

INCOME OPPORTUNITY REALTY INVESTORS INC /TX/  
Form 10-Q  
November 14, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-14784

INCOME OPPORTUNITY REALTY INVESTORS, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

1800 Valley View Lane, Suite 300, Dallas, Texas 75234  
(Address of principal executive offices)  
(Zip Code)

(469) 522-4200  
(Registrant's telephone number, including area code)

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



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## PART 1. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## INCOME OPPORTUNITY REALTY INVESTORS, INC.

## CONSOLIDATED BALANCE SHEETS

(unaudited)

	September 30, 2011	December 31, 2010
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate land holdings, at cost	\$ 24,511	\$ 24,511
Real estate subject to sales contracts, at cost	-	5,050
Total real estate	24,511	29,561
Notes and interest receivable from related parties	28,920	38,405
Less allowance for doubtful accounts	(1,826 )	(1,826 )
Total notes and interest receivable	27,094	36,579
Cash and cash equivalents	2	20
Investments in unconsolidated subsidiaries and investees, subject to sales contract	67	89
Receivable and accrued interest from related parties	53,331	48,598
Other assets	1,548	2,240
Total assets	\$ 106,553	\$ 117,087
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$ 28,630	\$ 34,214
Notes and interest payable related to subject to sales contracts	-	2,390
Deferred gain (from sales to related parties)	6,550	6,550
Accounts payable and other liabilities (including \$0 in 2011 and \$1 in 2010 to affiliated and related parties)	188	401
	35,368	43,555
Commitments and contingencies:		
Shareholders' equity:		
Common stock, \$.01 par value, authorized 10,000,000 shares; issued 4,173,675 shares in 2011 and 2010	42	42
Treasury stock at cost, 5,461 in 2011 and 2010	(39 )	(39 )
Paid-in capital	61,955	61,955
Retained earnings	9,227	11,574
Total shareholders' equity	71,185	73,532
Total liabilities and shareholders' equity	\$ 106,553	\$ 117,087

The accompanying notes are an integral part of these financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
	(dollars in thousands, except share and per share amounts)			
Revenues:				
Rental and other property revenues	\$-	\$-	\$-	\$-
Expenses:				
Property operating expenses	6	7	18	39
General and administrative (including \$52 and \$30 for the three months ended, \$167 and \$92 for the nine months ended 2011 and 2010 respectively from affiliates and related parties)	94	70	370	247
Advisory fee to affiliates	219	217	650	650
Total operating expenses	319	294	1,038	936
Operating loss	(319)	(294)	(1,038)	(936)
Other income (expense):				
Interest income from related party notes receivable	543	512	1,560	1,842
Mortgage and loan interest	(282)	(279)	(928)	(841)
Earnings from unconsolidated subsidiaries and investees	28	(8)	(22)	(5)
Total other income (expenses)	289	225	610	996
Income (loss) from continuing operations before tax	(30)	(69)	(428)	60
Income tax benefit (expense)	(170)	13	(672)	49
Net income (loss) from continuing operations	(200)	(56)	(1,100)	109
Discontinued operations:				
Income (loss) from discontinued operations	(10)	37	(1,444)	4
Loss on sale of real estate from discontinued operations	(475)	-	(475)	-
Income tax benefit (expense) from discontinued operations	170	(13)	672	(1)
Net income (loss) from discontinued operations	(315)	24	(1,247)	3
Net income (loss)	\$(515)	\$(32)	\$(2,347)	\$112
Earnings per share - basic				
Income (loss) from continuing operations	\$(0.05)	\$(0.01)	\$(0.26)	\$0.03
Income (loss) from discontinued operations	(0.08)	0.01	(0.30)	-
Net income (loss) applicable to common shares	\$(0.13)	\$-	\$(0.56)	\$0.03
Earnings per share - diluted				
Income (loss) from continuing operations	\$(0.05)	\$(0.01)	\$(0.26)	\$0.03
Income (loss) from discontinued operations	(0.08)	0.01	(0.30)	-
Net income (loss) applicable to common shares	\$(0.13)	\$-	\$(0.56)	\$0.03
	4,168,214	4,168,214	4,168,214	4,168,214

Weighted average common share used in computing  
earnings per share

Weighted average common share used in computing diluted  
earnings per share

4,168,214	4,168,214	4,168,214	4,168,214
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The accompanying notes are an integral part of these financial statements.

INCOME OPPORTUNITY REALTY INVESTORS, INC.  
 CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
 For the Nine Months Ended September 30, 2011  
 (unaudited)  
 (dollars in thousands)

	Total	Common Stock Shares	Common Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings
Balance, December 31, 2010	\$73,532	4,173,675	\$42	\$(39 )	\$61,955	\$11,574
Net loss	(2,347 )	-	-	-	-	(2,347 )
Balance, September 30, 2011	\$71,185	4,173,675	\$42	\$(39 )	\$61,955	\$9,227

The accompanying notes are an integral part of these financial statements.

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

	For the Nine Months Ended September 30, 2011          2010 (dollars in thousands)	
<b>Cash Flow From Operating Activities:</b>		
Net income (loss) applicable to common shares	\$(2,347	) \$112
Adjustments to reconcile net income (loss) applicable to common shares to net cash used in operating activities:		
Loss on sale of income producing properties	(475	) -
Depreciation and amortization	-	7
Earnings from unconsolidated subsidiaries and investees	22	5
Provision on impairment of real estate assets	1,474	-
(Increase) decrease in assets:		
Accrued interest receivable	-	(751
Other assets	686	147
Increase (decrease) in liabilities:		
Accrued interest payable	886	94
Other liabilities	(213	) 46
Net cash provided by (used in) operating activities	1,280	(343
<b>Cash Flow From Investing Activities:</b>		
Proceeds from notes receivable	2,585	2,371
Proceeds from income producing properties	1,892	-
Proceeds from sales of land	1,210	-
Real estate improvements	-	(58
Affiliate receivable	(4,733	) (1,585
Net cash provided by investing activities	954	728
<b>Cash Flow From Financing Activities:</b>		
Payments on notes payable	414	(391
Payments or debt assumption on maturing notes payable	(2,374	) -
Deferred financing costs	6	5
Net cash used in financing activities	(1,954	) (386
Net increase (decrease) in cash and cash equivalents	(18	) 2
Cash and cash equivalents, beginning of period	20	2
Cash and cash equivalents, end of period	\$2	\$4
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	\$998	\$977
Cash received for income taxes	\$22	\$-

Schedule of noncash investing and financing activities

Satisfaction of notes receivable related to Centura land	\$6,900	\$-
Satisfaction of notes payable related to Centura Land	\$(6,900	) \$-

The accompanying notes are an integral part of these financial statements.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

#### Organization

As used herein, the terms “IOT,” “the Company,” “we,” “our,” “us” refer to Income Opportunity Realty Investors, Inc., a Nevada corporation, individually or together with its subsidiaries. Income Opportunity Realty Investors, Inc. is the successor to a California business trust organized on December 14, 1984, which commenced operations on April 10, 1985. The Company is headquartered in Dallas, Texas and its common stock trades on the American Stock Exchange under the symbol “AMEX: IOT”.

Transcontinental Realty Investors, Inc. (“TCI”) owns approximately 82.7% of the Company’s common stock. Effective July 17, 2009, IOT’s financial results were consolidated with those of American Realty Investors, Inc. (“ARL”) and TCI and their subsidiaries. IOT is a “C” Corporation for U.S. federal income tax purposes and files an annual consolidated income tax return with ARL. ARL is the common parent for the consolidated group.

IOT invests in real estate through direct ownership, leases and partnerships and it also invests in mortgage loans on real estate. Prior to April 30, 2011, Prime Income Asset Management, LLC (“Prime”) was the Company’s external Advisor and Cash Manager. Prime also served as an Advisor and Cash Manager to ARL and TCI. Effective April 30, 2011, Pillar Income Asset Management, Inc. (“Pillar”) became the Company’s external Advisor and Cash Manager under the same terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to ARL and TCI. Prior to December 31, 2010, Triad Realty Services, L.P. (“Triad”) managed the Company’s commercial properties and Regis Realty I, LLC (“Regis Realty”) provided brokerage services. Triad and Regis Realty are affiliates of Prime. Effective January 1, 2011, Regis Realty Prime, LLC (“Regis”), an affiliate of Prime, manages our commercial properties and provides brokerage services under the same terms as the previous agreements with Triad and Regis Realty, for a term of five years. We have no employees.

Our primary business is investing in real estate. Land held for development or sale is our sole operating segment. As of September 30, 2011, our land consisted of 178.1 acres. All of our land holdings are located in Texas. The principal source of revenue for the Company is interest income on over \$28.9 million of note receivables due from affiliated and/or related parties.

#### Basis of presentation

The accompanying unaudited financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, or GAAP, have been condensed or omitted in accordance with such rules and regulations, although management believes the disclosures are adequate to prevent the information presented from being misleading. In the opinion of management, all adjustments (consisting of normal recurring matters) considered necessary for a fair presentation have been included. The results of operations for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for other interim periods or for the full fiscal year.

The year-end Balance Sheet at December 31, 2010, was derived from the audited financial statements at that date, but does not include all of the information and disclosures required by GAAP for complete financial statements. For further information, refer to the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010. Certain 2010 financial statement amounts have been reclassified to conform to the 2011 presentation, including adjustments for discontinued operations.

## Principles of consolidation

The accompanying Consolidated Financial Statements include our accounts, our subsidiaries, generally all of which are wholly-owned, and all entities in which we have a controlling interest. Arrangements that are not controlled through voting or similar rights are accounted for as a Variable Interest Entity (“VIE”), in accordance with the provisions and guidance of ASC Topic 810 “Consolidation”, whereby we have determined that we are a primary beneficiary of the VIE and meet certain criteria of a sole general partner or managing member as identified in accordance with Emerging Issues Task Force (“EITF”) Issue 04-5, Investor’s Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Rights (“EITF 04-5”). VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders as a group lack adequate decision making ability, the obligation to absorb expected losses or residual returns of the entity, or have voting rights that are not proportional to their economic interests. The primary beneficiary generally is the entity that provides financial support and bears a majority of the financial risks, authorizes certain capital transactions, or makes operating decisions that materially affect the entity’s financial results. All significant intercompany balances and transactions have been eliminated in consolidation.

In determining whether we are the primary beneficiary of a VIE, we consider qualitative and quantitative factors, including, but not limited to: the amount and characteristics of our investment; the obligation or likelihood for us or other investors to provide financial support; our and the other investors’ ability to control or significantly influence key decisions for the VIE; and the similarity with and significance to the business activities of us and the other investors. Significant judgments related to these determinations include estimates about the current future fair values and performance of real estate held by these VIEs and general market conditions. As of September 30, 2011, IOT was not the primary beneficiary of a VIE.

For entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary, the entities are accounted for using the equity method of accounting. Accordingly, our share of the net earnings or losses of these entities is included in net income. Our investment in TCI Eton Square, LP is accounted for under the equity method.

#### Real estate, depreciation, and impairment

Real estate assets are stated at the lower of depreciated cost or fair value, if deemed impaired. Major replacements and betterments are capitalized and depreciated over their estimated useful lives. Depreciation is computed on a straight-line basis over the useful lives of the properties (buildings and improvements – 10-40 years; furniture, fixtures and equipment – 5-10 years). We continually evaluate the recoverability of the carrying value of our real estate assets using the methodology prescribed in ASC Topic 360, “Property, Plant and Equipment”. Factors considered by management in evaluating impairment of our existing real estate assets held for investment include significant declines in property operating profits, annually recurring property operating losses and other significant adverse changes in general market conditions that are considered permanent in nature. Under ASC Topic 360, a real estate asset held for investment is not considered impaired if the undiscounted, estimated future cash flows of an asset (both the annual estimated cash flow from future operations and the estimated cash flow from the theoretical sale of the asset) over its estimated holding period are in excess of the asset’s net book value at the balance sheet date. If any real estate asset held for investment is considered impaired, a loss is provided to reduce the carrying value of the asset to its estimated fair value.

#### Real estate held for sale

We periodically classify real estate assets as “held for sale”. An asset is classified as held for sale after the approval of our board of directors and after an active program to sell the asset has commenced. Upon the classification of a real estate asset as held for sale, the carrying value of the asset is reduced to the lower of its net book value or its estimated fair value, less costs to sell the asset. Subsequent to the classification of assets as held for sale, no further depreciation expense is recorded. Real estate assets held for sale are stated separately on the accompanying Consolidated Balance Sheets. Upon a decision to no longer market as an asset for sale, the asset is classified as an operating asset and depreciation expense is reinstated. The operating results of real estate assets held for sale and sold are reported as discontinued operations in the accompanying statements of operations. Income from discontinued operations includes the revenues and expenses, including depreciation and interest expense, associated with the assets. This classification of operating results as discontinued operations applies retroactively for all periods presented. Additionally, gains and losses on assets designated as held for sale are classified as part of discontinued operations.

#### Cost capitalization

Costs related to planning, developing, leasing and constructing a property are capitalized and classified as Real Estate in the Consolidated Balance Sheets. We capitalize interest to qualifying assets under development based on average accumulated expenditures outstanding during the period. In capitalizing interest to qualifying assets, we first use the interest incurred on specific project debt, if any, and next use the weighted average interest rate of non-project specific debt.

We capitalize interest, real estate taxes and certain operating expenses until building construction is substantially complete and the building is ready for its intended use, but no later than one year from the cessation of major construction activity.

We capitalize leasing costs which include commissions paid to outside brokers, legal costs incurred to negotiate and document a lease agreement and any internal costs that may be applicable. We allocate these costs to individual

tenant leases and amortize them over the related lease term.

#### Fair value measurement

We apply the guidance in ASC Topic 820, “Fair Value Measurements and Disclosures”, to the valuation of real estate assets. These provisions define fair value as the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date, establish a hierarchy that prioritizes the information used in developing fair value estimates and require disclosure of fair value measurements by level within the fair value hierarchy. The hierarchy gives the highest priority to quoted prices in active markets (Level 1 measurements) and the lowest priority to unobservable data (Level 3 measurements), such as the reporting entity’s own data.

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date and includes three levels defined as follows:

Level 1 – Unadjusted quoted prices for identical and unrestricted assets or liabilities in active markets.

Level 2 – Quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Unobservable inputs that are significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

#### Newly issued accounting pronouncements

We have considered all other newly issued accounting guidance that is applicable to our operations and the preparation of our statements, including that which we have not yet adopted. We do not believe that any such guidance will have a material effect on our financial position or results of operation.

#### NOTE 2. REAL ESTATE ACTIVITY

Our properties consist of 178.1 acres of land held for future development or sale.

On July 5, 2011, we recognized the September 21, 2010 13.0 acres of land with a 29,784 square foot storage warehouse know as Eagle Crest located in Farmers Branch, Texas, to Warren Road Farm, Inc., a related party under common control, for a sale price of \$3.8 million . The buyer assumed the existing mortgage of \$2.4 million secured by the property. We recorded a loss of \$0.5 million when ownership transferred to the existing lender.

On July 5, 2011, we recognized the December 23, 2010 sale of 6.6 acres of land known as Three Hickory land located in Farmers Branks, Texas, to Fenton Real Estate, Inc., a related party under common control, for a sales price of \$1.3 million. There was no gain or loss recorded when ownership transferred to the existing lender.

In 2005, IOT purchased 10.08 acres of Centura land, located in Dallas County, Texas, from TCI (a related party) for \$13.0 million. The purchase price was paid with cash of \$6.1 million and the conveyance, to the seller, of \$6.9 million in notes receivable held by IOT. The cash was obtained from financing the land acquired in the transaction. The agreement includes a put option whereby IOT has the right to resell the property to the seller for a price of \$13.0 million plus a preferred return of 9% per annum accruing from the closing date. Due to the related party nature of the transaction, including the likelihood that IOT will exercise its put option; this transaction has been treated as a financing transaction. IOT continued to carry the \$6.9 million as a note payable and has recorded the \$6.9 million as a receivable from TCI. TCI pays IOT interest in an amount equal to what IOT pays for its loan on the property. On August 2, 2011, we recognized the sale of 10.08 acres of land known as Centura land located in Dallas, Texas, to ABCLD Real Estate, LLC (ABCLD), a related party under common control, for a sales price of \$13.0 million. The buyer assumed the existing mortgage fo \$7.2 million secured by the property. Ownership of this property was then transferred from ABCLD to the lender. There was no gain or loss recorded on the sale.

As of September 30, 2011, there are no remaining properties that we have treated as “subject to sales contract” on the Consolidated Balance Sheets and deferred recognition of the sale to a related party. For asset listings of properties treated as “subject to sales contract” in prior periods, on the Consolidated Balance Sheets, they are listed in detail in Schedule III, “Real Estate and Accumulated Depreciation” in the Company’s Annual Report on Form 10-K. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and have been ultimately resulted in ownership transfer to the lender or satisfactory resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. We do not believe that IOT is liable for any deficiencies that may have resulted from corporate guarantees after the lender took possession of the property from the related party owner.

NOTE 3. DISCONTINUED OPERATIONS

We apply the provisions of ASC Topic 360, "Property, Plant and Equipment", which requires that long-lived assets that are to be disposed of by sale be measured at the lesser of (1) book value or (2) fair value less cost to sell. In addition, it requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions.

Discontinued operations relates to properties that were either sold or held for sale as of the period ended September 30, 2011. Included in discontinued operations is one property for 2011 and 2010. Properties sold in 2011 have been reclassified to discontinued operations for current and prior year reporting periods. In 2011, we sold 13.0 acres of land with a storage warehouse (Eagle Crest). There were no properties sold in 2010. The gain on sale of the properties is also included in discontinued operations for those years. The following table summarizes revenue and expense information for the properties sold and held for sale (dollars in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue				
Rental	\$-	\$110	\$159	\$236
Property operations	7	22	42	78
	(7	) 88	117	158
Expenses				
Interest	(2	) (51	) (85	) (151
General and administration	(1	) -	(2	) (3
Provision on impairment of real estate assets	-	-	(1,474	) -
	(3	) (51	) (1,561	) (154
Income (loss) from discontinued operations before gains on sale of real estate, taxes, and fees	(10	) 37	(1,444	) 4
Loss on sale of discontinued operations	(475	) -	(475	) -
Income (loss) from discontinued operations	\$(485	) \$37	\$(1,919	) \$4
Tax benefit (expense)	170	(13	) 672	(1
Net income (loss) from discontinued operations	\$(315	) \$24	\$(1,247	) \$3

Our application of ASC Topic 360 results in the presentation of the net operating results of these qualifying properties sold or held for sale during 2011 as income from discontinued operations. This does not have an impact on net income available to common shareholders and only impacts the presentation of these properties within the Consolidated Statements of Operations.

#### NOTE 4. NOTES AND INTEREST RECEIVABLE FROM AFFILIATE

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

At September 30, 2011, we had junior mortgage loans and accrued interest receivable from affiliates, net of allowances, totaling \$27.1 million. The loans mature at various dates through December 2027 with interest rates of 5.25%. Payments are due from surplus cash flow or sale or refinancing of the underlying properties. These notes are cross-collateralized to the extent that any surplus cash available from the sale or refinance of any of the properties underlying these notes will be used to repay outstanding interest and principal for the remaining notes. The allowance on the notes was a purchase allowance that was netted against the notes when acquired (dollars in thousands):

Borrower	Date	Rate	Amount	Security
Performing loans:				
Unified Housing Foundation, Inc. (Lakeshore Villas)	12/27	5.25%	2,000	Unsecured
Unified Housing Foundation, Inc. (Lakeshore Villas)	12/27	5.25%	6,363	Membership interest in Housing for Seniors of Humble, LLC
United Housing Foundation, Inc. (Cliffs of El Dorado)	12/27	5.25%	2,990	100% Interest in Unified Housing of McKinney, LLC
United Housing Foundation, Inc. (Echo Station)	12/27	5.25%	1,481	100% Interest in Unified Housing of Temple, LLC
	07/15	5.25%	3,057	

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United Housing Foundation, Inc. (Limestone Canyon)				100% Interest in Unified Housing of Austin, LLC
United Housing Foundation, Inc. (Limestone Ranch)	07/15	5.25%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
United Housing Foundation, Inc. (Parkside Crossing)	12/27	5.25%	1,936	100% Interest in Unified Housing of Parkside Crossing, LLC
United Housing Foundation, Inc. (Sendero Ridge)	07/15	5.25%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC
United Housing Foundation, Inc. (Timbers of Terrell)	12/27	5.25%	1,323	100% Interest in Unified Housing of Terrell, LLC
United Housing Foundation, Inc. (Tivoli)	12/27	5.25%	1,826	100% Interest in Unified Housing of Tivoli, LLC
Accrued interest			520	
Total Performing			\$ 28,920	
Allowance for estimated losses			(1,826)	
Total			\$ 27,094	

All are related party notes.

## NOTE 5. NOTES AND INTEREST PAYABLE

The following table lists the mortgage notes payable as of September 30, 2011 (dollars in thousands):

Project	Principal Balance
Mercer Crossing/Travelers Land *	27,635
Accrued interest	995
	\$ 28,630

\* This mortgage note represents the allocation of a note with an aggregate outstanding balance of \$36.0 million as of September 30, 2011. The remaining balance of this note of \$8.4 million is held on the books of Transcontinental Realty Investors, Inc., an affiliated entity. As a joint grantor of the mortgage loan, we have joint and several liability of the obligations and liabilities of the loan in its entirety, which include, but are not limited to, payment of all unpaid and accrued interest and principal for the entire outstanding loan balance. Since April 11, 2010, interest has accrued on the loan and as of April 12, 2011, the borrower is in default under the current loan documents and the lender accelerated the maturity of the indebtedness. On April 28, 2011, a forbearance agreement was entered into between the borrower, the guarantor and the lender in order to temporarily suspend the lender from the exercise of its rights and remedies under the loan documents and foreclose on the property. The forbearance period expires April 17, 2012 and requires the borrower to make monthly payments of \$150,000. Upon reconciliation of the balance due to the lender, an adjustment was made to the allocation of the loan balance between TCI and IOT. The total amount did not change but the allocations of payments were corrected to reflect the pro-rata share in correlation to the original loan balance allocation.

As of September 30, 2011, there are no remaining properties that we have treated as “subject to sales contract” on the Consolidated Balance Sheets and deferred recognition of the sale to a related party. For asset listings of properties treated as “subject to sales contract” in prior periods on the Consolidated Balance Sheets, they are listed in detail in Schedule III, “Real Estate and Accumulated Depreciation” in the Company’s Annual Report on Form 10-K. These properties were sold to a related party in order to help facilitate an appropriate debt or organizational restructure and have been ultimately resulted in ownership transfer to the lender or satisfactory resolution. These properties have mortgages that are secured by the property and many have corporate guarantees. We do not believe that IOT is liable for any deficiencies that may have resulted from corporate guarantees after the lender took possession of the property from the related party owner.

## NOTE 6. RECEIVABLE FROM AND PAYABLE TO AFFILIATES

From time to time, IOT and its affiliates and related parties have made unsecured advances to each other which include transactions involving the purchase, sale, and financing of property. In addition, we have a cash management agreement with our advisor. The agreement provides for excess cash to be invested in and managed by our advisor Pillar, an affiliated entity. The table below reflects the various transactions between IOT, Pillar, Prime, and TCI (dollars in thousands):

	TCI	Prime	Pillar	Total
Balance, December 31, 2010	\$48,598	\$-	\$-	\$48,598
Cash transfers	-	2,409	(159 )	2,250
Advisory fees	-	(293 )	(357 )	(650 )
Cost reimbursements	-	(116 )	(51 )	(167 )
Expenses paid by advisor	-	73	78	151

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Financing (mortgage payments)	-	718	(320	)	398	
Sales/Purchases transactions	-	-	1,202		1,202	
Interest income	567	640	352		1,559	
POA fees	-	(2	)	(5	) (7	)
Property transfers	-	-	(3	)	(3	)
Purchase of obligation	4,166	(3,429	)	(737	)	-
Balance, September 30, 2011	\$53,331	\$-	\$-		\$53,331	

## NOTE 7. OPERATING SEGMENTS

Our segments are based on our method of internal reporting which classifies our operations by property type. Our segments are land and other. Presented below is the operating segment information for the three and nine months ended September 30, 2011 and 2010 (dollars in thousands):

For the Three Months Ended September 30, 2011	Land	Other	Total
Operating revenue	\$-	\$-	\$-
Operating expenses	6	-	6
Depreciation and amortization	-	-	-
Mortgage and loan interest	282	-	282
Interest income	-	543	543
Gain on land sales	-	-	-
Segment operating income (loss)	\$(288)	) \$543	\$255
Capital expenditures	-	-	-
Assets	24,511	-	24,511

For the Three Months Ended September 30, 2010	Land	Other	Total
Operating revenue	\$-	\$-	\$-
Operating expenses	4	3	7
Depreciation and amortization	-	-	-
Mortgage and loan interest	279	-	279
Interest income	-	512	512
Gain on land sales	-	-	-
Segment operating income (loss)	\$(283)	) \$509	\$226
Capital expenditures	-	-	-
Assets	29,561	-	29,561

The table below reconciles the segment information to the corresponding amounts in the Statements of Operations:

	For the Three Months Ended	
	September 30,	
	2011	2010
Segment operating income	\$255	\$226
Other non-segment items of income (expense)		
General and administrative	(94)	(70)
Advisory fee	(219)	(217)
Equity in earnings of investees	28	(8)
Income tax benefit (expense)	(170)	13
Loss from continuing operations	\$(200)	\$(56)

The table below reconciles the segment assets to total assets:

	September 30,	
	2011	2010
Segment assets	\$24,511	\$29,561
Investments in real estate partnerships	67	89

Other assets and receivables	81,990	87,437
Total assets	\$106,553	\$115,527

For the Nine Months Ended September 30, 2011	Land	Other	Total
Operating revenue	\$-	\$-	\$-
Operating expenses	10	8	18
Mortgage and loan interest	928	-	928
Interest income	-	1,560	1,560
Segment operating income (loss)	\$(938	) \$1,552	\$614
Capital expenditures	-	-	-
Assets	24,511	-	24,511

For the Nine Months Ended September 30, 2010	Land	Other	Total
Operating revenue	\$-	\$-	\$-
Operating expenses	35	4	39
Mortgage and loan interest	841	-	841
Interest income	-	1,842	1,842
Segment operating income (loss)	\$(876	) \$1,838	\$962
Capital expenditures	-	-	-
Assets	29,561	-	29,561

The table below reconciles the segment information to the corresponding amounts in the Statements of Operations:

	For the Nine Months Ended September 30,	
	2011	2010
Segment operating income	\$614	\$962
Other non-segment items of income (expense)		
General and administrative	(370	) (247
Advisory fee	(650	) (650
Equity in earnings of investees	(22	) (5
Income tax benefit (expense)	(672	) 49
Income (loss) from continuing operations	\$(1,100	) \$109

The table below reconciles the segment assets to total assets:

	September 30,	
	2011	2010
Segment assets	\$24,511	\$29,561
Investments in real estate partnerships	67	89
Other assets and receivables	81,975	85,879
Total assets	\$106,553	\$115,527

#### NOTE 8. RELATED PARTY TRANSACTIONS

We have historically engaged in and will continue to engage in certain business transactions with related parties, including but not limited to asset acquisitions and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in the best

interest of our company.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Litigation. IOT is 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.

NOTE 10. SUBSEQUENT EVENTS

There were no subsequent events for the period ending September 30, 2011.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

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

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 following:

- general risks affecting the real estate industry (including, without limitation, the inability to enter into or renew leases, dependence on tenants' financial condition, and competition from other developers, owners and operators of real estate);
- risks associated with the availability and terms of construction and mortgage financing and the use of debt to fund acquisitions and developments;
- demand for apartments and commercial properties in the Company's markets and the effect on occupancy and rental rates;
- the Company's ability to obtain financing, enter into joint venture arrangements in relation to or self-fund the development or acquisition of properties;
- risks associated with the timing and amount of property sales and the resulting gains/losses associated with such sales;
- failure to manage effectively our growth and expansion into new markets or to integrate acquisitions successfully;
- risks and uncertainties affecting property development and construction (including, without limitation, construction delays, cost overruns, inability to obtain necessary permits and public opposition to such activities);
-

risks associated with downturns in the national and local economies, increases in interest rates, and volatility in the securities markets;

- costs of compliance with the Americans with Disabilities Act and other similar laws and regulations;
  - potential liability for uninsured losses and environmental contamination; and
- risks associated with our dependence on key personnel whose continued service is not guaranteed.

The risks included here are not exhaustive. 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 in Part I, 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, 2010.

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 risks and 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 to other materials we may furnish to the public from time to time through Forms 8-K or otherwise as we file them with the SEC.

## Overview

We are an externally advised and managed real estate investment company that currently owns land held for development or sale. As of September 30, 2011, we owned or had interests in 178.1 acres of land held for future development or sale.

Our primary source of revenue is from the interest income on over \$28.9 million of notes receivable due from affiliated and/or related parties.

We have historically engaged in and may continue to engage in certain business transactions with related parties, including but not limited to asset acquisition and dispositions. Transactions involving related parties cannot be presumed to be carried out on an arm's length basis due to the absence of free market forces that naturally exist in business dealings between two or more unrelated entities. Related party transactions may not always be favorable to our business and may include terms, conditions and agreements that are not necessarily beneficial to or in our best interest.

Prior to April 30, 2011, Prime Income Asset Management, LLC ("Prime") was the Company's external Advisor and Cash Manager. Prime also served as an Advisor and Cash Manager to ARL and TCI. Effective April 30, 2011, Pillar Income Asset Management, Inc. ("Pillar") became the Company's external Advisor and Cash Manager under the same terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to ARL and TCI. Prior to December 31, 2010, Triad Realty Services, L.P. ("Triad") managed the Company's commercial properties and Regis Realty I, LLC ("Regis Realty") provided brokerage services. Triad and Regis Realty are affiliates of Prime. Effective January 1, 2011, Regis Realty Prime, LLC ("Regis"), an affiliate of Prime, manages our commercial properties and provides brokerage services under the same terms as the previous agreements with Triad and Regis Realty.

## Critical Accounting Policies

We present our financial statements in accordance with generally accepted accounting principles in the United States ("GAAP"). In June 2009, the Financial Accounting Standards Board ("FASB") completed its accounting guidance codification project. The FASB Accounting Standards Codification ("ASC") became effective for our financial statements issued subsequent to June 30, 2009, and is the single source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. As of the effective date, we no longer refer to the authoritative guidance dictating our accounting methodologies under the previous accounting standards hierarchy. Instead, we refer to the ASC guidance as the sole source of authoritative literature.

The accompanying financial statements include our accounts, our subsidiaries, generally all of which are wholly-owned, and all entities in which we have a controlling interest. Arrangements that are not controlled through voting or similar rights are accounted for as a Variable Interest Entity ("VIE"), in accordance with the provisions and guidance of ASC Topic 810 "Consolidation", whereby we have determined that we are a primary beneficiary of the VIE and meet certain criteria of a sole general partner or managing member as identified in accordance with Emerging Issues Task Force ("EITF") Issue 04-5, Investor's Accounting for an Investment in a Limited Partnership when the Investor is the Sole General Partner and the Limited Partners have Certain Rights ("EITF 04-5"). VIEs are generally entities that lack sufficient equity to finance their activities without additional financial support from other parties or whose equity holders, as a group, lack adequate decision making ability, the obligation to absorb expected losses or residual returns of the entity, or have voting rights that are not proportional to their economic interests. The primary beneficiary generally is the entity that provides financial support and bears a majority of the financial risks, authorizes certain capital transactions, or makes operating decisions that materially affect the entity's financial results. All significant intercompany balances and transactions have been eliminated in consolidation.

In determining whether we are the primary beneficiary of a VIE, we consider qualitative and quantitative factors, including, but not limited to: the amount and characteristics of our investment; the obligation or likelihood for us or other investors to provide financial support; our and the other investors' ability to control or significantly influence key decisions for the VIE; and the similarity with and significance to the business activities of us and the other investors. Significant judgments related to these determinations include estimates about the current future fair values and performance of real estate held by these VIEs and general market conditions.

For entities in which we have less than a controlling financial interest or entities where we are not deemed to be the primary beneficiary, the entities are accounted for using the equity method of accounting. Accordingly, our share of the net earnings or losses of these entities are included in net income. Our investment in TCI Eton Square, LP is accounted for under the equity method.

#### Real Estate

Upon acquisitions of real estate, we assess the fair value of acquired tangible and intangible assets, including land, buildings, tenant improvements, "above-market" and "below-market" leases, origination costs, acquired in-place leases, other identified intangible assets and assu