6,101	717	2,833	742	27,502	44,341

Liquidity and Capital Resources

Cash and cash equivalents totaled $399,000, $58,000, and $10,000 at December 31, 2004, 2003 and 2002. 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 2005 due to increased interest income and 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 assets, refinance real estate and incur additional borrowings secured by real estate to meet cash requirements.

Net cash (used in) provided by operating activities was ($124,000) in 2004, $92,000 in 2003, and ($2.5) million in 2002. 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 $3.0 million in 2004, $4.8 million in 2003, and $3.4 million in 2002. The decrease of $1.8 million in 2004 from 2003 was primarily due to a decrease in rental income caused by sale of five properties during the year. The increase of $1.4 million

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in 2003 from 2002 was primarily due to a decrease in property operating expenses.

Interest collected was $2.4 million in 2004, $262,000 in 2003, and $291,000 in 2002. The significant increase in 2004 was due to the increase in notes receivable from sale of properties throughout 2004. The decrease in 2003 was due to the reduction of two notes from 2002, offset by funding of a new note in 2003.

Interest paid on notes payable was $3.9 million in 2004, $3.7 million in 2003, and $4.3 million in 2002. Of the decrease in 2003 from 2002, $300,000 was due to the sale of three commercial properties in 2003 and the sale of two commercial properties in 2002, and $300,000 was the effect of Metra refinancing in 2002 and the payments to Metra for its return on capital.

Advisory and net income fee paid to affiliate was $1.1 million in 2004, $451,000 in 2003, and $868,000 in 2002. The increase in 2004 from 2003 was due to $323,000 increase in net income fee and $269,000 increase in advisory fee incurred. The decrease in 2003 from 2002 was due to a decrease in advisory fees caused by the increase in the operating expenses over the specified limit. See NOTE 8. ADVISORY AGREEMENT.

General and administrative expenses paid was $562,000 in 2004, $785,000 in 2003, and $1.0 million in 2002. The decrease in 2004 from 2003 was primarily due to a decrease in legal expense and advisor cost reimbursement paid. The decrease in 2003 from 2002 was primarily due to a decrease in director insurance expense.

Net cash provided by investing activities was $1.8 million in 2004, $60,000 in 2003, and $6.8 million in 2002. Cash from investing activities increased in 2004 from 2003 due to less payments were made to the advisor and the affiliates. The cash increases were partially offset by less proceeds received from sale of real estate in 2004 than in 2003.

Net cash used in financing activities was $1.3 million in 2004, $104,000 in 2003, and $4.3 million in 2002. The increase of cash spending on financing activities in 2004 from 2003 was primarily due to repurchase of IORI common stock and more payments were made on notes payable in 2004.

Scheduled principal payments on notes payable of $6.5 million are due in 2005. For those mortgages that come due in 2005, 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 assets. 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 assets, 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 until it was sold in 2002. IORI received a distribution of $25,000 in 2002 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. IORI received no distributions and made no contributions to the partnership in from 2002 to 2004. IORI owns a 10% limited partnership interest in the TCI Eton Square partnership. IORI received no distributions and made no contributions to the partnership from 2002 to 2004. See NOTE 4. INVESTMENT IN EQUITY METHOD PARTNERSHIPS.

IORI paid no dividends in 2004 and 2003. 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 cash dividends for 2005.

In 2001, IORI repurchased 75,100 shares of Common Stock in a private block purchase for a total of $1.3 million. In 2004, IORI repurchased 49,600 shares of IORI Common Stock for a total cost of $791,327. Through December 31, 2004, a total of 268,404 shares had been repurchased at a cost of $2.7 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 a net income of $5.4 million in 2004, net income of $1.3 million in 2003, and net income of $2.1 million in 2002. Fluctuations in these and the other components of revenue and expense are discussed in the following paragraphs.

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Rents were $5.9 million in 2004, $5.2 million in 2003 and $5.3 million in 2002. Rents in 2005 are expected to increase if IORI selectively buys properties.

Property operations expense was $3.1 million in 2004, $3.3 million in 2003, and $2.8 million in 2002. The slight decrease in 2004 from 2003 was due to a decrease in property taxes. The increase in 2003 from 2002 was due to an overall increase in various operating expenses including property taxes. Property operations expense is expected to increase in 2005 if IORI purchases more properties.

Interest income was $3.3 million in 2004, $626,000 in 2003, and $270,000 in 2002. The significant increase in 2004 from 2003 was due to additional interest earned from the additional notes receivable obtained from affiliates of IORI. The increase in 2003 from 2002 was due to interest income earned from the payment of the notes receivable on Rosedale Towers. Interest income is expected to increase in 2005 due to the increase in notes receivable during 2004.

Interest expense was $3.6 million in 2004, $1.8 million in 2003, and $1.5 million in 2002. The increase in 2004 from 2003 was due to increase in Metra net income, purchase of Parkway Centre and One Hickory Center in late 2003. Interest expense in 2005 is expected to decrease due to the retirement of four notes payable from sale of properties during 2004, however, it may possibly increase if IORI purchases additional properties in 2005.

Depreciation expense was $740,000 in 2004, $816,000 in 2003, and $748,000 in 2002. The decrease in 2004 from 2003 was due to sale of properties and fully depreciated tenant improvements in 2004. Depreciation expense in 2005 is expected to approximate 2004 and/or increase if IORI adds more properties.

Advisory fees to affiliates were $741,000 in 2004, $424,000 in 2003, and $714,000 in 2002. The increase in 2004 was due to decrease in the operating expenses which resulted in no refund from SWI for the cost reimbursement payment IORI had made to SWI during the year. See NOTE 8.   ADVISORY AGREEMENT.

IORI paid net income fees to its contractual advisors of $440,000 in 2004, $109,000 in 2003, and $169,000 in 2002. The net income fee is based on 7.5% of IORI   s net income.

General and administrative expense was $563,000 in 2004, $779,000 in 2003, and $1.0 million in 2002. The decrease in 2004 from 2003 was primarily due to decrease in legal fees and advisor cost reimbursement. The decrease in 2003 from 2002 resulted from reduced director and officers insurance premiums.

Equity losses in partnerships were $3,000 in 2004 and $7,000 in 2003, and equity gains were $862,000 in 2002. The Tri-City partnership was dissolved in 2002, which resulted in equity gain in that year.

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IORI realized gains on the sale of real estate of $5.5 million in 2004, $3.8 million in 2003, and $6.8 million in 2002. In 2004, the gains on sale of real estate derived from the sale of Akard and Yeager, Treehouse (San Antonio), and Frankel Land. In 2003, the gains on sale of real estate represent the gain on the sale of Mowry and La Mesa, commercial properties. In 2002, the gain on sale of real estate represents the gain from the sale of Daley Corporate Center.

IORI realized a loss on operations from discontinued operations of $89,000, $1.8 million, and $3.1 million in 2004, 2003 and 2002. The loss relates to the operating losses on two commercial properties, two residential properties, and a land property that IORI sold during 2004. The following table summarizes revenue and expense information for the properties sold.

	2004	2003	2002
Revenue			
Rental Revenue	$ 1,771	$ 4,581	$ 5,101
Property operations	981	3,087	3,582
	790	1,494	1,519
Interest Income		462	
Expenses			
Interest	556	2,987	3,457
Depreciation	323	740	1,117
	879	3,727	4,574
Net loss from discontinued operations	(89)	(1,771)	(3,055)
Gain on sale of real estate	5,473	3,824	6,769
Equity in gain on sale of real estate by equity investees			383
Net income (loss) from discontinued operations	$ 5,384	$ 2,053	$ 4,097

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 that would have a material adverse effect on IORI s business, assets or results of operations.

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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 investments 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 from that time.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT 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 change 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 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 2004 was not material. If market interest rates for variable rate debt average 100 basis points more in 2005 than they did during 2004, IORI s interest expense would increase and income would decrease by $101,000. This amount is determined by considering the impact of hypothetical interest rates on IORI s

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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 analysis assumes no change in IORI s financial structure. The following table contains only those exposures that existed at December 31, 2004. 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) See ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS-Obligations and Commitments and NOTE 5. NOTES AND INTEREST PAYABLE .

Liabilities

Notes payable

Variable interest rate-fair value							$ 1,639
	2005	2006	2007	2008	2009	Thereafter	Total
Instrument s maturities	$ 5,175	$ 3,542	$	$	$	$	$ 8,717
Instrument s amortization	500	458					958
Interest	493	243					736
Average rate	7.3%	7.0%					

Fixed interest rate-fair value							$ 29,869
	2005	2006	2007	2008	2009	Thereafter	Total
Instrument s maturities		1,371		2,083		25,536	28,990
Instrument s amortization	771	730	717	750	742	1,966	5,676
Interest	2,337	2,204	2,093	2,006	1,852	3,947	14,439
Average rate	7.6%	7.5%	7.5%	7.5%	7.6%	6.3%	

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ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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 sheet of Income Opportunity Realty Investors, Inc. and Subsidiaries as of December 31, 2004, and the related consolidated statements of operations, stockholders equity and cash flows for year ended December 31, 2004. 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 audit.

We conducted our audit 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 audit provides 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, 2004 and the consolidated results of their operations and their cash flows for year ended December 31, 2004, 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.

Swalm & Associates, P.C.

March 2, 2005, except for the effects of the changes contained in Note 18, which is dated August 19, 2005

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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 sheet 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 audit.

We conducted our audit 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 audit provides 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 REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors of
Income Opportunity Realty Investors, Inc.

We have audited the accompanying consolidated statements of operations, stockholders equity and cash flow of Income Opportunity Realty Investors, Inc. for the year 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 based on our audit.

We conducted our audit 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 are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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.

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

Also, in our opinion, the schedules 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, 2004 (Restated)	December 31, 2003 (Restated)
	(dollars in thousands, except per share)	
Assets		
Real estate held for investment	$ 34,988	$ 56,367
Less accumulated depreciation	(3,620)	(6,002)
	31,368	50,365
Notes and interest receivable	54,911	45,531
Investment in real estate partnerships	604	607
Cash and cash equivalents	399	58
Receivables from affiliates	261	479
Other assets	3,095	4,053
	$ 90,638	$ 101,093
Liabilities and Stockholders Equity		
Liabilities		
Notes and interest payable	$ 44,571	$ 60,825
Payables to affiliates	1,248	
Other liabilities	1,529	1,615
	47,348	62,440
Commitments and contingencies		
Stockholders equity		
Common Stock, $.01 par value; authorized 10,000,000 shares; issued and outstanding and 1,389,345 shares in 2004 and 1,438,945 shares in 2003	14	14
Paid-in capital	61,983	62,774
Accumulated deficit	(18,707)	(24,135)
	43,290	38,653
	$ 90,638	$ 101,093

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,		
	2004 (Restated)	2003 (Restated)	2002
	(dollars in thousands, except per share)		
Property revenue			
Rents	$ 5,905	$ 5,224	$ 5,298
Property expense			
Property operations	3,129	3,331	2,748
Operating income	2,776	1,893	2,550
Other income			
Interest	3,325	626	270
Equity in income (loss) of equity partnerships	(3)	(7)	862
Recovery of loss provision on receivable from related party		1,569	
	3,322	2,188	1,132
Other expense			
Interest	3,570	1,812	1,457
Depreciation	740	816	748
Advisory fee to affiliate	741	424	714
Net income fee to affiliate	440	109	169
Provision for loss on receivable from related party			1,568
Provision for Asset Impairment		848	
General and administrative	563	779	1,038
	6,054	4,788	5,694
Net income (loss) from continuing operations	44	(707)	(2,012)
Discontinued operations:			
Income (loss) from operations	(89)	(1,771)	(3,055)
Gain on sale of real estate by equity investees			383
Gain on sale of operations	5,473	3,824	6,769
Net income (loss) from discontinued operations	5,384	2,053	4,097
Net income (loss)	$ 5,428	$ 1,346	$ 2,085

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

	For the Years Ended December 31,		
	2004 (Restated)	2003 (Restated)	2002
	(dollars in thousands, except per share)		
Earnings per share			
Net income (loss) from continuing operations	$ 0.03	$ (0.49)	$ (1.40)
Discontinued operations	3.88	1.43	2.85
Net income (loss)	$ 3.91	$ 0.94	$ 1.45
Weighted average shares of Common Stock used in computing earnings per share	1,389,345	1,438,945	1,438,945

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	Common Stock Amount	Paid-in Capital	Accumulated Deficit	Stockholders Equity
	(dollars in thousands, except shares)				
Balance, January 1, 2002	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 (as restated)	1,438,945	$ 14	$ 62,774	$ (24,135)	$ 38,653
Repurchase of Common Stock	(49,600)		(791)		(791)
Net income (as restated)				5,428	5,428
Balance, December 31, 2004 (as restated)	1,389,345	$ 14	$ 61,983	$ (18,707)	$ 43,290

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,		
	2004	2003	2002
		(dollars in thousands)	
	(Restated)	(Restated)	
Cash Flows from Operating Activities			
Rents collected	$ 8,106	$ 10,671	$ 10,554
Payments for property operations	(5,086)	(5,903)	(7,131)
Interest collected	2,413	262	291
Interest paid	(3,885)	(3,702)	(4,339)
Advisory and net income fee paid to affiliate	(1,110)	(451)	(868)
General and administrative expenses paid	(562)	(785)	(1,029)
Distributions from equity partnerships operating cash flow			25
Net cash provided by (used in) operating activities	(124)	92	(2,497)
Cash Flows from Investing Activities			
Real estate improvements			(365)
Deposits on pending purchases and financings			
Proceeds from sale of real estate	5,680	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
Payments from (to) advisor and affiliates	(3,866)	(7,955)	(6,244)
Net cash provided by investing activities	1,814	60	6,764
Cash Flows from Financing Activities			
Proceeds from notes payable	1,193	917	23,152
Payments on notes payable	(1,435)	(603)	(26,308)
Deferred financing costs	(316)	(418)	(1,167)
Retirement of Treasury Stock	(791)		
Net cash used in financing activities	(1,349)	(104)	(4,323)
Net increase (decrease) in cash and cash equivalents	341	48	(56)
Cash and cash equivalents, beginning of year	58	10	66
Cash and cash equivalents, end of year	$ 399	$ 58	$ 10

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,		
	2004	2003	2002
		(dollars in thousands)	
	(Restated)	(Restated)	
Reconciliation of net income (loss) to net cash used in operating activities			
Net income	$ 5,428	$ 1,346	$ 2,085
Adjustments to reconcile net income (loss) to net cash used in operating activities			
Depreciation and amortization	1,392	2,165	1,867
Gain on sale of real estate	(5,473)	(3,824)	(7,152)
Impairment of asset		848	
Equity in (income) loss of partnerships	3	2	(862)
Distributions from equity partnerships operating cash flow			25
Provision for loss			1,568
(Increase) decrease in interest receivable	(807)	(368)	5
(Increase) decrease in other assets	(781)	1	774
Increase (decrease) in interest payable	(168)	29	(9)
Increase (decrease) in other liabilities	282	(107)	(798)
Net cash (used in) provided by Operating activities	$ (124)	$ 92	$ (2,497)
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	15,844	9,637	
Notes receivable collected by affiliates			5,541
Notes receivable collected from affiliates	8,339	44,706	

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 2003 and 2002 have been reclassified to conform to the 2004 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.

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. SFAS No. 151 In November 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 151, Inventory Costs, an Amendment of ARB No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) be recognized as current period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 is not expected to have a material impact on the consolidated financial position or results of operations of IORI.

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

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

SFAS No. 152   In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 152,   Accounting for Real Estate Time-Sharing Transactions   (SFAS No. 152). SFAS No. 152 amends FASB Statement No. 66, Accounting for Sales of Real Estate, to reference the financial accounting and reporting guidance for real estate time-sharing transactions that is provided in AICPA Statement of Position 04-2, Accounting for Real Estate Time-Sharing Transactions (SOP 04-2). This Statement also amends FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to state that the guidance for (a) incidental operations and (b) costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. The accounting for those operations and costs is subject to the guidance in SOP 04-2.

SFAS No. 152 is effective for financial statements for fiscal years beginning after June 15, 2005, and is to be reported as a cumulative effect of a change in accounting principle. 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.

SFAS No. 123   In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, Share-Based Payment, revised (SFAS No. 123R). SFAS No. 123R addresses the accounting for share-based payments to employees, including grants of employee stock options. Under the new standard, companies will no longer be able to account for share-based compensation transactions using the intrinsic method in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees. Instead, companies will be required to account for such transactions using a fair-value method and recognize the expense in the consolidated statement of income. SFAS No. 123R will be effective for periods beginning after June 15, 2005 and allows, but does not require, companies to restate the full fiscal year of 2005 to reflect the impact of expensing share-based payments under SFAS No. 123R. The Company has not yet determined which fair-value method and transitional provision it will follow. The adoption of SFAS No. 123R is not expected to have a material impact on the Company s consolidated financial position or results of operations.

SFAS No. 153   In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 153, Exchanges of Non-monetary Assets, An Amendment of APB Opinion No. 29 (SFAS No. 153). The guidance in APB Opinion No. 29, Accounting for Non-monetary Transactions, is based on the principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB Opinion No. 29, however, included certain exceptions to that principle. SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges

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

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

of non-monetary assets that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for non-monetary asset exchanges in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material impact on the consolidated financial position or results of operations of IORI.

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.

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

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

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

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 2004, IORI sold the following properties:

Property	Location	Sq.Ft.	Sales Price	Net Cash Received	Debt Discharged	Gain/(Loss) on Sale
Office Building						
Akard Building	Dallas, TX	42,258 Sq.Ft.	$ 3,900	$ 2,007	$ 1,849	$ 427
Yeager Building	Chantilly, VA	60,060 Sq.Ft.	$ 7,600	$ 2,174	$ 5,230	$ 1,939
Residential Building						
Treehouse (San Antonio)	San Antonio, TX	88,957 Sq.Ft.	$ 5,400	$ 1,437	$ 3,747	$ 3,091
Treehouse(Irving)	Irving, TX	153,072 Sq.Ft.	$ 7,500		$ 5,018	
Land						
Frankel Land	Midland County, TX	1 Acre	$ 63	$ 61		$ 16

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. 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.

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

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.

On September 30, 2004, a Secured Promissory Note in the amount of $1,222,500 given by UHF for Unified Housing of Parkside Crossing, LLC to Regis I and the accrued interest receivable of $112,878 were assigned from Regis I to IORI as a paydown of certain intercompany receivables.

On September 30, 2004, a Secured Promissory Note in the amount of $1,053,616 given by UHF for Unified Housing of Temple, LLC to Regis I and the accrued interest receivable of $98,338 were assigned from Regis I to IORI as a paydown of certain intercompany receivables.

On September 30, 2004, a Secured Promissory Note in the amount of $835,658 given by UHF for Unified Housing of Terrell, LLC to Regis I and the accrued interest receivable of $80,223 were assigned from Regis I to IORI as a paydown of certain intercompany receivables.

On September 30, 2004, a Secured Promissory Note in the amount of $1,770,000 given by UHF for Housing for Seniors of Lewisville, LLC to Regis I and the accrued interest receivable of $174,640 were assigned from Regis I to IORI as a paydown of certain intercompany receivables.

On May 24, 2004, a Secured Promissory Note in the amount of $2,990,000 given by UHF for UHM to Transcontinental Eldorado, Inc. was assigned from TCI to IORI as a partial payment for TCI s repurchase of 100% of the outstanding common shares of Treehouse-IR from IORI.

On December 30, 2003, a Secured Promissory Note in the amount of $6,363,360 given by Humble to NLP was assigned from ARI to IORI as a paydown of certain intercompany receivables.

On December 30, 2003, a Secured Promissory Note in the amount of $2,000,000 given by Humble to NLP was assigned from ARI to IORI as additional paydown of certain intercompany receivables.

On October 14, 2003, IORI purchased, sold, and conveyed an office building known as One Hickory Centre, and sold 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 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 bears interest at 5.5% per annum. 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

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

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. As with the prior transaction, the difference between the purchase price and the promissory note represented adjustments for various prorations. The note bears interest at 5.5% 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 bears interest at 5.5% per annum.

NOTE 4. *INVESTMENT IN EQUITY METHOD PARTNERSHIPS*

Investments in equity method partnerships consisted of the following:

	2004	2003
Nakash Income Associates (NIA)	402	341
TCI Eton Square, L.P. (Eton Square)	202	266
	$ 604	$ 607

IORI 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 also owns a 10% limited partner interest in Eton Square, which at December 31, 2004, 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:

	2004	2003
Notes receivable	$ 902	$ 902
Real estate, net of accumulated depreciation ($2,146 in 2004 and $1,631 in 2003)	14,595	13,753
Other assets	(262)	(262)
Notes payable	(10,054)	(10,206)
Other liabilities	(2,154)	(677)
Partners capital	$ 3,027	$ 3,510

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

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

	2004	2003	2002
Rents	$ 1,365	$ 1,233	$ 2,981
Interest income	156	156	156
Interest expense	(739)	(685)	(1,119)
Property operations expense	(775)	(802)	(1,453)
Depreciation	(475)	(400)	(628)
Loss before gains on sale of real estate	(468)	(498)	(63)
Gain on sale			1,054
Net income (loss)	$ (468)	$ (498)	$ 991

IORI s equity share of:

	2004	2003	2002
Income (loss) before gains on sale of real estate	$ (3)	$ (7)	$ 862*
Gain on sale of real estate			383
Net income (loss)	$ (3)	$ (7)	$ 1,245

* 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:

	2004		2003	
	Estimated Fair Value	Book Value	Estimated Fair Value	Book Value
Notes payable	$ 42,444	$ 44,342	$ 60,930	$ 60,427
Interest payable		229		398
		$ 44,571		$ 60,825

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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:

2005	$ 6,446
2006	6,101
2007	717
2008	2,833
2009	742
Thereafter	27,503
	$ 44,342

Notes payable at December 31, 2004, bear interest at rates ranging from 4.48% to 9.56% and mature between 2005 and 2012. The mortgages are collateralized by deeds of trust on real estate with a net carrying value of $31.4 million. As indicated in the foregoing schedule, the book value of notes payable decreased $16.1 million in 2004 from 2003 due to retirement of notes payable resulting from sale of four properties during 2004. See ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS-Obligations and Commitments and ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK-Liabilities .

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 former 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 continues to report the assets and the new debt incurred by the Metra partnerships on the IORI financial statements. The debt on the properties totaled $21.4 million at the time of sale, and it 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 Treehouse property was subsequently sold to a non-related party in February 2004 and all of its debts have been repaid to the lenders at the time of sale.

The dividend on the Preferred Shares was to be funded entirely and

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

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 was to have no obligation to cover any shortfall.

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 2004, IORI refinanced the following property:

Property	Location	Sq.Ft./Acrs	Debt Incurred	Debt Discharged	Net Cash Received/ (Paid)	Interest Rate	Maturity Date
Office Building							
Chuck Yeager	Chantilly, VA	60,060 Sq.Ft.	$ 5,500	$ 4,307	$ 1,193	5.25%(1)	1/07

(1) Variable rate.

NOTE 6. *RELATED PARTY TRANSACTIONS*

On September 30, 2004, a Secured Promissory Note in the amount of $1,222,500 given by UHF for Unified Housing of Parkside Crossing, LLC to Regis I and the accrued interest receivable of $112,878 were assigned from Regis I to IORI as a paydown in the same amount of certain intercompany receivables due to IORI.

On September 30, 2004, a Secured Promissory Note in the amount of $1,053,616 given by UHF for Unified Housing of Temple, LLC to Regis I and the accrued interest receivable of $98,338 were assigned from Regis I to IORI as a paydown in the same amount of certain intercompany receivables due to IORI.

On September 30, 2004, a Secured Promissory Note in the amount of $835,658 given by UHF for Unified Housing of Terrell, LLC to Regis I and the accrued interest receivable of $80,223 were assigned from Regis I to IORI as a paydown in the same amount of certain intercompany receivables due to IORI.

On September 30, 2004, a Secured Promissory Note in the amount of $1,770,000 given by UHF for Housing for Seniors of Lewisville, LLC to Regis I and the accrued interest receivable of $174,640 were assigned from Regis I to IORI as a paydown in the same amount of certain intercompany receivables due to IORI.

On May 24, 2004, a Secured Promissory Note in the amount of $2,990,000 given by UHF for UHM to Transcontinental Eldorado, Inc. was assigned from TCI to IORI as a partial payment for TCI s repurchase of 100% of the outstanding common shares of Treehouse-IR from IORI.

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

On December 30, 2003, a Promissory Note in the amount of $6.3 million given by Humble to NLP was assigned from ARI to IORI. On December 30, 2003, a Promissory Note in the amount of $2.0 million given by Humble 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 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, 2004.

	SWI	Regis I	ARI	TCI
Balance, December 31, 2003 (as restated)	324	(473)	$ 367	$ 261
Cash transfers	11,530			
Cash repayments	(5,831)		(367)	
Other additions	192	1,075		
Other repayments	(7,463)	(602)		
Balance, December 31, 2004 (as restated)	(1,248)	$	$	$ 261

Returns on Metra Properties. As described 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 are to have priority over distributions to any of the other partners.

NOTE 7. *DIVIDENDS*

While IORI was a REIT, 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 quarterly dividends were declared or paid in 2004, 2003 or 2002. Management expects to pay no cash dividends in 2005.

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

NOTE 8. *RENTS UNDER OPERATING LEASES*

Operations include the leasing of office buildings. The leases thereon expire at various dates through 2012. The following is a schedule of minimum future rents on non-cancelable operating leases as of December 31, 2004:

2005	$ 1,134
2006	867
2007	638
2008	529
2009	176
Thereafter	446
	$ 3,790

NOTE 9. *ADVISORY AGREEMENT*

SWI is 100% owned by Gene E. Phillips. Mr. Phillips is Chairman, President, Chief Executive Officer, and Director of SWI, 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.

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

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

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 $-0- of the 2004 annual advisory fee, $227,000 of the 2003 annual advisory fee, and $68,000 of the 2002 annual advisory fee.

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 10. PROPERTY MANAGEMENT, Triad Realty Services, Ltd., an affiliate of BCM, provides property management services and, as discussed in NOTE 11. REAL ESTATE BROKERAGE, Regis Realty I, LLC., 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 6% 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. 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 I, which is also owned by Highland, provided property management services. Regis was and Regis I 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 2002. Regis was and Regis I 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 affiliates:

	2004	2003	2002
Fees	(Restated)	(Restated)	
Fees Advisory	$ 741	$ 424	$ 714
Net income	440	109	169
Commission on property sale	301	473	
Mortgage brokerage and equity refinancing	518	547	262
Property & Construction Mgt. & Leasing Comm	120	323	0
	$ 2,120	$ 1,876	$ 1,145
Cost reimbursements	$ 78	$ 173	$ 246

NOTE 13. *INCOME TAXES*

For the year 2002, 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 2004, 2003 and 2002. 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. Deferred income taxes reflect the tax effects of temporary timing differences between carrying amounts of assets and liabilities reflected on the financial statements and the amounts used for income tax purposes. The tax effects of temporary differences and net operating loss carryforwards that give rise to the deferred tax assets are presented below:

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

	December 31, 2004	December 31, 2003
Deferred tax assets		
Basis difference in preferred stock	$ 1,542	$ 1,960
Accumulated Depreciation and amortization	284	449
Basis difference in Metra assets and liabilities	425	219
Other	182	
Federal benefit of net operating loss carryforward	122	855
Deferred tax asset	2,555	3,483
Less valuation allowance	(2,555)	(3,483)
Total deferred tax asset		

Recognition of the benefits of the deferred tax assets will require the Company to generate future taxable income. There is no assurance that the Company will generate earnings in future years. Therefore the Company has established a valuation allowance for deferred tax assets of approximately $2,555,000 and $3,483,000 as of December 31, 2004 and 2003.

In prior years the Company had losses, which resulted in net operating losses carryforwards for tax purposes amounting to approximately $321,000 at December 31, 2004 that may be offset against future taxable income. These carryforwards expire in 2021.

The following table presents the principal reasons for the differences between the Company s effective tax rate and the United States statutory income tax rate of 35%.

	2004	2003	2002
Federal income tax at statutory rate	1,922	623	730
State tax expense	100	41	110
Gain on sale differences	(1,261)	(243)	62
Other	(36)	(106)	282
Utilization of net operating loss carryforward	(725)	(315)	(1,184)
Income tax expense			
Effective income tax rate	0%	0%	0%

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

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

reflected in the segments are interest and equity in partnerships totaling $3.3 million, $2.2 million, $1.1 million for 2004, 2003 and 2002, 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 $1.8 million, $2.2 million, and $3.5 million for 2004, 2003 and 2002, respectively. Excluded from operating segment assets are assets of $59.3 million at December 31, 2004, $50.8 million at December 31, 2003, and $15.4 million at December 31, 2002, 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.

2004 (as restated)	Land	Commercial Properties	Apartments	Total
Rents	$	$ 1,244	$ 4,661	$ 5,905
Property operating expenses		673	2,456	3,129
Operating income (loss)	$	$ 571	$ 2,205	$ 2,776
Depreciation	$	$ 294	$ 446	$ 740
Interest	996	874	1,700	3,570
Real estate improvements				
Assets		12,998	18,370	31,368

Property Sales	Land	Commercial Properties	Apartments	Total
Sales price	$ 63	$ 11,500	$ 12,900	$ 24,463
Cost of sale	47	9,134	9,809	18,990
Gain on sale	$ 16	$ 2,366	$ 3,091	$ 5,473

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INCOME OPPORTUNITY REALTY INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued
NOTE 14. *OPERATING SEGMENTS* (Continued)

2003 (as restated)	Land	Commercial Properties	Apartments	Total
Rents	$	$ 718	$ 4,506	$ 5,224
Property operating expenses		389	2,942	3,331
Operating income	$	$ 329	$ 1,564	$ 1,893
Depreciation	$	$ 456	$ 360	$ 816
Interest		217	1,595	1,812
Real estate improvements		494		494
Assets	44	22,105	28,216	50,365

Property Sales	Land	Commercial Properties	Apartments	Total
Sales price	$ 63	$ 11,500	$ 12,900	$ 24,463
Cost of sale	47	9,134	9,809	18,990
Gain on sale	$ 16	$ 2,366	$ 3,091	$ 5,473

2002	Land	Commercial Properties	Apartments	Total
Rents	$	$ 778	$ 4,520	$ 5,298
Property operating expenses		360	2,388	2,748
Operating income	$	$ 418	$ 2,132	$ 2,550
Depreciation	$	$ 320	$ 428	$ 748
Interest		149	1,308	1,457
Real estate improvements		240		240
Assets	24,929	28,688	21,133	74,750

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

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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 2004, 2003, and 2002, income (loss) from discontinued operations relates to two properties that IORI sold during 2002, four properties sold during 2003, and five properties sold during 2004. The following table summarizes revenue and expense information for these properties sold.

	2004	2003	2002
Revenue			
Rental	$ 1,771	$ 4,581	$ 5,101
Property operations	981	3,087	3,582
	790	1,494	1,519
Interest Income		462	
Expenses			
Interest	556	2,987	3,457
Depreciation	323	740	1,117
	879	3,727	4,574
Net income (loss) from discontinued operations	(89)	(1,771)	(3,055)
Gain on sale of real estate	5,473	3,824	6,769
Equity in gain on sale of real estate by equity investees			383
Net income (loss) from discontinued operations	$ 5,384	$ 2,053	$ 4,097

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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 2004, 2003 and 2002 (unaudited).

	Three Months Ended			
2004 (as restated)	March 31	June 30	September 30	December 31
Rents	$ 1,448	$ 1,469	$ 1,428	$ 1,560
Property expense	842	764	902	621
Operating income	606	705	526	939
Interest income	598	605	1,017	1,105
Income (loss) in equity partnerships	(1)	11	(20)	7
Other expense	1,820	1,453	1,274	1,507
Net loss from continuing operations	(617)	(132)	249	544
Discontinued operations	3,131	466	15	1,772
Net income (loss)	$ 2,514	$ 334	$ 264	$ 2,316
Earnings per share				
Net income (loss)	$ 1.81	$ 0.24	$ 0.19	$ 1.67

	Three Months Ended			
2003 (as restated)	March 31	June 30	September 30	December 31
Rents	$ 1,319	$ 1,297	$ 1,321	$ 1,287
Property expense	670	729	873	1,059
Operating income	649	568	448	228
Recovery of A/R written off		1,569		
Interest income		614	12	
Income (loss) in equity partnerships	(15)		(13)	21
Other expense	1,015	1,723	1,071	979
Net loss from continuing operations	(381)	1,028	(624)	(730)
Discontinued operations	(546)	(372)	(455)	3,426
Net income (loss)	$ (927)	$ 656	$ (1,079)	$ 2,696
Earnings per share				
Net income (loss)	$ (0.64)	$ 0.46	$ (.75)	$ 1.87

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

NOTE 16. *QUARTERLY DATA* (Continued)

	Three Months Ended			
2002	March 31	June 30	September 30	December 31
Rents	$ 1,271	$ 1,280	$ 1,444	$ 1,303
Property expense	557	618	854	719
Operating income	714	662	590	584
Interest income	37	310	185	(262)
Income (loss) in equity partnerships	(17)	48	60	771
Other expense	2,076	1,184	724	1,710
Net income (loss) from continuing operations	(1,342)	(164)	111	(617)
Discontinued operations	6,415	(723)	(1,352)	(243)
Net income (loss)	$ 5,073	$ (887)	$ (1,241)	$ (860)
Earnings per share				
Net income (loss)	$ 3.53	$ (0.62)	$ (0.86)	$ (0.60)

In the first quarter of 2004, the Treehouse (San Antonio) Building was sold and $3.1 million gain on sale was recognized. In the second quarter of 2004, Treehouse (Irving) Building was sold and $150,000 deferred gain on sale was recognized. In the third quarter of 2004, Akard Building was sold and $427,000 gain on sale was recognized. In the fourth quarter of 2004, Frankel Land and Yeager Building were sold. $16,000 gain was recognized on the sale of Frankel Land, and $1.9 million gain was recognized on the sale of Yeager Building.

NOTE 17. *COMMITMENTS AND CONTINGENCIES AND LIQUIDITY*

Olive Litigation. In February 1990, IORI, together with National Income Realty Trust, Continental Mortgage and Equity Trust, which subsequently merged with and into TCI, 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 a stock option agreement to purchase TCI shares (which was entered into by IORI and an affiliate of IORI, 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.

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 (which were subsequently contributed to a subsidiary and later acquired by SWI) 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 2005 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 assets, refinance real estate and/or 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 a process involving the deferral of operating income or expense from the Metra properties until the sale of the property. The result is that the Company concluded that changes should be made to its financial statements for the year ending December 31, 2003 and for the year ending December 31, 2004. The resulting impact in these financial statements was to decrease net income for the year ending December 31, 2004 by $64,000 from a reported $5,492,000 to $5,428,000, an overall decrease in net income per share by $0.04 from a reported $3.95 per share to $3.91 per share. This decrease resulted from an increase in interest expense of approximately $79,000, decrease of net income fee to affiliate of $13,000, and a decrease of advisory fee to affiliate of $2,000. Total assets decreased by approximately $563,000 due to a decrease in other assets ($458,000 in 2003 and $105,000 in 2004), and total liabilities decreased by $62,000 due to a decrease in payable to affiliate of $38,000 other liabilities of $24,000. The changes for the fiscal year ended December 31, 2003 were a decrease in net income by $436,000 from a reported $1,782,000 to $1,346,000, and a decrease 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 a 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, 2004

Property/Location	Encumbranches	Initial Cost Land	Initial Cost Building & Improvements	Cost Capitalized Subsequent to Acquisition	Gross Amount Carried at End of Year[(1)] Land	Gross Amount Carried at End of Year[(1)] Building & Improvements	Total	Accumulated Depreciation	Date of Construction	Date Acquired	Life on Which Depreciation in Latest Statement of Operation is Computed
				(dollars in thousands)							
Properties Held For Investment											
Apartments											
Brighton Court, Midland, TX	$ 2,843	$ 339	$ 3,051	$	$ 339	$ 3,051	$ 3,390	$ 344	1983	06/00	40 years
Del Mar, Midland, TX	2,725	324	2,919		324	2,919	3,243	328	1983	06/00	40 years
Enclave, Midland, TX	2,882	324	2,919		324	2,919	3,243	328	1983	06/00	40 years
Meridian, Midland, TX	4,502	1,138	4,553		1,138	4,553	5,691	569	1983	12/99	40 years
Signature Place, Midland, TX	2,410	265	2,388		265	2,388	2,653	269	1983	06/00	40 years
Sinclair Place, Midland, TX	2,054	221	1,990		221	1,990	2,211	224	1983	06/00	40 years
Office Buildings											
2010 Valley View, Farmers Branch, TX	2,426	120	479	2,979	120	3,458	3,578	1,423	1998	09/97	5-40 years
Parkway Ctr, Farmers Branch, TX	1,631	333	3,511		333	3,511	3,844	88	1979	12/03	5-40 years
Industrial Warehouse											
Eagle Crest, Farmers Branch, TX		2,129	1,906		2,129	1,906	4,035	47		12/03	5-40 years
Land											
		2,804		296	3,100		3,100				

3 Hickory Ctr, Farmers Branch, TX								
	$ 21,473	$ 7,997	$ 23,716	$ 3,275	$ 8,293	$ 26,695	$ 34,988	$ 3,620

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SCHEDULE III
(Continued)

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

	2004	2003	2002
		(dollars in thousands)	
Reconciliation of Real Estate			
Balance at January 1,	$ 56,367	$ 82,252	$ 95,190
Additions			
Acquisitions and Improvements		15,365	677
Deductions			
Retirements			(462)
Sale of real estate	(21,379)	(41,250)	(13,153)
Balance at December 31,	$ 34,988	$ 56,367	$ 82,252
Reconciliation of Accumulated Depreciation			
Balance at January 1,	$ 6,002	$ 7,502	$ 7,875
Additions			
Depreciation	1,063	1,552	1,867
Deductions			
Retirements			
Sale of real estate	(3,445)	(3,052)	(2,240)
Balance at December 31,	$ 3,620	$ 6,002	$ 7,502

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SCHEDULE IV

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

	2004	2003	2002
	(dollars in thousands)		
Balance at January 1,	$ 45,531	$	$ 500
Additions			
New mortgage loans	8,655	45,531	7,109
Interest receivable on mortgage loans	913		
Deductions			
Amounts charged off	(188)		(1,568)
Collections of principal by IORI			(500)
Collections of principal by affiliates			(5,541)
Balance at December 31,	$ 54,911	$ 45,531	$

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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 the Company engaged Farmer, Fuqua & Huff, P.C. as the independent accountant to audit the Company s financial statements for the fiscal year ending December 31, 2003. During the Company s two most recent fiscal years ended December 31, 2002 and any subsequent interim period, the Company 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 the Company necessarily resulted in the termination or dismissal of the then principal accountant which audited the Company s financial statements for the past two fiscal years ended December 31, 2001 and 2002, BDO Seidman, LLP. BDO Seidman, LLP made a fee proposal estimate to the Company for 2003 which was greater than the fee proposal of Farmer, Fuqua & Huff, P.C. for the same work. During the Company s two most recent fiscal years and any subsequent interim period through July 1, 2003, BDO Seidman, LLP s report on the Company 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 Company and BDO Seidman, LLP 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 then Audit Committee of the Board of Directors of the Company which then consisted of Messrs. Ted P. Stokely, Earl D. Cecil (who resigned as a director on February 29, 2004) and Martin L. White (who resigned as a director on March 15, 2004),

Effective June 1, 2004, Farmer, Fuqua & Huff, P.C. was engaged by the Audit Committees of two affiliates of the Company to serve as those entities independent accountant for the fiscal year ending December 31, 2004. By virtue of the other assignments for Farmer, Fuqua & Huff, P.C. with those affiliates of IOT, Farmer, Fuqua & Huff suggested that perhaps another firm should handle the audit of IOT s financial statements for the fiscal year ending December 31, 2004 and in fact recommended Swalm & Associates, P.C. The approval of the engagement of Swalm & Associates, P.C. was given by the Audit Committee of the Board of Directors of IOT effective June 1, 2004, and a Current Report on Form 8-K for event occurring May 31, 2004 was filed with the Securities and Exchange Commission (the SEC). However, it was discovered that Swalm & Associates, P.C. had not completed the registration process with the Public Company Accounting Oversight Board (PCAOB). Accordingly, on June 17, 2004, the Audit Committee of the Board of Directors (consisting of Messrs. Allard, Jakuszewski and Larsen) re-engaged Farmer, Fuqua & Huff, P.C. as the independent accountants for the Company. During the short period of time of engagement of Swalm & Associates, P.C. (June 1, 2004 through June 17, 2004), Swalm & Associates, P.C. performed no work for the Company. In addition, during the Company s two most recent fiscal years ended December 31, 2003, and any subsequent interim period through May 31, 2004, the Company did not consult with Swalm & Associates, P.C. or any of its members about the application of accounting principles to any specified transaction or any other matter.

On July 19, 2004, the Company received notification that Swalm & Associates, P.C. s registration with the PCAOB had become effective. Effective July 22, 2004, the Audit Committee (consisting of Messrs. Allard, Jakuszewski and Larsen) of the board of Directors re-engaged the Plano, Texas firm of Swalm & Associates, P.C. as the independent accountant to audit the Company s financial statements for the fiscal year ending December 31, 2004. The engagement effective July 22, 2004 of Swalm & Associates, P.C. as the independent accountant for the Company necessarily resulted in the termination or dismissal of the principal accountant which had audited the Company s financial statements for the fiscal year ended December 31, 2003, Farmer, Fuqua & Huff, P.C. During the Company s most recent fiscal year and any subsequent interim period, Farmer, Fuqua & Huff, P.C. report on the Company s financial statements for that year 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 Company and Farmer, Fuqua & Huff, P.C. concerning any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure.

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 Exchange 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, 2004, IORI s Acting Principal Executive Officer and Principal Accounting Officer concluded that IORI s disclosure controls and procedures were effective at December 31, 2004 to ensure that information relating to IORI and its consolidated subsidiaries required to be disclosed in IORI s reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. There has been no change in IORI s internal control over financial reporting during the quarter ended December 31, 2004, that was believed to have materially affected or was then reasonably likely to materially affect IORI s internal control over financial reporting.

However, subsequent to the filing of the original Form 10-K for the fiscal year ended December 31, 2004, IORI and its accountants identified a control deficiency in its internal controls over financial reporting as of April 2002 (which was not material in 2002) 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 undetected 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 undetected error, which was undetected for a period of almost three years, 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 undetected 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.

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ITEM 9B. OTHER INFORMATION

Not Applicable.