

INCOME OPPORTUNITY REALTY INVESTORS INC /TX/

Form 10-Q

May 15, 2007

[Table of Contents](#)

---

## **FORM 10-Q**

---

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTER ENDED MARCH 31, 2007**

**Or**

**“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM TO**

**Commission File Number 001-14784**

---

**INCOME OPPORTUNITY REALTY INVESTORS, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Nevada**  
**(State or Other Jurisdiction of**

**Incorporation or Organization)**

**75-2615944**  
**(I.R.S. Employer**

**Identification No.)**

**1755 Wittington Place, Suite 340**

**Dallas, Texas 75234**

**(Address of principal executive offices)**

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

(Zip Code)

(469) 522-4200

(Registrant's telephone number, including area code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer x

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE  
PRECEDING FIVE YEARS:**

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

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

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

4,167,635  
(Outstanding at April 30, 2007)

**Table of Contents**

**INCOME OPPORTUNITY REALTY INVESTORS, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

Item 1.	<u>Financial Statements</u>	3
	<u>Consolidated Balance Sheets at March 31, 2007 (unaudited) and December 31, 2006</u>	3
	<u>Consolidated Statements of Operations for the three months ended March 31, 2007 and 2006 (unaudited)</u>	4
	<u>Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2007 (unaudited)</u>	5
	<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2007 and 2006 (unaudited)</u>	6
	<u>Notes to Consolidated Financial Statements</u>	7
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	14
Item 4.	<u>Controls and Procedures</u>	15

**PART II. OTHER INFORMATION**

Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	16
Item 6.	<u>Exhibits</u>	16
	<u>SIGNATURE PAGE</u>	17
	<u>CERTIFICATIONS</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

The accompanying Consolidated Financial Statements as of and for the three months ended March 31, 2007 have not been audited by independent certified public accountants but, in the opinion of the management of Income Opportunity Realty Investors, Inc. ( IORI or the Company ), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of IORI s consolidated financial position, consolidated results of operations and consolidated cash flows at the dates and for the periods indicated, have been included.

**INCOME OPPORTUNITY REALTY INVESTORS, INC.****CONSOLIDATED BALANCE SHEETS**

(amounts in thousands except per share data)

	March 31, 2007 (unaudited)	December 31, 2006
<b>Assets</b>		
Real estate held for investment	\$ 63,432	\$ 63,682
Less accumulated depreciation	(5,259)	(5,061)
	58,173	58,621
Notes and interest receivable	28,258	27,777
Investment in real estate partnerships	515	515
Cash and cash equivalents	65	80
Receivables from affiliates	17,052	17,766
Other assets	3,830	4,152
	\$ 107,893	\$ 108,911
<b>Liabilities and Stockholders Equity</b>		
<b>Liabilities</b>		
Notes and interest payable	\$ 61,512	\$ 61,546
Other liabilities	835	1,921
	62,347	63,467
<b>Commitments and contingencies</b>		
Minority interest	642	605
<b>Stockholders equity</b>		
Common Stock, \$.01 par value, authorized 10,000,000 shares; issued and outstanding 4,167,635 and 4,168,035 shares at March 31, 2007 and at December 31, 2006, respectively	42	42
Paid-in capital	61,954	61,955
Accumulated deficit	(17,092)	(17,158)
	44,904	44,839

\$ 107,893      \$ 108,911

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

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

(amounts in thousands, except per share data)

	<b>For the Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(unaudited)</b>	
Property revenue		
Rents and other property revenues	\$ 2,089	\$ 1,697
Operating expenses		
Property operations	1,107	804
Depreciation	198	170
General and administrative	143	150
Advisory fee	211	194
Total operating expenses	1,659	1,318
Operating income	430	379
Other income (expense):		
Interest income (includes \$514 in 2007 and \$180 in 2006 from related parties)	1,099	1,174
Mortgage and loan interest	(1,420)	(896)
Net income fee	(5)	(50)
Total other income (expense)	(326)	228
Income before minority interest	104	607
Minority interest	(38)	(13)
Net income	\$ 66	\$ 594
Earnings per share:		
Net earnings from continuing operations	\$ 0.02	\$ 0.14
Weighted average common shares used in computing earnings per share	4,167,635	4,168,035

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

**Table of Contents**

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

**For the Three months Ended March 31, 2007**

(amounts in thousands)

(Unaudited)

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-in	Deficit	Stockholders
			Capital		Equity
Balance, December 31, 2006	4,168,035	\$ 42	\$ 61,955	\$ (17,158)	\$ 44,839
Repurchased shares	(400)		(1)		(1)
Net income				66	66
Balance, March 31, 2007	4,167,635	\$ 42	\$ 61,954	\$ (17,092)	\$ 44,904

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

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

(amounts in thousands)

	For the Three Months	
	Ended March 31, 2007	2006 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 66	\$ 594
Reconciliation of net income to net cash used by operating activities		
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation	198	170
Amortization	85	63
Minority interest	37	13
Increase in interest receivable	(481)	(373)
Decrease (increase) in other assets	487	(729)
Increase (decrease) in interest payable	50	(57)
Increase (decrease) in other liabilities	(1,087)	(351)
Net cash provided by (used in) operating activities	(645)	(670)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of real estate		(3,787)
Advances from (payments to) advisor and affiliates	714	3,231
Net cash provided by (used in) investing activities	714	(556)
CASH FLOWS FROM FINANCING ACTIVITIES		
Notes payable payments	(84)	(308)
Notes payable proceeds		1,500
Net cash provided by (used in) financing activities	(84)	1,192
Increase (decrease) in cash and cash equivalents	(15)	(34)
Cash and cash equivalents, beginning of period	80	201
Cash and cash equivalents, end of period	\$ 65	\$ 167
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ 1,284	\$ 831

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



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

The accompanying Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, accordingly, do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Dollar amounts in tables are in thousands, except per share amounts.

Operating results for the three-month period ended March 31, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the Consolidated Financial Statements and notes included in IORI's Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Form 10-K).

Certain balances from 2006 have been reclassified to conform to the 2007 presentation.

**NOTE 2. REAL ESTATE**

On March 31, 2006, IORI acquired a 218-unit apartment complex located in Indianapolis, Indiana (Falcon Point) from Syntek West, Inc. (SWI), a related party for \$3,750,000, which included the assumption of a \$1,500,000 existing mortgage. IORI did not acquire any properties during the three months ended March 31, 2007.

IORI sold no properties during the three months ended March 31, 2007 or 2006.

The following is a list of properties owned by IORI on March 31, 2007:

				Accumulated
Property	Location	Units /Sq. Ft. / Acres	Cost Basis	Depreciation
Apartments				
Brighton Court	Midland, TX <sup>1</sup>	60 Units /90,672 Sq. Ft.	\$ 3,390	\$ 515
Del Mar	Midland, TX <sup>1</sup>	92 Units / 105,348 Sq. Ft.	3,243	493
Enclave	Midland, TX <sup>1</sup>	68 Units / 89,734 Sq. Ft.	3,243	493
Falcon Point	Indianapolis, IN	218 Units / 162,425 Sq. Ft.	3,643	116
Meridian	Midland, TX <sup>1</sup>	280 Units / 264,000 Sq. Ft.	5,690	825
Signature Place	Midland, TX <sup>1</sup>	57 Units / 72,480 Sq Ft.	2,211	336
Sinclair Place	Midland, TX <sup>1</sup>	114 Units / 91,529 Sq. Ft.	2,653	403
Office Buildings				
2010 Valley View	Farmers Branch, TX	40,666 Sq. Ft.	3,642	1,623
Shopping Centers				
Parkway Center	Dallas, TX	28,374 Sq. Ft.	3,956	304
Industrial Warehouse				
Eagle Crest	Farmers Branch, TX	133,000 Sq. Ft.	4,070	151
Land				
Three Hickory Centre	Farmers Branch, TX	9 Acres	3,100	
Travelers Land	Farmers Branch, TX	202 Acres	24,591	
			\$ 63,432	\$ 5,259

<sup>1</sup> The Company transferred these six residential properties along with another residential property to partnerships formed with Metra Capital LLC ("Metra") which was recorded as a financing transaction under SFAS 66 "Accounting for Real Estate Sales." The participation in the transaction of a former director of ARI, a related party, as well as the fact that at the time ARI was a related party to the Company, required the treatment as a financing transaction, although title to the residential properties was transferred to another entity. The effect is

for these properties to remain as assets on the financial statements of the Company and liabilities associated with the financing transaction recorded.

**Table of Contents****NOTE 3. NOTES AND INTEREST RECEIVABLE**

The following is a list of notes and interest receivable due IORI on March 31, 2007:

<b>Borrower</b>	<b>Maturity</b>	<b>Principal</b>	<b>Accrued</b>	<b>Interest Rate</b>
		<b>Balance</b>	<b>Interest</b>	
Housing for Seniors of Humble, LLC	12/27/09	\$ 2,000	\$ 57	11.20%
Housing for Seniors of Humble, LLC	12/27/09	6,363	2,421	11.50%
Unified Housing Foundation, Inc. (Marquis at VR)	12/10/13	2,438	90	12.00%
Unified Housing Foundation, Inc. (Echo Station)	12/26/13	1,488	48	12.00%
Unified Housing Foundation, Inc.	9/15/10	2,990	363	10.00%
Unified Housing Foundation, Inc. (Parkside Crossing)	12/29/13	1,726	53	12.00%
Unified Housing Foundation, Inc. (Timbers of Terrell)	12/18/08	1,180	41	12.00%
Centura Land Mortgage (due from TCI)	8/22/07	7,000		Prime + 2%
		<b>\$ 25,185</b>	<b>\$ 3,073</b>	

**NOTE 4. NOTES AND INTEREST PAYABLE**

The following is a list of notes and interest payable owed by IORI on March 31, 2007:

<b>Project</b>	<b>Maturity</b>	<b>Principal</b>	<b>Accrued</b>
	<b>Date</b>	<b>Balance</b>	<b>Interest</b>
Brighton Court	5/1/12	\$ 2,751	\$ 18
Del Mar	5/1/12	2,637	17
Enclave	5/1/12	2,789	18
Signature Place	5/1/12	2,331	15
Sinclair	5/1/12	1,987	13
Meridian	5/1/12	4,356	28
Falcon Point	11/30/07	1,200	39
2010 Valley View	10/3/08	2,209	
Eagle Crest	11/1/11	2,438	
Parkway Center	6/30/36	2,684	
Centura Land	8/22/07	7,000	
Traveler's Land	8/10/08	28,652	330
		<b>\$ 61,034</b>	<b>\$ 478</b>

**NOTE 5. ADVISORY AGREEMENT**

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

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



**Table of Contents**

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

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

	For Three months	
	Ended March 31,	
	2007	2006
Revenue, fees, interest on cash advances and cost reimbursements to SWI:		
Advisory Fees to SWI	\$ 211	\$ 194
Interest Income on cash advances from IORI	\$ (335)	\$ (20)
Net income fee to SWI	\$ 5	\$ 50

**NOTE 6. RECEIVABLE FROM AND PAYABLE TO AFFILIATES**

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

	SWI	TCI	Total
Balance, December 31, 2006	\$ 16,654	\$ 1,112	\$ 17,766
Cash received	(1,698)		(1,698)
Cash payments	1,289		1,289
Other additions	390	180	570
Other repayments	(875)		(875)
Balance, March 31, 2007	\$ 15,760	\$ 1,292	\$ 17,052

**NOTE 7. OPERATING SEGMENTS**

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

## Table of Contents

Presented below is the operating income of each operating segment for the three months ended March 31, 2007 and 2006 and each segment's assets at March 31, 2007 (amounts in thousands).

	Commercial			
	Land	Properties	Apartments	Total
<b>Three Months Ended March 31, 2007</b>				
Rental and other property revenues	\$	\$ 335	\$ 1,754	\$ 2,089
Property operating expenses		247	860	1,107
Depreciation		57	141	198
Interest expense	700	377	343	1,420
Segment Income (Loss)	\$ (700)	\$ (346)	\$ 410	\$ (636)
Real estate assets, net of depreciation	\$ 27,673	\$ 9,606	\$ 20,894	\$ 58,173
<b>Three Months Ended March 31, 2006</b>				
Rental and other property revenues	\$	\$ 359	\$ 1,338	\$ 1,697
Property operating expenses		168	636	804
Depreciation		59	111	170
Interest expense	239	309	348	896
Segment Income (Loss)	\$ (239)	\$ (177)	\$ 243	\$ (173)
Real estate assets, net of depreciation	\$	\$ 12,790	\$ 21,599	\$ 34,389

The following table reconciles the segment information to the corresponding amounts in the consolidated statements of operations:

	For the Three months	
	Ended March 31, 2007	2006
Segment operating income	\$ (636)	\$ (173)
Interest income	1,099	1,174
General and administrative	(143)	(150)
Advisory fees	(211)	(194)
Net income fee	(5)	(50)
Minority interest	(38)	(13)
Net income	\$ 66	\$ 594

## NOTE 8. COMMITMENTS AND CONTINGENCIES

**Liquidity.** Management anticipates that IORI may not generate sufficient excess funds from operations in 2007 to discharge all of IORI's debt obligations as they mature. Management may selectively sell income producing assets, refinance real estate, and/or incur additional borrowings against real estate to meet its cash requirements.

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

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

***WARNING CONCERNING FORWARD-LOOKING STATEMENTS***

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

This Report on Form 10-Q may contain forward-looking statements within the meaning of the federal securities laws, principally, but not only, under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations. We caution investors that any forward-looking statements in this report, or which management may make orally or in writing from time to time, are based on management's beliefs and on assumptions made by, and information currently available to, management. When used, the words anticipate, believe, expect, intend, may, might, plan, estimate, project, should, will, result and similar expressions which do not relate solely to historical matters are intended to identify forward-looking statements. These

## **Table of Contents**

statements are subject to risks, uncertainties and assumptions and are not guarantees of future performance, which may be affected by known and unknown risks, trends, uncertainties and factors that are beyond our control. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. We caution you that, while forward-looking statements reflect our good faith beliefs when we make them, they are not guarantees of future performance and are impacted by actual events when they occur after we make such statements. We expressly disclaim any responsibility to update our forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on results and trends at the time they are made, to anticipate future results or trends.

Some of the risks and uncertainties that may cause our actual results, performance, or achievements to differ materially from those expressed or implied by forward-looking statements include, among others, the factors listed and described at Item 1A. Risk Factors in the Company's Annual Report on Form 10-K, which investors should review. There have been no changes from the risk factors previously described in the Company's Form 10-K for the fiscal year ended December 31, 2006.

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

### ***Overview***

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

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

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

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

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

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

Foreclosed real estate is initially recorded at new cost, defined as the lower of original cost or fair value minus estimated costs of sale. SFAS No. 144 also requires that properties held-for-sale be reported at the lower of carrying amount or fair value less costs of sale. If a reduction in a held-for-sale property's carrying amount to fair value less costs of sale is required, a provision for loss is recognized





## **Table of Contents**

by a charge against earnings. Subsequent revisions, either upward or downward, to a held-for-sale property's estimated fair value less costs of sale are recorded as an adjustment to the property's carrying amount, but not in excess of the property's carrying amount when originally classified as held-for-sale. A corresponding charge against or credit to earnings is recognized. Properties held for sale are not depreciated.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## **Table of Contents**

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

Cash and cash equivalents at March 31, 2007 were \$65,000 compared to \$80,000 at December 31, 2006. IORI's principal sources of cash have been and will continue to be property operations, proceeds from asset sales, interest earned on notes receivable, financings and refinancings and partnership distributions. Management anticipates that IORI will generate excess cash from operations in 2007 due to increased rental receipts at its properties. However, such excess may not be sufficient to discharge all of IORI's debt obligations as they mature. Management may selectively sell income producing assets, refinance real estate, and/or incur additional borrowings against real estate to meet its cash requirements.

The Company reported net income of \$66,000 for the three months ended March 31, 2007, which included the following items for the period: depreciation and amortization of \$283,000, a decrease in other assets of \$487,000, an increase in notes and interest receivable of \$481,000, an increase in notes and interest payable of \$50,000, a decrease in other liabilities of \$1.1 million and an increase in minority interest of \$37,000. Net cash used in operating activities totaled \$645,000 for the three months ended March 31, 2007. During the three months ended March 31, 2007 net cash provided by investing activities was \$714,000, consisting almost entirely of advances from the Company's Advisor under the terms of the Cash Management Agreement. See Note 5. Cash Management Agreement. Net cash used in financing activities was \$84,000 which is principal payments for notes payable.

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

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

IORI had a net income of \$66,000 for the three months ended March 31, 2007 as compared to net income of \$594,000 for the corresponding period in 2006. Fluctuations in components of revenue and expense between March 31, 2007 and the corresponding period in 2006 are discussed below.

Rental income for the three months ended March 31, 2007 was \$2.1 million compared to \$1.7 in the corresponding period in 2006. \$264,000 of the increase is due to revenue from the Falcon Point Apartments which was acquired on March 31, 2006. The balance is due to increased average rents at the various properties.

Property operating expense for the three months ended March 31, 2007 was \$1.1 million compared to \$804,000 for the corresponding period in 2006. The increase is primarily due to operating expenses from the Falcon Point Apartments.

Depreciation expense for the three months ended March 31, 2007 was \$198,000 compared to \$170,000 for the corresponding period in 2006. The increase is due to additional depreciation from Falcon Point Apartments.

General and administrative expenses for the three months ended March 31, 2007 was \$143,000 compared to \$150,000 for the corresponding period in 2006.

Advisory fees to affiliate for the three months ended March 31, 2007 was \$211,000 compared to \$194,000 for the corresponding period in 2006. The increase was due to a net increase in gross assets which is the basis of the advisory fee.

Interest income for the three months ended March 31, 2007 was \$1.1 million compared to \$1.2 million for the corresponding period in 2006.

In May 12, 2006, Encino Executive Plaza Ltd. transferred One Hickory Center and the 202 acres of unimproved real property known as Travelers Land back to IORI in satisfaction of the three notes receivable totaling \$36 million. Interest income received by IORI on the Encino Notes for the three months ended March 31, 2006 was \$499,000.

The overall loss of interest income from the above notes was partially offset by interest income from SWI of \$335,000 in 2007 as compared to \$20,000 in 2006. The interest paid or received from SWI is based upon the Cash Management Agreement between IORI and SWI whereby interest is paid or received at a rate of prime plus one percent based upon the outstanding intercompany balances throughout the period. See NOTE 5. ADVISORY AGREEMENT.



**Table of Contents**

Interest expense for the three months ended March 31, 2007 was \$1.4 million compared to \$896,000 for the corresponding period in 2006. The increase was primarily due to the additional debt incurred by IORI during 2006 due to new loans, refinancings and the acquisition of Falcon Point Apartments. The increase was also due to increased interest rates for IORI's variable interest rate debt.

The net income fee to affiliates for the three months ended March 31, 2007 was \$5,000 as compared to \$50,000 for the corresponding period in 2006. The net income fee is based on 7 1/2% of IORI's net income. See NOTE 5. ADVISORY AGREEMENT.

***Related Party Transactions***

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

***Income Taxes***

Financial statement income varies from taxable income principally due to the accounting for income and losses of investees, gains and losses from asset sales, depreciation on owned properties, amortization of discounts on notes receivable and payable and the difference in the allowance for estimated losses. At March 31, 2007, IORI had a net deferred tax asset of approximately \$1.3 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that IORI will realize the benefit of the deferred tax asset, a 100% valuation allowance has been established.

At March 31, 2007, IORI had a net deferred tax asset of approximately \$1.4 million due to tax deductions available to it in future years. However, as management cannot determine that it is more likely than not that IORI will realize the benefit of the deferred tax asset, a 100% valuation allowance has been established.

***Inflation***

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

***Environmental Matters***

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

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

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

At March 31, 2007 IORI's exposure to a change in interest rates on its debt was as follows:

	Balance	Weighted Average Interest Rate	Effect of 1% Increase In Base Rates
Notes payable:			
Variable rate	\$ 8,200,000	10.40%	\$ 82,000

Total decrease in IORI s annual net income	82,000
Per share	\$ .02

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

Based upon their most recent evaluation, which was completed as of the end of the period covered by this Report, the Principal Executive Officer and the Principal Financial and Accounting Officer concluded that the Company's disclosure controls and procedures were effective at March 31, 2007 to ensure that information required to be disclosed in reports that the Company files or submits under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time period specified in Securities and Exchange Commission rules and forms. There were no changes in the Company's internal controls over financial reporting during the quarter ended March 31, 2007 that have materially affected or are reasonably likely to materially affect the Company's internal controls over financial reporting.

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

During the period of time covered by the Report, Income Opportunity Realty Investors, Inc. repurchased 600 shares of its equity securities. The following table sets forth a summary for the quarter indicating the repurchases made and that at the end of the period covered by this Report, a specified number of shares may yet be purchased under the programs specified below:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program <sup>(a)</sup>
Balance as of December 31, 2006				219,090
January 1-31, 2007		\$		219,090
February 1-28, 2007	300	5.52		218,790
March 1-31, 2007	100	5.67		218,690
Total	400	\$ 5.56		218,690

- (a) On June 23, 2000, the IORI Board of Directors approved a share repurchase program for up to 1,409,000 shares of our common stock. This repurchase program has no termination date.

**ITEM 6. EXHIBITS**

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

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

\* filed herewith



**Table of Contents**

**SIGNATURE PAGE**

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

INCOME OPPORTUNITY REALTY INVESTORS, INC.

Date: May 15, 2007

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

(Principal Executive Officer)

By: /s/ Steven A. Abney  
Steven A. Abney  
Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)