

INCOME OPPORTUNITY REALTY INVESTORS INC /TX/  
Form 10-Q  
August 14, 2012

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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 June 30, 2012

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.)

1603 Lyndon B. Johnson Freeway, Suite 800, 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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if smaller reporting company)	Smaller reporting company	<input checked="" type="checkbox"/>

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

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)	4,168,214 (Outstanding at August 5, 2012)
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FORM 10-Q  
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## PART 1. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

INCOME OPPORTUNITY REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

	June 30, 2012	December 31, 2011
	(dollars in thousands, except share and par value amounts)	
Assets		
Real estate land holdings, at cost	\$ 24,511	\$ 24,511
Total real estate	24,511	24,511
Notes and interest receivable from related parties	27,073	31,612
Less allowance for doubtful accounts	(1,826 )	(1,826 )
Total notes and interest receivable	25,247	29,786
Cash and cash equivalents	11	1
Investments in unconsolidated subsidiaries and investees, subject to sales contract	14	37
Receivable and accrued interest from related parties	58,206	52,160
Other assets	1,507	1,546
Total assets	\$ 109,496	\$ 108,041
Liabilities and Shareholders' Equity		
Liabilities:		
Notes and interest payable	\$ 28,470	\$ 28,588
Deferred gain (from sales to related parties)	5,127	5,127
Accounts payable and other liabilities	193	125
	33,790	33,840
Commitments and contingencies:		
Shareholders' equity:		
Common stock, \$.01 par value, authorized 10,000,000 shares; issued 4,173,675 shares in 2012 and 2011	42	42
Treasury stock at cost, 5,461 in 2012 and 2011	(39 )	(39 )
Paid-in capital	61,955	61,955
Retained earnings	13,748	12,243
Total shareholders' equity	75,706	74,201
Total liabilities and shareholders' equity	\$ 109,496	\$ 108,041

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 June		For the Six Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands, except share and per share amounts)			
<b>Revenues:</b>				
Rental and other property revenues	\$ -	\$ -	\$ -	\$ -
<b>Expenses:</b>				
Property operating expenses (including \$14 and \$0 for the three months and \$43 and \$2 for the six months ended 2012 and 2011 respectively from affiliates and related parties)	14	3	45	11
General and administrative (including \$117 and \$61 for the three months and \$200 and \$116 for the six months ended 2012 and 2011 respectively from affiliates and related parties)	207	182	360	276
Advisory fee to affiliates	205	211	402	431
Total operating expenses	426	396	807	718
Operating loss	(426 )	(396 )	(807 )	(718 )
<b>Other income (expense):</b>				
Interest income (including \$1,713 and \$723 for the three months and \$2,896 and \$1,017 for the six months ended 2012 and 2011 respectively from affiliates and related parties)	1,713	723	2,896	1,017
Mortgage and loan interest	(277 )	(365 )	(552 )	(646 )
Earnings from unconsolidated subsidiaries and investees	(12 )	(50 )	(23 )	(50 )
Total other income	1,424	308	2,321	321
Income (loss) from continuing operations before tax	998	(88 )	1,514	(397 )
Income tax expense	-	(503 )	(3 )	(502 )
	998	(591 )	1,511	(899 )

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Net income (loss) from continuing operations				
Discontinued operations:				
Loss from discontinued operations	-	(1,437 )	(9 )	(1,435 )
Income tax benefit from discontinued operations	-	503	3	502
Net loss from discontinued operations	-	(934 )	(6 )	(933 )
Net income (loss)	998	(1,525 )	1,505	(1,832 )
Earnings per share - basic				
Income (loss) from continuing operations	\$ 0.24	\$ (0.14 )	\$ 0.36	\$ (0.22 )
Loss from discontinued operations	-	(0.22 )	-	(0.22 )
Net income (loss) applicable to common shares	\$ 0.24	\$ (0.36 )	\$ 0.36	\$ (0.44 )
Earnings per share - diluted				
Income (loss) from continuing operations	\$ 0.24	\$ (0.14 )	\$ 0.36	\$ (0.22 )
Loss from discontinued operations	-	(0.22 )	-	(0.22 )
Net income (loss) applicable to common shares	\$ 0.24	\$ (0.36 )	\$ 0.36	\$ (0.44 )
Weighted average common share used in computing earnings per share	4,168,214	4,168,214	4,168,214	4,168,214
Weighted average common share used in computing diluted earnings per share	4,168,214	4,168,214	4,168,214	4,168,214

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

INCOME OPPORTUNITY REALTY INVESTORS, INC.  
 CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
 For the Six Months Ended June 30, 2012  
 (unaudited)  
 (dollars in thousands)

	Total	Common Stock Shares	Common Stock Amount	Treasury Stock	Paid-in Capital	Retained Earnings
Balance, December 31, 2011	\$74,201	4,173,675	\$42	\$(39 )	\$61,955	\$12,243
Net income	1,505	-	-	-	-	1,505
Balance, June 30, 2012	\$75,706	4,173,675	\$42	\$(39 )	\$61,955	\$13,748

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



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

	For the Six Months Ended June 30,	
	2012	2011
	(dollars in thousands)	
Cash Flow From Operating Activities:		
Net income (loss)	\$1,505	\$(1,832 )
Adjustments to reconcile net income (loss) applicable to common shares to net cash used in operating activities:		
Provision on impairment of real estate assets	-	1,474
Earnings from unconsolidated subsidiaries and investees	23	50
(Increase) decrease in assets:		
Accrued interest receivable	1,548	-
Other assets	40	61
Increase (decrease) in liabilities:		
Accrued interest payable	552	948
Other liabilities	68	25
Net cash provided by operating activities	3,736	726
Cash Flow From Investing Activities:		
Proceeds from notes receivable	2,990	2,585
Affiliate receivable	(6,046 )	(3,709 )
Net cash used in investing activities	(3,056 )	(1,124 )
Cash Flow From Financing Activities:		
Payments on notes payable	(670 )	414
Deferred financing costs	-	6
Net cash provided by (used in) financing activities	(670 )	420
Net increase in cash and cash equivalents	10	22
Cash and cash equivalents, beginning of period	1	20
Cash and cash equivalents, end of period	\$11	\$42
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$552	\$716

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 (“IOT”).

Transcontinental Realty Investors, Inc. (“TCI”) owns approximately 81.1% 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 also invests in mortgage loans on real estate. Prime Income Asset Management, LLC (“Prime”) served as the Company’s external Advisor and Cash Manager from July 1, 2009 until April 30, 2011. 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 substantially the same terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to ARL and TCI. Regis Realty Prime, LLC (“Regis”) provides property management services and brokerage services of our commercial properties. 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 June 30, 2012, 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 \$27.1 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 six months ended June 30, 2012 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, 2011, 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, 2011. Certain 2011 financial statement amounts have been reclassified to conform to the 2012 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 June 30, 2012, 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.

## NOTE 3. 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 June 30, 2012, we had junior mortgage loans and accrued interest receivable from affiliates, net of allowances, totaling \$25.2 million. The loans mature on December 31, 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	Maturity Date	Interest Rate	Amount	Security
Performing loans:				
Unified Housing Foundation, Inc. (Echo Station)	12/27	5.25%	1,481	100% Interest in Unified Housing of Temple, LLC
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
Unified Housing Foundation, Inc. (Limestone Canyon)	12/27	5.25%	3,057	100% Interest in Unified Housing of Austin, LLC
Unified Housing Foundation, Inc. (Limestone Ranch)	12/27	5.25%	2,250	100% Interest in Unified Housing of Vista Ridge, LLC
Unified Housing Foundation, Inc. (Parkside Crossing)	12/27	5.25%	1,936	100% Interest in Unified Housing of Parkside Crossing, LLC
Unified Housing Foundation, Inc. (Sendero Ridge)	12/27	5.25%	5,174	100% Interest in Unified Housing of Sendero Ridge, LLC

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	Unified Housing Foundation, Inc. (Timbers of Terrell)	12/27	5.25%	1,323	100% Interest in Unified Housing of Terrell, LLC
	Unified Housing Foundation, Inc. (Tivoli)	12/27	5.25%	1,826	100% Interest in Unified Housing of Tivoli, LLC
	Accrued interest			1,663	
Total Performing				\$ 27,073	
	Allowance for estimated losses			(1,826)	
Total				\$ 25,247	

All are related party notes.

NOTE 4. INVESTMENT IN UNCONSOLIDATED SUBSIDIARIES AND INVESTEEES

Investments in unconsolidated subsidiaries, jointly owned companies and other investees in which we have a 20% to 50% interest or otherwise exercise significant influence are carried at cost, adjusted for the Company's proportionate share of their undistributed earnings or losses, via the equity method of accounting. Investments accounted for via the equity method consists of the following:

Investee	Percent ownership			
	2012		2011	
TCI Eton Square, L.P. ("Eton Square")	10.00	%	10.00	%

Our interest in Eton Square in the amount of 10% is accounted for under the equity method because the general partner is an affiliated entity, thus allowing us to exercise significant influence over the operations and financial activities. Accordingly, the investment is carried at cost, adjusted for the companies' proportionate share of earnings or losses.

On May 18, 2010, we sold our 10.0% investment in TCI Eton Square, LP to TX Highland RS Corp, a related party under common control, for a sales price of \$1.37 million. This entity owns a 225,566 square foot office and retail center known as Eton Square located in Tulsa, Oklahoma. A three-year note receivable for the full sales price was given as consideration, with an interest rate of prime plus 2%, payable at maturity on May 18, 2013. IOT has deferred the recognition of the sale in accordance with ASC 360-20 due to our continuing involvement, the inadequate initial investment and questionable recovery of investment cost.

The market values as of the period ended June 30, 2012 and 2011 were not determinable as there were no traded markets, either active or inactive, for this investment.

The following is a summary of the financial position and results of operations from our investees (dollars in thousands):

	For the Six Months Ended June 30,	
	2012	2011
Real estate, net of accumulated depreciation	\$12,761	\$13,142
Other assets	660	347
Notes payable	(9,363 )	(9,363 )
Other liabilities	(3,916 )	(3,733 )
Shareholders equity/partners capital	\$(142 )	\$(393 )
Revenue	\$677	\$463
Depreciation	(233 )	(235 )
Operating expenses	(422 )	(420 )
Interest expense	(246 )	(300 )
Loss from continuing operations	(224 )	(492 )
Income from discontinued operations	-	-
Net loss	\$(224 )	\$(492 )
Company's proportionate share of earnings	\$(22 )	\$(49 )

#### NOTE 5. NOTES AND INTEREST PAYABLE

The following table lists the mortgage notes payable as of June 30, 2012 (dollars in thousands):

Project	Maturity	Principal Balance
Mercer Crossing/Travelers Land *	10/05/11	\$ 25,873
Accrued interest		2,597
		\$ 28,470



\* This mortgage note represents the allocation of a note with an aggregate outstanding balance of \$33.6 million as of June 30, 2012. The remaining balance of this note of \$7.7 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 one-year 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 has been extended and will expire October 17, 2012 and requires the borrower to make monthly payments of \$150,000.

## 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, and TCI (dollars in thousands):

	TCI	Pillar	Total
Balance, December 31, 2011	\$ 52,160	\$ -	\$ 52,160
Cash transfers	-	2,571	2,571
Advisory fees	-	(402 )	(402 )
Net income fee	-	(119 )	(119 )
POA fees	-	(43 )	(43 )
Cost reimbursements	-	(81 )	(81 )
Expenses paid by advisor	-	50	50
Financing (mortgage payments)	-	2,587	2,587
Interest income	735	748	1,483
Purchase of obligation	5,311	(5,311 )	-
Balance, June 30, 2012	\$ 58,206	\$ -	\$ 58,206

## 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 six months ended June 30, 2012 and 2011 (dollars in thousands):

For the Three Months Ended June 30,  
2012

	Land	Other	Total
Operating revenue	\$ -	\$ -	\$ -
Operating expenses	-	14	14
Depreciation and amortization	-	-	-
Mortgage and loan interest	277	-	277
Interest income	-	1,713	1,713
Gain on land sales	-	-	-
Segment operating income (loss)	\$ (277 )	\$ 1,699	\$ 1,422
Capital expenditures	-	-	-
Assets	24,511	-	24,511

For the Three Months Ended June 30,  
2011

	Land	Other	Total
Operating revenue	\$ -	\$ -	\$ -
Operating expenses	-	3	3
Depreciation and amortization	-	-	-
Mortgage and loan interest	365	-	365
Interest income	-	723	723
Gain on land sales	-	-	-

Segment operating income (loss)	\$ (365	) \$ 720	\$ 355
Capital expenditures	-	-	-
Assets	28,087	-	28,087

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

	For Three Months Ended	
	June 30,	
	2012	2011
Segment operating income	\$ 1,422	\$ 355
Other non-segment items of income (expense)		
General and administrative	(207 )	(182 )
Advisory fee	(205 )	(211 )
Equity in earnings of investees	(12 )	(50 )
Income tax expense	-	(503 )
Income (loss) from continuing operations	\$ 998	\$ (591 )

The table below reconciles the segment assets to total assets:

	June 30,	
	2012	2011
Segment assets	\$ 24,511	\$ 28,087
Investments in real estate partnerships	14	39
Other assets and receivables	84,971	88,506
Total assets	\$ 109,496	\$ 116,632

For the Six Months Ended June 30,  
2012

	Land	Other	Total
Operating revenue	\$ -	\$ -	\$ -
Operating expenses	31	14	45
Depreciation and amortization	-	-	-
Mortgage and loan interest	552	-	552
Interest income	-	2,896	2,896
Gain on land sales	-	-	-
Segment operating income (loss)	\$ (583 )	\$ 2,882	\$ 2,299
Capital expenditures	-	-	-
Assets	24,511	-	24,511

For the Six Months Ended June 30,  
2011

	Land	Other	Total
Operating revenue	\$ -	\$ -	\$ -
Operating expenses	4	7	11
Depreciation and amortization	-	-	-
Mortgage and loan interest	646	-	646
Interest income	-	1,017	1,017
Gain on land sales	-	-	-
Segment operating income (loss)	\$ (650 )	\$ 1,010	\$ 360
Capital expenditures	-	-	-
Assets	28,087	-	28,087

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

	For Six Months Ended	
	June 30,	
	2012	2011
Segment operating income	\$ 2,299	\$ 360
Other non-segment items of income (expense)		
General and administrative	(360 )	(276 )
Advisory fee	(402 )	(431 )
Equity in earnings of investees	(23 )	(50 )
Income tax expense	(3 )	(502 )
Income (loss) from continuing operations	\$ 1,511	\$ (899 )

The table below reconciles the segment assets to total assets:

	June 30,	
	2012	2011
Segment assets	\$ 24,511	\$ 28,087
Investments in real estate partnerships	14	39
Other assets and receivables	84,971	88,506
Total assets	\$ 109,496	\$ 116,632

#### NOTE 8. 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 June 30, 2012. Included in discontinued operations is one property for 2012 and 2011. There were no properties sold in 2012. In 2011, we sold 13.0 acres of land with a storage warehouse (Eagle Crest). The gain on sale of the properties, if applicable, 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 Six Months Ended June 30,	
	2012	2011
Revenue		
Rental	\$ -	\$ 159
	-	159
Expenses		
Property operations	1	35
General and administration	8	2
Provision on impairment of real estate assets	-	1,474
Interest	-	83
	9	1,594
Loss from discontinued operations before gains on sale of real estate, taxes, and fees	(9 )	(1,435 )
Gain (loss) on sale of discontinued operations	-	-
Loss from discontinued operations	\$ (9 )	\$ (1,435 )
Tax benefit	3	502
Net loss from discontinued operations	\$ (6 )	\$ (933 )

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 2012 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 9. 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 10. 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 11. SUBSEQUENT EVENTS**

There were no subsequent events for the period ending June 30, 2012.

## 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, 2011.

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 June 30, 2012, 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 \$27.1 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.

Prime Income Asset Management, LLC ("Prime") served as the Company's external Advisor and Cash Manager from July 1, 2009 until April 30, 2011. 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 substantially the same terms as the previous agreement with Prime. Pillar also serves as an Advisor and Cash Manager to ARL and TCI. Regis Realty Prime, LLC ("Regis") provides property management services and brokerage services for our commercial properties.

## 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 assumed liabilities in accordance with ASC Topic 805 "Business Combinations", and allocate the purchase price to the acquired assets and assumed liabilities, including land at appraised value and buildings at replacement cost.

We assess and consider fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates, as well as available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known and anticipated trends, and market and economic conditions. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant. We also consider an allocation of purchase price of other acquired intangibles, including acquired in-place leases that may have a customer relationship intangible value, including (but not limited to) the nature and extent of the existing relationship with the tenants, the tenants' credit quality and expectations of lease renewals. Based on our acquisitions to date, our allocation to customer relationship intangible assets has been immaterial.

We record acquired "above-market" and "below-market" leases at their fair values (using a discount rate which reflects the risks associated with the leases acquired) equal to the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) management's estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market fixed rate renewal options for below-market leases.

Other intangible assets acquired include amounts for in-place lease values that are based on our evaluation of the specific characteristics of each tenant's lease. Factors to be considered include estimates of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider leasing commissions, legal and other related expenses.

#### Depreciation and Impairment

Real estate is stated at depreciated cost. The cost of buildings and improvements includes the purchase price of property, legal fees and other acquisition costs. Costs directly related to the development of properties are capitalized. Capitalized development costs include interest, property taxes, insurance, and other project costs incurred during the period of development.

Management reviews its long-lived assets used in operations for impairment when there is an event or change in circumstances that indicates impairment in value. An impairment loss is recognized if the carrying amount of its assets is not recoverable and exceeds its fair value. If such impairment is present, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. The