

INVESTORS REAL ESTATE TRUST

Form 10-Q/A

September 10, 2004

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C.  
20549**

**Form 10-Q/A**

**Amendment No. 1**

**Quarterly Report under Section 13 or 15(d)  
of the Securities Exchange Act of 1934**

**For Quarter Ended July 31, 2004**

**Commission File Number 0-14851**

**INVESTORS REAL ESTATE TRUST**

(Exact name of registrant as specified in its charter)

**North Dakota**

(State or other jurisdiction of  
incorporation or organization)

**Post Office Box 1988**

**12 South Main Street**

**Minot, ND**

(Address of principal executive offices)

**45-0311232**

(I.R.S. Employer Identification No.)

**58702-1988**

(Zip code)

**(701) 837-4738**

(Registrant's telephone number, including area code)

**N/A**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

**Yes**  **No**

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

**Yes**  **No**

Registrant is a North Dakota Real Estate Investment Trust. As of August 26, 2004, it had 42,357,297 common shares of beneficial interest outstanding.



**Table of Contents**

**Investors Real Estate Trust**

**Form 10-Q/A**

**Amendment No. 1**

**For the Quarterly Period Ended July 31, 2004**

Explanatory Note:

This Amendment No. 1 to the Quarterly Report on Form 10-Q of Investors Real Estate Trust for the quarterly period ended July 31, 2004 is being filed solely to amend and revise the subsection of our Quarterly Report entitled Funds From Operations for the Three Months Ended July 31, 2004 and 2003 included in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations. This subsection is amended and revised to correct an error that resulted in incorrect numbers being reported for Funds From Operations ( FFO ) applicable to common shares and Units for the first quarter of fiscal year 2005, and also resulted in an incorrect number being reported for the increase in FFO applicable to common shares and Units in comparison to the first quarter of fiscal year 2004.

No other items or disclosures in our original report are being amended, and accordingly this Amendment No. 1 does not otherwise change or update any information that was presented in the Company's original Quarterly Report on Form 10-Q for the quarterly period ended July 31, 2004, filed with the Securities and Exchange Commission on September 9, 2004. While not amended, the remaining items of the Form 10-Q are included with this Amendment No. 1 for convenience.

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**TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| <b><u>Part I Financial Information</u></b>   |             |
| <u>Item 1. Financial Statements – First Quarter – Fiscal 2005:</u>   |             |
| <u>Consolidated Balance Sheets July 31, 2004 (unaudited) and April 30, 2004</u>                            | 1           |
| <u>Consolidated Statements of Operations (unaudited) For the Three Months ended July 31, 2004 and 2003</u> | 2           |
| <u>Consolidated Statement of Shareholders' Equity (unaudited) For the Three Months ended July 31, 2004</u> | 3           |
| <u>Consolidated Statements of Cash Flows (unaudited) For the Three Months ended July 31, 2004 and 2003</u> | 4           |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>  | 6           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>       | 14          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>                                  | 29          |
| <u>Item 4. Controls and Procedures</u>   | 29          |
| <b><u>Part II Other Information</u></b>  |             |
| <u>Item 1. Legal Proceedings</u>   | 30          |
| <u>Item 2. Changes in Securities and Use of Proceeds; Unregistered Sales of Equity Securities</u>          | 30          |
| Item 3. Defaults Upon Senior Securities – None   | 30          |
| Item 4. Submission of Matters to a Vote of Security Holders – None   | 30          |
| Item 5. Other Information – None   | 30          |
| <u>Item 6. Exhibits and Reports on Form 8-K</u>  | 30          |
| <b><u>Signatures</u></b>   | 31          |
| <u>Certification of CEO Pursuant to Section 302</u>  |             |
| <u>Certification of CFO Pursuant to Section 302</u>  |             |
| <u>Certification of CEO and CFO Pursuant to Section 906</u>  |             |



Table of Contents**PART I****ITEM 1. FINANCIAL STATEMENTS FIRST QUARTER FISCAL 2005****INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

|  | (in thousands)               |                    |
|--|------------------------------|--------------------|
|  | (unaudited)<br>July 31, 2004 | April 30, 2004     |
| <b>ASSETS</b>  |                              |                    |
| Real estate investments  |                              |                    |
| Property owned   | \$1,146,795                  | \$1,100,434        |
| Less accumulated depreciation/amortization                         | (105,376)                    | (100,250)          |
|  | <u>1,041,419</u>             | <u>1,000,184</u>   |
| Undeveloped land   | 2,847                        | 2,994              |
| Mortgage loans receivable, net of allowance                        | 638                          | 4,893              |
|  | <u>1,044,904</u>             | <u>1,008,071</u>   |
| <b>Total real estate investments</b>                               |                              |                    |
| Other assets   |                              |                    |
| Cash and cash equivalents  | 35,596                       | 31,704             |
| Marketable securities available-for-sale                           | 2,335                        | 2,336              |
| Receivable arising from straight-lining of rents, net of allowance | 6,175                        | 5,976              |
| Accounts receivable net of allowance                               | 2,278                        | 2,155              |
| Real estate deposits   | 748                          | 1,567              |
| Prepaid and other assets   | 2,028                        | 2,677              |
| Tax, insurance, and other escrow                                   | 10,394                       | 11,301             |
| Property and equipment, net  | 2,338                        | 2,292              |
| Goodwill   | 1,441                        | 1,441              |
| Deferred charges and leasing costs net                             | 7,663                        | 6,797              |
|  | <u>\$1,115,900</u>           | <u>\$1,076,317</u> |
| <b>TOTAL ASSETS</b>  |                              |                    |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                         |                              |                    |
| <b>LIABILITIES</b>   |                              |                    |
| Accounts payable, accrued expenses and other liabilities           | \$ 20,951                    | \$ 22,639          |
| Notes payable  |                              | 25,000             |
| Mortgages payable  | 690,444                      | 633,124            |

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|   |             |             |
|---|-------------|-------------|
| Investment certificates issued  | 6,633       | 7,074       |
| Other debt  | 826         | 843         |
|   | <hr/>       | <hr/>       |
| TOTAL LIABILITIES   | 718,854     | 688,680     |
| COMMITMENTS AND CONTINGENCIES (NOTE 6)  |             |             |
| MINORITY INTEREST IN PARTNERSHIPS   | 16,249      | 16,386      |
| MINORITY INTEREST OF UNIT HOLDERS IN OPERATING PARTNERSHIP  |             |             |
| <i>(12,436,312 units on July 31, 2004 and 11,819,350 units on April 30, 2004)</i>   | 98,597      | 92,622      |
| SHAREHOLDERS EQUITY   |             |             |
| Preferred shares of beneficial interest <i>(Cumulative redeemable preferred shares, no par value, 1,150,000 shares issued and outstanding at July 31, 2004 and April 30, 2004)</i>                            | 27,343      | 27,343      |
| Common shares of beneficial interest <i>(Unlimited authorization, no par value, 42,279,418 shares issued and outstanding at July 31, 2004 and 41,693,256 shares issued and outstanding at April 30, 2004)</i> | 297,858     | 292,400     |
| Accumulated distributions in excess of net income   | (42,973)    | (41,083)    |
| Accumulated other comprehensive loss  | (28)        | (31)        |
|   | <hr/>       | <hr/>       |
| TOTAL SHAREHOLDERS EQUITY   | 282,200     | 278,629     |
|   | <hr/>       | <hr/>       |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY   | \$1,115,900 | \$1,076,317 |
|   | <hr/>       | <hr/>       |

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

**Table of Contents****INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS** *(unaudited)**for the three months ended July 31, 2004 and 2003*

|  | <b>(in thousands, except per share data)</b> |             |
|--|--|-------------|
|  | <b>2004</b>                                  | <b>2003</b> |
| REVENUE  |  |             |
| Real estate rentals  | \$ 33,103                                    | \$ 27,465   |
| Tenant reimbursement   | 6,372  | 4,766       |
|  | <hr/>  | <hr/>       |
| TOTAL REVENUE  | 39,475                                       | 32,231      |
|  | <hr/>  | <hr/>       |
| OPERATING EXPENSE  |  |             |
| Interest   | 11,671                                       | 9,945       |
| Depreciation/amortization related to real estate investments | 8,005  | 5,443       |
| Utilities  | 2,667  | 1,852       |
| Maintenance  | 4,359  | 3,436       |
| Real estate taxes  | 4,595  | 3,941       |
| Insurance  | 685  | 673         |
| Property management expenses                                 | 2,458  | 2,041       |
| Property management related party                            | 150  | 129         |
| Administrative expense                                       | 745  | 629         |
| Advisory and trustee services                                | 24   | 28          |
| Other operating expenses                                     | 140  | 171         |
| Amortization   | 276  | 185         |
| Amortization of related party costs                          | 20   | 14          |
|  | <hr/>  | <hr/>       |
| TOTAL OPERATING EXPENSE                                      | 35,795                                       | 28,487      |
| Operating income   | 3,680  | 3,744       |
| Non-operating income   | 211  | 150         |
| Income before minority interest and discontinued operations  | 3,891  | 3,894       |
| Minority interest portion of other partnerships income       | (89)   | (257)       |
| Minority interest portion of operating partnership income    | (1,457)                                      | (814)       |
|  | <hr/>  | <hr/>       |
| Income from continuing operations                            | 2,345  | 2,823       |
| Discontinued operations, net                                 | 3,125  | 97          |
|  | <hr/>  | <hr/>       |
| NET INCOME   | 5,470  | 2,920       |
|  | <hr/>  | <hr/>       |



|  |                   |                   |
|--|-------------------|-------------------|
| Dividends to preferred shareholders                    | (593)             | 0                 |
|  | <u>          </u> | <u>          </u> |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS            | \$ 4,877          | \$ 2,920          |
|  | <u>          </u> | <u>          </u> |
| BASIC  |                   |                   |
| Earnings per common share from continuing operations   | \$ .04            | \$ .08            |
| Earnings per common share from discontinued operations | .08               | .00               |
|  | <u>          </u> | <u>          </u> |
| NET INCOME PER COMMON SHARE                            | \$ .12            | \$ .08            |
|  | <u>          </u> | <u>          </u> |
| DILUTED  |                   |                   |
| Earnings per common share from continuing operations   | \$ .06            | \$ .08            |
| Earnings per common share from discontinued operations | .06               | .00               |
|  | <u>          </u> | <u>          </u> |
| NET INCOME PER COMMON SHARE                            | \$ .12            | \$ .08            |
|  | <u>          </u> | <u>          </u> |

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

**Table of Contents****INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY** *(unaudited)**for the three months ended July 31, 2004***(in thousands)**

|   | NUMBER<br>OF<br>PREFERRED<br>SHARES | DEFERRED<br>SHARES | NUMBER<br>OF<br>COMMON<br>SHARES | COMMON<br>SHARES | DISTRIBUTIONS<br>IN EXCESS<br>OF NET<br>INCOME | ACCUMULATED<br>OTHER<br>COMPREHENSIVE<br>INCOME<br>(LOSS) | TOTAL<br>SHAREHOLDERS<br>EQUITY |
|---|-------------------------------------|--------------------|----------------------------------|------------------|--|---|---------------------------------|
| Balance May 1, 2004                                     | 1,150                               | \$ 27,343          | 41,693                           | \$ 292,400       | \$ (41,083)                                    | \$ (31)   | \$ 278,629                      |
| Comprehensive<br>Income                                 |                                     |                    |                                  |                  |  |   |                                 |
| Net income  |                                     |                    |                                  |                  | 5,470  |   | 5,470                           |
| Unrealized gain on<br>securities<br>available-for- sale |                                     |                    |                                  |                  |  | 3   | 3                               |
| Total comprehensive<br>income                           |                                     |                    |                                  |                  |  |   | 5,473                           |
| Distributions   |                                     |                    |                                  |                  | (7,360)  |   | (7,360)                         |
| Distribution<br>reinvestment plan                       |                                     |                    | 259                              | 2,509            |  |   | 2,509                           |
| Sale of shares  |                                     |                    | 266                              | 2,550            |  |   | 2,550                           |
| Redemption of units<br>for common shares                |                                     |                    | 64                               | 424              |  |   | 424                             |
| Fractional shares<br>repurchased                        |                                     |                    | (3)                              | (25)             |  |   | (25)                            |
| Balance July 31, 2004                                   | 1,150                               | \$ 27,343          | 42,279                           | \$ 297,858       | \$ (42,973)                                    | \$ (28)   | \$ 282,200                      |

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

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**Table of Contents****INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS** *(unaudited)**for the three months ended July 31, 2004 and 2003*

|   | <b>(in thousands)</b> |                 |
|---|-----------------------|-----------------|
|   | <b>2004</b>           | <b>2003</b>     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                       |                 |
| Net Income  | \$ 5,470              | \$ 2,920        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                       |                 |
| Depreciation and amortization   | 8,408                 | 5,777           |
| Minority interest portion of income   | 1,563                 | 1,100           |
| Gain on sale of real estate, land and other investments                           | (3,064)               | 0               |
| Interest reinvested in investment certificates                                    | 86                    | 98              |
| Bad debt expense:   |                       |                 |
| Straight-line allowance   | 50                    | 90              |
| Past due rent   | 158                   | 0               |
| Changes in other assets and liabilities:  |                       |                 |
| (Increase) decrease in real estate deposits                                       | 819                   | (829)           |
| Increase in receivable arising from straight-lining of rents                      | (250)                 | (554)           |
| Increase in accounts receivable   | (281)                 | (10)            |
| (Increase) decrease in prepaid and other assets                                   | 649                   | (1,616)         |
| Decrease in tax, insurance and other escrow                                       | 907                   | 495             |
| Increase in deferred charges and leasing costs                                    | (1,150)               | (1,196)         |
| (Increase) decrease in related party capitalized leasing commissions              | (11)                  | 9               |
| Increase (decrease) in accounts payable, accrued expenses and other liabilities   | (1,411)               | (107)           |
|   | <u>11,943</u>         | <u>6,177</u>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                       |                 |
| Principal payments on mortgage loans receivable                                   | 4,255                 | 4               |
| Investment in mortgage loans receivable   | 0                     | (531)           |
| Purchase of marketable securities available-for-sale                              | 4                     | 0               |
| Proceeds from sale of property  | 19,545                | 0               |
| Payments for acquisitions and improvements of properties                          | (38,261)              | (22,234)        |
|   | <u>(14,457)</u>       | <u>(22,761)</u> |

*continued*

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**Table of Contents**

**INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS** *(unaudited continued)*  
*for the three months ended July 31, 2004 and 2003*

|   | <b>(in thousands)</b> |             |
|---|-----------------------|-------------|
|   | <b>2004</b>           | <b>2003</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                       |             |
| Proceeds from sale of common shares, net of issue costs   | \$ 2,518              | \$ 57       |
| Proceeds from mortgages payable   | 53,232                | 31,287      |
| Proceeds from notes payable   |                       | 11          |
| Repurchase of shares and minority interest units  | (25)                  | (2)         |
| Distributions paid to shareholders, net of reinvestment   | (4,825)               | (3,351)     |
| Distributions paid to unitholders of operating partnership  | (1,741)               | (1,407)     |
| Distributions paid to other minority partners   | (226)                 | (210)       |
| Redemption of investment certificates   | (527)                 | (568)       |
| Principal payments on mortgages payable   | (16,983)              | (6,047)     |
| Principal payments on notes payable and other debt  | (25,017)              | (5)         |
|   | 6,406                 | 19,765      |
| Net cash provided by financing activities   | 6,406                 | 19,765      |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>  | 3,892                 | 3,181       |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>   | 31,704                | 18,642      |
|   | \$ 35,596             | \$21,823    |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>   |                       |             |
| <br><b>SUPPLEMENTARY SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES FOR THE PERIOD</b>   |                       |             |
| Distribution reinvestment plan  | \$ 2,337              | \$ 2,592    |
| UPREIT distribution reinvestment plan   | 172                   | 204         |
| Preferred dividends payable   | 198                   | 0           |
| Property acquired through issue of shares   | 32                    | 0           |
| Real estate investment acquired through assumption of mortgage loans payable and accrual of costs | 21,071                | 0           |
| Assets acquired through the issuance of minority interest units in the operating partnership      | 6,838                 | 13,149      |
| Operating partnership units converted to shares   | 424                   | 476         |
| <br><b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                                       |                       |             |
| Cash paid during the period for:  |                       |             |
| Interest on mortgages   | 11,136                | 9,910       |
| Interest on investment certificates   | 61                    | 95          |
| Interest on margin account and other  | 291                   | 88          |

\$ 11,488

\$10,093

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

**Table of Contents**

**INVESTORS REAL ESTATE TRUST AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** *(unaudited)*

*for the three months ended July 31, 2004 and 2003*

**NOTE 1 ORGANIZATION**

Investors Real Estate Trust ( IRET or the Company ) is a self-advised real estate investment trust engaged in acquiring, owning and leasing multi-family and commercial real estate. IRET has elected to be taxed as a Real Estate Investment Trust ( REIT ) under Sections 856-860 of the Internal Revenue Code of 1986, as amended. REITs are subject to a number of organizational and operational requirements, including a requirement to distribute 90% of ordinary taxable income to shareholders, and, generally, are not subject to federal income tax on net income. IRET 's multi-family residential properties and commercial properties are located mainly in the states of North Dakota and Minnesota, but also in the states of Colorado, Idaho, Iowa, Georgia, Kansas, Montana, Nebraska, South Dakota, Texas, Michigan, Washington and Wisconsin. As of July 31, 2004, IRET owned 65 multi-family residential properties with 8,671 apartment units and 148 commercial properties totaling 7.7 million net rentable square feet. IRET conducts a majority of its business activities through its consolidated operating partnership, IRET Properties, a North Dakota Limited Partnership (the Operating Partnership ), as well as through a number of other subsidiary entities.

All references to IRET or the Company refer to Investors Real Estate Trust and its consolidated subsidiaries.

**NOTE 2 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

**BASIS OF PRESENTATION**

The accompanying consolidated financial statements include the accounts of IRET and all its subsidiaries in which it maintains a controlling interest. All significant intercompany balances and transactions are eliminated in consolidation. The Company 's fiscal year ends April 30.

The accompanying consolidated financial statements include the accounts of IRET and its general partnership interest in the Operating Partnership. The Company 's interest in the Operating Partnership was 77.3% and 78.0%, respectively, as of July 31, 2004, and April 30, 2004, which includes 100% of the general partnership interest. The limited partners have a redemption option that they may exercise. IRET has the option of redeeming the limited partners ' interests ( Units ) for IRET common shares of beneficial interest, on a one-for-one basis, or for cash payment to the unitholder. The redemption generally may be exercised by the limited partners at any time after the first anniversary of the date of the acquisition of the Units (provided, however, that in general not more than two redemptions by a limited partner may occur during each calendar year, and each limited partner may not exercise the redemption for less than 1,000 Units, or, if such limited partner holds less than 1,000 Units, for all of the Units held by such limited partner). The Operating Partnership and some limited partners have contractually agreed to a holding period of greater than one year and/or a greater number of redemptions during a calendar year.

**Table of Contents**

**NOTE 2** *continued*

The consolidated financial statements also reflect the ownership by the Operating Partnership of certain joint venture entities in which the Operating Partnership has a general partner or controlling interest. These entities are consolidated into IRET's other operations, with minority interests reflecting the minority partners' share of ownership and income and expenses.

**UNAUDITED INTERIM FINANCIAL STATEMENTS**

The interim consolidated financial statements of IRET have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the applicable rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America are omitted. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting solely of normal recurring adjustments, necessary for the fair presentation of the Company's financial position, results of operations and cash flows for the interim periods have been included.

The current period's results of operations are not necessarily indicative of results which ultimately may be achieved for the year. The interim consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2004, filed with the SEC.

**RECLASSIFICATIONS**

Certain previously reported amounts have been reclassified to conform to the current financial statement presentation.

**NOTE 3 EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. The Company has no outstanding options, warrants, convertible stock or other contractual obligations requiring issuance of additional common shares that would result in a dilution of earnings. While Units can be exchanged for common shares on a one-for-one basis after a minimum holding period of one year, the exchange of Units for common shares has no effect on net income per share, as Unitholders and common shareholders effectively share equally in the net income of the Operating Partnership. The following table presents a reconciliation of the numerator and denominator used to calculate basic and diluted earnings per share reported in the consolidated financial statements for the three months ended July 31, 2004 and 2003:



**Table of Contents****NOTE 3** *continued*

|  | (in thousands, except per share data) |               |
|--|---------------------------------------|---------------|
|  | 2004                                  | 2003          |
| <b>NUMERATOR</b>   |                                       |               |
| Income from continuing operations  | \$ 2,345                              | \$ 2,823      |
| Discontinued operations  | 3,125                                 | 97            |
|  | <hr/>                                 | <hr/>         |
| Net income   | 5,470                                 | 2,920         |
| Dividends to preferred shareholders  | (593)                                 | 0             |
|  | <hr/>                                 | <hr/>         |
| Numerator for basic earnings per share net income available to common shareholders | 4,877                                 | 2,920         |
| Minority interest portion of operating partnership income                          | 1,474                                 | 843           |
|  | <hr/>                                 | <hr/>         |
| Numerator for diluted earnings per share   | \$ 6,351                              | \$ 3,763      |
|  | <hr/>                                 | <hr/>         |
| <b>DENOMINATOR</b>   |                                       |               |
| Denominator for basic earnings per share weighted average shares                   | 41,981                                | 36,358        |
| Effect of dilutive securities convertible operating partnership units              | 11,987                                | 10,149        |
|  | <hr/>                                 | <hr/>         |
| Denominator for diluted earnings per share   | 53,968                                | 46,507        |
|  | <hr/>                                 | <hr/>         |
| <b>BASIC</b>   |                                       |               |
| Earnings per common share from continuing operations                               | \$ .04                                | \$ .08        |
| Earnings per common share from discontinued operations                             | .08                                   | .00           |
|  | <hr/>                                 | <hr/>         |
| <b>NET INCOME PER COMMON SHARE</b>   | <b>\$ .12</b>                         | <b>\$ .08</b> |
|  | <hr/>                                 | <hr/>         |
| <b>DILUTED</b>   |                                       |               |
| Earnings per common share from continuing operations                               | \$ .06                                | \$ .08        |
| Earnings per common share from discontinued operations                             | .06                                   | .00           |
|  | <hr/>                                 | <hr/>         |
| <b>NET INCOME PER COMMON SHARE</b>   | <b>\$ .12</b>                         | <b>\$ .08</b> |

**NOTE 4 SHAREHOLDERS EQUITY**

During the three months ended July 31, 2004, we issued 259,000 shares pursuant to our distribution reinvestment plan, for total proceeds of \$2.5 million. In addition, as of July 31, 2004, 64,000 Units have been converted to shares during fiscal year 2005, with a total value of \$424,000 included in shareholders' equity.

**NOTE 5 SEGMENT REPORTING**

IRET is engaged in acquiring, owning and leasing multi-family residential and commercial real estate. Each property is considered a separate operating segment. Each segment on a stand-alone basis is less than 10% of the revenues, profit or loss, and assets of the combined reported operating segments, and meets the majority of the aggregation criteria under SFAS 131. Previously, IRET's operating segments were aggregated and classified as multi-family residential and commercial properties, producing two reportable segments. Beginning with this first quarter of IRET's current fiscal year, IRET is reporting its results in five segments: multi-family residential properties, office, industrial (including miscellaneous commercial properties), retail, and medical (including assisted living facilities) properties.

**Table of Contents****NOTE 5** *continued*

We have expanded our number of reportable segments in response to our growth and to the increased diversity of our properties, in particular the increase in the number of retail and medical properties we own. In April and May 2004 we acquired a significant number of medical properties located in the Duluth, Minnesota area. This growth and increased diversity of property type prompted us to reorganize our asset management group, effective July 2004, in order to permit greater management specialization by property type. It also provides a basis for aggregating properties with similar economic characteristics. While we will continue to separately evaluate the performance of each of our properties, our management will also assess our performance in each of our five segments.

The revenues, profit (loss) and assets for these reportable segments are summarized as follows as of and for the three-month periods ended July 31, 2004 and 2003, along with reconciliations to the consolidated financial statements:

**Three Months Ended July 31, 2004**

|  | (in thousands)       |                       |                          |                      |                             |          |
|--|----------------------|-----------------------|--------------------------|----------------------|-----------------------------|----------|
|  | Commercial<br>Office | Commercial<br>Medical | Commercial<br>Industrial | Commercial<br>Retail | Multi-Family<br>Residential | Total    |
| Real Estate Revenue  | \$11,401             | \$ 6,247              | \$ 1,691                 | \$ 4,644             | \$ 15,492                   | \$39,475 |
| Expenses   |                      |                       |                          |                      |                             |          |
| Mortgage interest  | 3,079                | 1,950                 | 564                      | 953                  | 4,717                       | 11,263   |
| Depreciation/amortization related to real estate investments | 2,817                | 1,291                 | 377                      | 695                  | 2,781                       | 7,961    |
| Utilities and maintenance                                    | 2,251                | 910                   | 79                       | 545                  | 3,241                       | 7,026    |
| Real estate taxes  | 1,744                | 437                   | 233                      | 484                  | 1,697                       | 4,595    |
| Insurance  | 130                  | 70                    | 21                       | 50                   | 414                         | 685      |
| Property management  | 482                  | 267                   | 21                       | 76                   | 1,762                       | 2,608    |
| Total segment expense  | 10,503               | 4,925                 | 1,295                    | 2,803                | 14,612                      | 34,138   |
| Segment operating profit                                     | \$ 898               | \$ 1,322              | \$ 396                   | \$ 1,841             | \$ 880                      | 5,337    |
| Reconciliation to consolidated operations                    |                      |                       |                          |                      |                             |          |
| Interest discounts and fee revenue                           |                      |                       |                          |                      |                             | 211      |
| Other interest expense                                       |                      |                       |                          |                      |                             | (408)    |
| Depreciation furniture and fixtures                          |                      |                       |                          |                      |                             | (44)     |
| Administrative, advisory and trustee fees                    |                      |                       |                          |                      |                             | (769)    |
| Operating expenses   |                      |                       |                          |                      |                             | (140)    |

|   |          |
|---|----------|
| Amortization  | (296)    |
|   | <hr/>    |
| Income before minority interest and discontinued operations | \$ 3,891 |
|   | <hr/>    |

**Table of Contents****NOTE 5** *continued***Three Months Ended July 31, 2003**

|  | (in thousands)       |                       |                          |                      |                             |          |
|--|----------------------|-----------------------|--------------------------|----------------------|-----------------------------|----------|
|  | Commercial<br>Office | Commercial<br>Medical | Commercial<br>Industrial | Commercial<br>Retail | Multi-Family<br>Residential | Total    |
| Real Estate Revenue  | \$9,138              | \$ 4,205              | \$ 1,718                 | \$ 2,874             | \$ 14,296                   | \$32,231 |
| Expenses   |                      |                       |                          |                      |                             |          |
| Mortgage interest  | 2,670                | 1,469                 | 521                      | 833                  | 4,259                       | 9,752    |
| Depreciation/amortization related to real estate investments | 1,380                | 784                   | 310                      | 463                  | 2,469                       | 5,406    |
| Utilities and maintenance                                    | 1,731                | 505                   | 39                       | 207                  | 2,806                       | 5,288    |
| Real estate taxes  | 1,347                | 310                   | 186                      | 487                  | 1,611                       | 3,941    |
| Insurance  | 104                  | 31                    | 16                       | 40                   | 482                         | 673      |
| Property management  | 316                  | 328                   | 23                       | 13                   | 1,490                       | 2,170    |
| Total segment expense  | 7,548                | 3,427                 | 1,095                    | 2,043                | 13,117                      | 27,230   |
| Segment operating profit                                     | \$ 1,590             | \$ 778                | \$ 623                   | \$ 831               | \$ 1,179                    | 5,001    |
| Reconciliation to consolidated operations:                   |                      |                       |                          |                      |                             |          |
| Interest discounts and fee revenue                           |                      |                       |                          |                      |                             | 150      |
| Other interest expense                                       |                      |                       |                          |                      |                             | (193)    |
| Depreciation furniture and fixtures                          |                      |                       |                          |                      |                             | (37)     |
| Administrative, advisory and trustee fees                    |                      |                       |                          |                      |                             | (657)    |
| Operating expenses   |                      |                       |                          |                      |                             | (171)    |
| Amortization   |                      |                       |                          |                      |                             | (199)    |
| Income before minority interest and discontinued operations  |                      |                       |                          |                      |                             | \$ 3,894 |

**Segment Assets and Accumulated Depreciation****July 31, 2004**

(in thousands)

|   | <b>Commercial-<br/>Office</b> | <b>Commercial-<br/>Medical</b> | <b>Commercial-<br/>Industrial</b> | <b>Commercial-<br/>Retail</b> | <b>Multi-<br/>Family<br/>Residential</b> | <b>Total</b>       |
|---|-------------------------------|--------------------------------|-----------------------------------|-------------------------------|--|--------------------|
| Segment assets                                    |                               |                                |                                   |                               |  |                    |
| Property owned                                    | \$316,014                     | \$216,103                      | \$58,573                          | \$121,289                     | \$434,816                                | \$1,146,795        |
| Less accumulated<br>depreciation/<br>amortization | <u>(20,154)</u>               | <u>(10,426)</u>                | <u>(4,240)</u>                    | <u>(8,217)</u>                | <u>(62,339)</u>                          | <u>(105,376)</u>   |
| Total property owned                              | <u>\$295,860</u>              | <u>\$205,677</u>               | <u>\$54,333</u>                   | <u>\$113,072</u>              | <u>\$372,477</u>                         | <u>\$1,041,419</u> |

**April 30, 2004**

(in thousands)

|   | <b>Commercial-<br/>Office</b> | <b>Commercial-<br/>Medical</b> | <b>Commercial-<br/>Industrial</b> | <b>Commercial-<br/>Retail</b> | <b>Multi-<br/>Family<br/>Residential</b> | <b>Total</b>       |
|---|-------------------------------|--------------------------------|-----------------------------------|-------------------------------|--|--------------------|
| Segment assets                                    |                               |                                |                                   |                               |  |                    |
| Property owned                                    | \$301,401                     | \$171,180                      | \$58,573                          | \$123,108                     | \$446,172                                | \$1,100,434        |
| Less accumulated<br>depreciation/<br>amortization | <u>(17,307)</u>               | <u>(9,135)</u>                 | <u>(3,860)</u>                    | <u>(8,338)</u>                | <u>(61,610)</u>                          | <u>(100,250)</u>   |
| Total property owned                              | <u>\$284,094</u>              | <u>\$162,045</u>               | <u>\$54,713</u>                   | <u>\$114,770</u>              | <u>\$384,562</u>                         | <u>\$1,000,184</u> |

**Table of Contents**

**NOTE 6 COMMITMENTS AND CONTINGENCIES**

*Litigation.* IRET is involved in various lawsuits arising in the normal course of business. Management believes that such matters will not have a material effect on the Company's financial statements.

*Insurance.* IRET carries insurance coverage on its properties in amounts and types that the Company believes are customarily obtained by owners of similar properties.

*Purchase Options.* The Company has granted options to purchase certain Company properties to various parties. In general, the options grant the parties the right to purchase these properties at the greater of their appraised value or an annual compounded increase of 2% to 2.5% of the initial cost of the property to the Company. The total property cost of the 18 properties subject to purchase options is approximately \$82.3 million, and the gross rental revenue from these properties was approximately \$2.0 million for the three months ended July 31, 2004.

*Real Estate Expansions and Development.* The Company has certain funding commitments under contracts for property development and expansion projects. As of July 31, 2004, IRET's funding commitments included the following:

*Grand Forks Apartment Construction.* The Company is obligated under a construction contract and an excavating contract for the construction of a multi-family residential property in Grand Forks, ND. The Company is obligated to pay approximately \$7.5 million under the construction contract, subject to additions and deductions as provided in the contract, and approximately \$300,000 under the excavating contract, for this development project. As of July 31, 2004, approximately \$2.1 million and \$118,000 have been paid under the construction contract and the excavating contract, respectively.

*Lithia Springs, Georgia Expansion Project.* The Company is obligated to pay up to \$500,000 to construct expansion premises at its Lithia Springs, Georgia assisted living facility. As of July 31, 2004, the Company has not paid any amounts under this obligation.

*Kalispell Retail Center, Kalispell, MT.* The Company has entered into a ten-year lease agreement with Conlin's Furniture, Inc. The Company is obligated to pay approximately \$620,000 for tenant improvements and leasing commissions under the lease agreement. As of July 31, 2004, the Company has not paid any amounts under this obligation.

*Environmental Matters.* Under various federal, state and local laws, ordinances and regulations, a current or previous owner or operator of real estate may be liable for the costs of removal of, or remediation of, certain hazardous or toxic substances in, on, around or under the property. While IRET currently has no knowledge of any violation of environmental laws, ordinances or regulations at any of its properties, there can be no assurance that areas of contamination will not be identified at any of the Company's properties, or that changes in environmental laws, regulations or cleanup requirements would not result in significant costs to the Company.

**Table of Contents****NOTE 6** *continued*

*Pending Acquisitions and Dispositions.* As of July 31, 2004, the Company had signed an agreement for the purchase of an approximately 185,000 sq. ft. office building in the Minneapolis, MN area, for a purchase price of approximately \$22.0 million. In connection with this transaction, the seller of this office property would purchase from the Company an approximately 62,000 sq. ft. office building in Eden Prairie, MN, for a price of approximately \$5.8 million. This pending acquisition and disposition is subject to customary closing conditions, and no assurance can be given that this pending transaction will be consummated.

**NOTE 7 DISCONTINUED OPERATIONS**

SFAS No. 144, Accounting for the Impairment or Disposal of Long Lived Assets, requires the Company to report in discontinued operations the results of operations of a property that has either been disposed of or is classified as held for sale. It also requires that any gains or losses from the sale of a property be reported in discontinued operations. There were no properties held for sale as of July 31, 2004 or 2003. The following information shows the effect on net income, net of minority interest, and the gains or losses from the sale of properties classified as discontinued operations for the three months ended July 31, 2004 and 2003:

|   | <b>(in thousands)</b> |             |
|---|-----------------------|-------------|
|   | <b>2004</b>           | <b>2003</b> |
| REVENUE   |                       |             |
| Real estate rentals   | \$ 573                | \$701       |
| Tenant reimbursements                                       |                       | 2           |
|   | <hr/>                 | <hr/>       |
| Total revenue   | 573                   | 703         |
|   | <hr/>                 | <hr/>       |
| OPERATING EXPENSE   |                       |             |
| Interest  | 181                   | 206         |
| Depreciation/amortization                                   | 107                   | 134         |
| Utilities and maintenance                                   | 77                    | 93          |
| Real estate taxes   | 45                    | 52          |
| Insurance   | 9                     | 13          |
| Property management expenses                                | 69                    | 78          |
| Administrative expense                                      |                       | 1           |
| Loss on impairment of real estate                           | 7                     |             |
|   | <hr/>                 | <hr/>       |
| Total operating expense                                     | 495                   | 577         |
|   | <hr/>                 | <hr/>       |
| Operating income  | 78                    | 126         |
| Income before minority interest and discontinued operations | 78                    | 126         |
| Minority interest   | (17)                  | (29)        |
| Gain on sale of discontinued operations                     | 3,064                 | 0           |



|                              |         |       |
|------------------------------|---------|-------|
|                              | _____   | _____ |
| Discontinued operations, net | \$3,125 | \$ 97 |
|                              | _____   | _____ |

**NOTE 8 ACQUISITIONS AND DISPOSITIONS**

During the three months ended July 31, 2004, IRET acquired eight commercial properties, and sold three commercial properties and four apartment complexes.

**Table of Contents**NOTE 8 *continued***ACQUISITIONS**

|  | <b>(in thousands)</b>       |
|--|-----------------------------|
|  | <b>Acquisition<br/>Cost</b> |
| Commercial Property – Medical  |                             |
| 52,300 sq. ft. Nebraska Orthopedic Hospital Project – Omaha, NE                                | \$ 20,597                   |
| 45,081 sq. ft. Pavilion I Clinic – Duluth, MN  | 10,900                      |
| 60,294 sq. ft. High Pointe Health Campus Phase I (East Metro Medical Building) - Lake Elmo, MN | 13,050                      |
|  | <hr/>                       |
|  | 44,547                      |
|  | <hr/>                       |
| Commercial Property – Industrial (miscellaneous commercial property)                           |                             |
| 46,720 sq. ft. Sleep Inn Hotel – Brooklyn Park, MN   | 2,750                       |
|  | <hr/>                       |
|  | 2,750                       |
|  | <hr/>                       |
| Commercial Property – Office   |                             |
| 26,186 sq. ft. Plymouth I Office Building – Plymouth, MN                                       | 1,864                       |
| 26,186 sq. ft. Plymouth II Office Building – Plymouth, MN                                      | 1,748                       |
| 26,186 sq. ft. Plymouth III Office Building – Plymouth, MN                                     | 2,214                       |
| 79,377 sq. ft. Northgate I Office Building – Maple Grove, MN                                   | 8,175                       |
|  | <hr/>                       |
|  | 14,001                      |
|  | <hr/>                       |
| Total Property Acquisitions  | \$ 61,298                   |
|  | <hr/>                       |

The eight commercial properties were acquired in exchange for the issuance of 3,301 shares of common stock with a value of \$32,000 and for 681,189 Units with a value of \$6.8 million, plus \$54.5 million of cash and cash equivalents.

**DISPOSITIONS****(in thousands)**

|   | <u>Sales Price</u> | <u>Book Value<br/>and Sales<br/>Cost</u> | <u>Gain/Loss</u> |
|---|--------------------|--|------------------|
| <b>Multi-Family Residential</b>                 |                    |  |                  |
| 204-unit Ivy Club Apartments Vancouver, WA      | \$ 12,250          | \$ 12,070                                | \$ 180           |
| 26-unit Beulah Condominiums Beulah, ND          | 96                 | 96                                       | 0                |
| 36-unit Parkway Apartments Beulah, ND           | 159                | 159                                      | 0                |
| 18-unit Dakota Arms Apartments Minot, ND        | 825                | 566                                      | 259              |
| <b>Commercial Retail</b>                        |                    |  |                  |
| 30,000 sq. ft. Barnes & Noble Store Fargo, ND   | 4,590              | 2,916                                    | 1,674            |
| 18,040 sq. ft. Petco Store Fargo, ND            | 2,160              | 1,209                                    | 951              |
| <b>Vacant Land</b>                              |                    |  |                  |
| 205,347 sq. ft. parcel of vacant land Libby, MT | 151                | 151                                      | 0                |
| <b>Total Property Dispositions</b>              | <b>\$20,231</b>    | <b>\$ 17,167</b>                         | <b>\$ 3,064</b>  |

**Table of Contents**

**NOTE 9 SUBSEQUENT EVENTS**

*Van Mall Woods, Vancouver, WA Disposition.* On September 1, 2004, the Company closed on the disposition of the 100-unit apartment complex in Vancouver, Washington. The sales price was \$6.9 million, which resulted in a gain of approximately \$1.3 million.

**COMMON AND PREFERRED SHARE DISTRIBUTIONS**

On August 18, 2004, the Company's Board of Trustees declared a regular quarterly distribution of 16.10 cents per share on the Company's common shares and Units, payable October 1, 2004, to common shareholders and Unitholders of record on September 17, 2004. The Company's Board of Trustees also declared a distribution of 51.56 cents per share on the Company's preferred shares of beneficial interest, payable September 30, 2004 to preferred shareholders of record on September 15, 2004.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements included in this report, as well as the Company's audited financial statements for the fiscal year ended April 30, 2004, which are included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

*Forward Looking Statements.* Certain matters included in this discussion are forward looking statements within the meaning of the federal securities laws. Although we believe that the expectations reflected in the following statements are based on reasonable assumptions, we can give no assurance that the expectations expressed will actually be achieved. Many factors may cause actual results to differ materially from our current expectations, including general economic conditions, local real estate conditions, the general level of interest rates and the availability of financing, timely completion and lease-up of properties under construction and various other economic risks inherent in the business of owning and operating investment real estate.

*Overview.* IRET is a self-advised equity real estate investment trust engaged in owning and operating income-producing real properties. Our investments include multi-family residential properties and office, industrial, medical and retail properties located primarily in the upper Midwest states of Minnesota and North Dakota. Our properties are diversified by type and location. As of July 31, 2004, our real estate portfolio consisted of 65 multi-family residential properties containing 8,671 apartment units and having a total carrying amount (net of accumulated depreciation) of \$372 million, and 148 commercial properties containing approximately 7.7 million square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$669 million. Our commercial properties consist of:

47 office properties containing approximately 3,093,021 square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$296 million;

**Table of Contents**

11 industrial properties (including miscellaneous commercial properties) containing approximately 1,725,287 square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of 54 million;

60 retail properties containing approximately 1,626,712 square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$113 million; and

30 medical properties (including assisted living facilities) containing approximately 1,241,651 square feet of leasable space and having a total carrying amount (net of accumulated depreciation) of \$206 million.

Our primary source of income and cash is rents associated with multi-family residential and commercial leases. Our business objective is to increase shareholder value by employing a disciplined investment strategy. This strategy is focused on growing assets in desired geographical markets, achieving diversification by property type and location, and adhering to targeted returns in acquiring properties. We intend to continue to achieve our business objective by investing in multi-family residential properties and in office, industrial, retail and medical commercial properties that are leased to single or multiple tenants, usually for five years or longer, and are located throughout the upper Midwest. We operate mainly within the states of North Dakota and Minnesota, although we also have real estate investments in South Dakota, Montana, Nebraska, Colorado, Georgia, Idaho, Iowa, Kansas, Michigan, Washington, Texas and Wisconsin.

We compete with other owners and developers of multi-family and commercial properties to attract tenants to our properties, and we compete with other real estate investors to acquire properties. Principal areas of competition for tenants are in respect of rents charged and the attractiveness of location and quality of our properties. Competition for investment properties affects our ability to acquire properties we want to add to our portfolio, and the price we pay for acquisitions.

*Critical Accounting Policies.* In preparing the consolidated financial statements management has made estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. A summary of the Company's critical accounting policies is included in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2004, in Management's Discussion and Analysis of Financial Condition and Results of Operations and in the footnotes to the consolidated financial statements, Note 2 - Basis of Presentation and Significant Accounting Policies. There have been no significant changes to those policies during the first quarter of fiscal year 2005.

**RECENT ACCOUNTING PRONOUNCEMENTS**

There are no accounting standards or interpretations that have been issued, but which have not yet been adopted, that we believe will have a material impact on our financial statements.

**Table of Contents****RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JULY 31, 2004 AND 2003**

Throughout this section, we have provided certain information on a stabilized property basis. Information provided on a stabilized property basis is provided only for those properties owned for the entirety of both periods being compared, and includes properties which were redeveloped or expanded during the periods being compared. Properties purchased or sold, and properties under development during the periods being compared, are excluded from our stabilized property analysis.

**REVENUES**

Total IRET revenues for the first quarter of fiscal year 2005, were \$39.5 million, compared to \$32.2 million received in the first quarter of the prior fiscal year. This is an increase of \$7.2 million or 22.5%. This increase in revenue resulted primarily from the additional investments in real estate made by IRET during the first quarter of fiscal year 2005, as well as other factors shown by the following analysis:

|   | <b>(in thousands)</b>   |
|---|---|
|   | <b>Increase in Total<br/>Revenue<br/>Three Months ended<br/>July 31, 2004</b> |
| Rent from 28 properties acquired in Fiscal 2004 in excess of that received in 2004 from the same 28 properties                  | \$ 6,252  |
| Rent from 7 properties acquired in Fiscal 2005  | 863   |
| Increase in rental receipts and accruals on existing properties due to changes in scheduled rent and lease renewals/termination | 129   |
|   | <hr/>   |
| Net increase in total revenue   | \$ 7,244  |
|   | <hr/>   |

**SEGMENT EXPENSES AND OPERATING PROFIT**

The following table shows the changes in revenues, operating expenses, interest, and depreciation by reportable operating segment for the three months ended July 31, 2004, as compared to the three months ended July 31, 2003:

**Three Months Ended July 31**

|  | <b>(in thousands)</b> |             |               |          |
|--|-----------------------|-------------|---------------|----------|
|  | <b>2004</b>           | <b>2003</b> | <b>Change</b> | <b>%</b> |
|  | <hr/>                 | <hr/>       | <hr/>         | <hr/>    |
| Commercial-Office<br>Real estate revenue | \$ 11,401             | 9,138       | \$ 2,263      | 24.8%    |

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|                               |        |       |          |         |
|-------------------------------|--------|-------|----------|---------|
|                               | _____  | _____ | _____    | _____   |
| Expenses                      |        |       |          |         |
| Mortgage interest             | 3,079  | 2,670 | 409      | 15.3%   |
| Depreciation and amortization | 2,817  | 1,380 | 1,437    | 104.1%  |
| Utilities and maintenance     | 2,251  | 1,731 | 520      | 30.0%   |
| Real estate taxes             | 1,744  | 1,347 | 397      | 29.5%   |
| Insurance                     | 130    | 104   | 26       | 25.0%   |
| Property management           | 482    | 316   | 166      | 52.5%   |
|                               | _____  | _____ | _____    | _____   |
| Total segment expense         | 10,503 | 7,548 | 2,955    | 39.1%   |
|                               | _____  | _____ | _____    | _____   |
| Segment operating profit      | \$ 898 | 1,590 | \$ (692) | (43.5%) |
|                               | _____  | _____ | _____    | _____   |

**Table of Contents**

|                               | (in thousands) |       |         |         |
|-------------------------------|----------------|-------|---------|---------|
|                               | 2004           | 2003  | Change  | %       |
| Commercial-Medical            |                |       |         |         |
| Real estate revenue           | \$6,247        | 4,205 | \$2,042 | 48.6%   |
| Expenses                      |                |       |         |         |
| Mortgage interest             | 1,950          | 1,469 | 481     | 32.7%   |
| Depreciation and amortization | 1,291          | 784   | 507     | 64.7%   |
| Utilities and maintenance     | 910            | 505   | 405     | 80.2%   |
| Real estate taxes             | 437            | 310   | 127     | 41.0%   |
| Insurance                     | 70             | 31    | 39      | 125.8%  |
| Property management           | 267            | 328   | (61)    | (18.6%) |
| Total segment expense         | 4,925          | 3,427 | 1,498   | 43.7%   |
| Segment operating profit      | \$1,322        | 778   | \$ 544  | 69.9%   |

|                               | (in thousands) |       |         |         |
|-------------------------------|----------------|-------|---------|---------|
|                               | 2004           | 2003  | Change  | %       |
| Commercial-Industrial         |                |       |         |         |
| Real estate revenue           | \$1,691        | 1,718 | \$ (27) | (1.6%)  |
| Expenses                      |                |       |         |         |
| Mortgage interest             | 564            | 521   | 43      | 8.3%    |
| Depreciation and amortization | 377            | 310   | 67      | 21.6%   |
| Utilities and maintenance     | 79             | 39    | 40      | 102.6%  |
| Real estate taxes             | 233            | 186   | 47      | 25.3%   |
| Insurance                     | 21             | 16    | 5       | 31.3%   |
| Property management           | 21             | 23    | (2)     | (8.7%)  |
| Total segment expense         | 1,295          | 1,095 | 200     | 18.3%   |
| Segment operating profit      | \$ 396         | 623   | \$(227) | (36.4%) |



|                               | (in thousands) |         |         |        |
|-------------------------------|----------------|---------|---------|--------|
|                               | 2004           | 2003    | Change  | %      |
| Commercial-Retail             |                |         |         |        |
| Real estate revenue           | \$4,644        | \$2,874 | \$1,770 | 61.6%  |
| Expenses                      |                |         |         |        |
| Mortgage interest             | 953            | 833     | 120     | 14.4%  |
| Depreciation and amortization | 695            | 463     | 232     | 50.1%  |
| Utilities and maintenance     | 545            | 207     | 338     | 163.3% |
| Real estate taxes             | 484            | 487     | (3)     | (0.6%) |
| Insurance                     | 50             | 40      | 10      | 25.0%  |
| Property management           | 76             | 13      | 63      | 484.6% |
| Total segment expense         | 2,803          | 2,043   | 760     | 37.2%  |
| Segment operating profit      | \$1,841        | \$ 831  | \$1,010 | 121.5% |

|                               | (in thousands) |          |          |         |
|-------------------------------|----------------|----------|----------|---------|
|                               | 2004           | 2003     | Change   | %       |
| Multi-Family Residential      |                |          |          |         |
| Real estate revenue           | \$15,492       | \$14,296 | \$1,196  | 8.4%    |
| Expenses                      |                |          |          |         |
| Mortgage interest             | 4,717          | 4,259    | 458      | 10.8%   |
| Depreciation and amortization | 2,781          | 2,469    | 312      | 12.6%   |
| Utilities and maintenance     | 3,241          | 2,806    | 435      | 15.5%   |
| Real estate taxes             | 1,697          | 1,611    | 86       | 5.3%    |
| Insurance                     | 414            | 482      | (68)     | (14.1%) |
| Property management           | 1,762          | 1,490    | 272      | 18.3%   |
| Total segment expense         | 14,612         | 13,117   | 1,495    | 11.4%   |
| Segment operating profit      | \$ 880         | \$ 1,179 | \$ (299) | (25.4%) |

**Table of Contents**

**FACTORS IMPACTING NET INCOME:**

During the first three months of fiscal year 2005, the following factors were the most significant causes of the limited growth of our total revenue. These factors ultimately also negatively impacted our net income per share:

*Increased Economic Vacancy & Concessions.* While our stabilized apartment vacancy decreased to 9.2% from 9.5% for the three months ended July 31, 2004 and 2003, respectively, our vacancy levels at our stabilized commercial properties increased to 9.4% from 5.6% for the three months ended July 31, 2004 and 2003, respectively.

Our residential vacancy decrease on stabilized properties does not reflect the concessions, such as free rent, that have been granted to attract new tenants to our residential properties. Our stabilized apartment concessions were \$877,000 and \$549,000 for the three months ended July 31, 2004 and 2003, respectively, an increase of 59.7%.

Our commercial vacancy levels are primarily due to our inability to either renew existing leases or to re-lease space being vacated by tenants at the expiration of their lease. As we previously reported to our shareholders, despite some positive economic developments, we have yet to see a significant increase in demand for apartments or for commercial space. Our expectation is that demand in IRET's markets for both apartments and commercial space will continue to remain weak through the second quarter of fiscal year 2005. As a result, we do not expect our occupancy levels to improve significantly, or a reduction in the level of rent concessions during our fiscal year 2005, which ends April 30, 2005.

*Increased maintenance expense.* The maintenance expense category increased by \$923,000 or 26.9% for the three months ended July 31, 2004, as compared to the corresponding period in fiscal 2004. Of the increased maintenance costs for the three months ended July 31, 2004, \$688,000 or 74.5% is attributable to the addition of new real estate acquired in fiscal 2005, while \$235,000 or 25.5% is due to increased costs for maintenance on

existing real estate assets. Under the terms of most of our commercial leases, the full cost of maintenance is paid by the tenant as additional rent. For our noncommercial real estate properties, any increase in our maintenance costs must be collected from tenants in the form of a general rent increase. While we have implemented selected rent increases, the current economic conditions and increased vacancy levels have prevented us from raising rents in the amount necessary to fully recover our increased maintenance costs.

*Increased Utility Expense.* The utility expense category increased by \$815,000, or 44%, for the three months ended July 31, 2004, as compared to the corresponding period of fiscal year 2004. Of the increased utility costs for the three months ended July 31, 2004, \$427,000, or 52.4%, is attributable to the addition of new real estate, while \$388,000, or 47.6%, is due to increased costs for utilities on existing real estate assets. For the three months ended July 31, 2004, no one property accounts for a significant portion of this

**Table of Contents**

increase, as we have seen a general increase for natural gas, water, sewer and garbage disposal in the communities where our properties are located.

*Increased Administrative.* Administrative and operating expenses increased by \$116,000, or 18.9%, for the three months ended July 31, 2004, as compared to the corresponding period of fiscal year 2004, primarily because of increased salary and other expense resulting from our hiring of additional employees. We added a total of six additional employees during fiscal year 2004 and two additional employees in the first quarter of fiscal year 2005.

*Increased Mortgage Interest Expense.* Our mortgage debt increased \$57.3 million, or 9.1%, to \$690 million as of July 31, 2004, as compared to \$633 million on April 30, 2003. Our mortgage interest expense increased by \$1.5 million, or 15.5%, for the three months ended July 31, 2004. All of the increased mortgage interest expense for the three months ended July 31, 2004, is attributable to the addition of new real estate, as mortgage interest expenses on existing real estate assets declined by \$39,000. Our overall weighted average interest rate on all outstanding mortgage debt is 6.71% as of July 31, 2004.

*Increased Amortization Expense.* In accordance with SFAS No. 141, Business Combinations, which establishes standards for valuing in-place leases in purchase transactions, the Company allocates a portion of the purchase price paid for properties to in-place lease intangible assets. The amortization period of these intangible assets is the term of the lease, rather than the estimated life of the buildings and improvements. The Company accordingly records additional amortization expense due to this shorter amortization period, which has the effect of decreasing the Company's net income available to common shareholders.

**RESULTS ON A STABILIZED PROPERTY BASIS**

The following table presents results on a stabilized property basis for the three months ended July 31, 2004 and 2003, for our multi-family residential and commercial properties. Property Segment Operating Profit should not be considered as an alternative to operating net income as determined in accordance with GAAP as a measure of IRET's performance. The Company analyzes and compares results of operations on properties owned and in operation for the entirety of the periods being compared (including properties that were redeveloped or expanded during the periods being compared, with properties purchased or sold during the periods being compared being excluded from this analysis). This comparison allows the Company to evaluate the performance of existing properties and their contribution to net income.

Management believes that measuring performance on a stabilized property basis is useful to investors because it enables evaluation of how the Company's properties are performing year over year. Management uses this measure to assess whether or not it has been successful in increasing net operating income, renewing the leases of existing tenants, controlling operating costs and appropriately handling capital improvements.

**Table of Contents**

|                                   | (in thousands)                         |               |               |
|-----------------------------------|--|---------------|---------------|
|                                   | For the Three Months<br>Ended July 31, |               |               |
|                                   | 2004                                   | 2003          | % Change      |
| Multi-family residential          |  |               |               |
| Real Estate Revenue               | \$ 14,094                              | \$ 14,296     | (1.4%)        |
| Expenses:                         |  |               |               |
| Utilities & maintenance           | 2,968                                  | 2,805         | 5.8%          |
| Property management               | 1,576                                  | 1,490         | 5.8%          |
| Real estate taxes                 | 1,593                                  | 1,611         | (1.1%)        |
| Insurance                         | 382                                    | 482           | (20.7%)       |
| Depreciation and amortization     | 2,551                                  | 2,469         | 3.3%          |
| Mortgage interest                 | 4,325                                  | 4,223         | 2.4%          |
|                                   | <u>13,395</u>                          | <u>13,080</u> | <u>2.4%</u>   |
| Total expenses                    |  |               |               |
| Property segment operating profit | \$ 699                                 | \$ 1,216      | (42.5%)       |
| Commercial office                 |  |               |               |
| Real estate revenue               | \$ 8,633                               | \$ 9,104      | (5.2%)        |
| Expenses:                         |  |               |               |
| Utilities & maintenance           | 1,695                                  | 1,730         | (2.0%)        |
| Property management               | 379                                    | 316           | 19.9%         |
| Real estate taxes                 | 1,337                                  | 1,341         | (0.3%)        |
| Insurance                         | 98                                     | 103           | (4.9%)        |
| Depreciation and amortization     | 1,426                                  | 1,380         | 3.3%          |
| Mortgage interest                 | 2,543                                  | 2,670         | (4.8%)        |
|                                   | <u>7,478</u>                           | <u>7,540</u>  | <u>(0.8%)</u> |
| Total expenses                    |  |               |               |
| Property segment operating profit | \$ 1,155                               | \$ 1,564      | (26.2%)       |
| Commercial medical                |  |               |               |
| Real estate revenue               | \$ 4,244                               | \$ 4,205      | 0.9%          |
| Expenses:                         |  |               |               |
| Utilities & maintenance           | 787                                    | 505           | 55.8%         |
| Property management               | 204                                    | 299           | (31.8%)       |
| Real estate taxes                 | 363                                    | 310           | 17.1%         |

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|                                   |                   |                   |                   |
|-----------------------------------|-------------------|-------------------|-------------------|
| Insurance                         | 36                | 31                | 16.1%             |
| Depreciation and amortization     | 738               | 784               | (5.9%)            |
| Mortgage interest                 | 1,405             | 1,470             | (4.4%)            |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |
| Total expenses                    | 3,533             | 3,399             | 3.9%              |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |
| Property segment operating profit | \$ 711            | \$ 806            | (11.8%)           |
|                                   | <u>          </u> | <u>          </u> | <u>          </u> |

**Table of Contents**

|  | (in thousands)                         |          |          |
|--|--|----------|----------|
|  | For the Three Months Ended<br>July 31, |          |          |
|  | 2004                                   | 2003     | % Change |
| Commercial Industrial                      |  |          |          |
| Real Estate Revenue                        | \$ 1,571                               | \$ 1,718 | (8.6%)   |
| Expenses:                                  |  |          |          |
| Utilities & maintenance                    | 77                                     | 39       | 97.4%    |
| Property management                        | 19                                     | 23       | (17.4%)  |
| Real estate taxes                          | 212                                    | 186      | 14.0%    |
| Insurance                                  | 18                                     | 16       | 12.5%    |
| Depreciation and amortization              | 311                                    | 310      | 0.3%     |
| Mortgage interest                          | 548                                    | 522      | 5.0%     |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Total expenses                             | 1,185                                  | 1,096    | 8.1%     |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Property Segment Operating Profit          | \$ 386                                 | \$ 622   | (37.9%)  |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Commercial Retail                          |  |          |          |
| Real Estate Revenue                        | \$ 3,784                               | \$ 2,874 | 31.7%    |
| Expenses:                                  |  |          |          |
| Utilities & maintenance                    | 382                                    | 207      | 84.5%    |
| Property management                        | 22                                     | 13       | 69.2%    |
| Real estate taxes                          | 402                                    | 487      | (17.5%)  |
| Insurance                                  | 35                                     | 40       | (12.5%)  |
| Depreciation and amortization              | 472                                    | 463      | 1.9%     |
| Mortgage interest                          | 835                                    | 833      | 0.2%     |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Total expenses                             | 2,148                                  | 2,043    | 5.1%     |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Property segment operating profit          | \$ 1,636                               | \$ 831   | 96.9%    |
|  | <hr/>                                  | <hr/>    | <hr/>    |
| Total Stabilized Segment Operating Profit  | \$ 4,587                               | \$ 5,039 | (9.0%)   |
| Reconciliation to Segment Operating Profit |  |          |          |
| Real Estate Revenue Non-Stabilized         | 7,149                                  | 34       |          |
| Expenses Non-Stabilized                    |  |          |          |
| Utilities & Maintenance                    | (1,117)                                | (2)      |          |
| Property Management                        | (408)                                  | (29)     |          |

|                                |                   |                   |
|--------------------------------|-------------------|-------------------|
| Real Estate Taxes              | (688)             | (6)               |
| Insurance                      | (116)             | (1)               |
| Depreciation and Amortization  | (2,463)           |                   |
| Mortgage Interest              | (1,607)           | (34)              |
|                                | <u>          </u> | <u>          </u> |
| Total Segment Operating Profit | \$ 5,337          | \$ 5,001          |
|                                | <u>          </u> | <u>          </u> |

**ECONOMIC OCCUPANCY RATES**

IRET monitors both physical vacancy rates and economic vacancy rates at each of its properties. Physical vacancy for multi-family residential properties is calculated as the number of total habitable units that are vacant divided by the total number of units in the property. Physical



**Table of Contents**

vacancy for commercial buildings is calculated as the total number of vacant square feet in a particular building, divided by the total number of square feet (vacant and occupied) in the building. Economic vacancy is defined as total possible revenue less vacancy loss as a percentage of total possible revenue. Total possible revenue is determined by valuing occupied units or square footage at contract rates, and vacant units or square footage at market rates.

Economic occupancy rates are calculated as a percentage of the actual rent paid to IRET versus the scheduled rent charged by IRET for the period of time presented. The following tables compare economic occupancy rates on a stabilized property basis for the three months ended July 31, 2004 and 2003:

|                          | (in thousands) |        | Percent<br>Change |
|--------------------------|----------------|--------|-------------------|
|                          | 2004           | 2003   |                   |
| Commercial-Office        | 90.68%         | 92.93% | (2.25%)           |
| Commercial-Medical       | 92.12%         | 95.73% | (3.62%)           |
| Commercial-Industrial    | 89.66%         | 96.63% | (6.97%)           |
| Commercial-Retail        | 89.33%         | 95.47% | (6.14%)           |
| Multi-Family Residential | 90.77%         | 90.54% | .22%              |

**CREDIT RISK**

The following table lists our top ten commercial tenants on July 31, 2004, for all commercial properties owned by us. No single tenant accounted for more than 10% of revenues from commercial properties during the first quarter of fiscal year 2005.

| Lessee  | Monthly Rent          | % of Total Rental<br>Income from<br>Commercial<br>Properties |
|---|-----------------------|--|
| Edgewood Living Communities, Inc.             | \$ 341,629.22         | 5.60%  |
| St. Lukes                                     | 300,365.71            | 4.92%  |
| Healtheast Woodbury & Maplewood               | 169,302.85            | 2.78%  |
| Allina Health                                 | 156,428.11            | 2.56%  |
| Microsoft Great Plains                        | 156,250.00            | 2.56%  |
| Northland Insurance Company                   | 146,748.53            | 2.41%  |
| Nebraska Orthopaedic Hospital                 | 141,431.70            | 2.32%  |
| Smurfit Stone Container Corp.                 | 130,849.87            | 2.15%  |
| Wilson's the Leather Experts, Inc.            | 119,022.78            | 1.95%  |
| State of Idaho Department of Health & Welfare | 114,089.39            | 1.87%  |
| All Others                                    | 4,322,989.84          | 70.88%   |
| Total Monthly Rent as of July 31, 2004        | <u>\$6,099,108.00</u> | <u>100.00%</u>   |



**Table of Contents****PROPERTY ACQUISITIONS AND DISPOSITIONS**

During the three months ended July 31, 2004, IRET acquired and disposed of the following properties:

**ACQUISITIONS**

|  | <b>(in thousands)</b>       |
|--|-----------------------------|
|  | <b>Acquisition<br/>Cost</b> |
| Commercial Property – Medical  |                             |
| 52,300 sq. ft. Nebraska Orthopedic Hospital Project – Omaha, NE                                | \$ 20,597                   |
| 45,081 sq. ft. Pavilion I Clinic – Duluth, MN  | 10,900                      |
| 60,294 sq. ft. High Pointe Health Campus Phase I (East Metro Medical Building) – Lake Elmo, MN | 13,050                      |
|  | <hr/>                       |
|  | 44,547                      |
| Commercial Property – Industrial (miscellaneous commercial property)                           |                             |
| 46,720 sq. ft. Sleep Inn Hotel – Brooklyn Park, MN   | 2,750                       |
|  | <hr/>                       |
|  | 2,750                       |
| Commercial Property – Office   |                             |
| 26,186 sq. ft. Plymouth I Office Building – Plymouth, MN                                       | 1,864                       |
| 26,186 sq. ft. Plymouth II Office Building – Plymouth, MN                                      | 1,748                       |
| 26,186 sq. ft. Plymouth III Office Building – Plymouth, MN                                     | 2,214                       |
| 79,377 sq. ft. Northgate I Office Building – Maple Grove, MN                                   | 8,175                       |
|  | <hr/>                       |
|  | 14,001                      |
|  | <hr/>                       |
| Total Property Acquisitions  | \$ 61,298                   |
|  | <hr/>                       |

The eight commercial properties were acquired in exchange for the issuance of 3,301 shares of common stock with a value of \$32,000 and for 681,189 Units with a value of \$6.8 million, plus \$54.5 million of cash and cash equivalents.

**DISPOSITIONS**

**(in thousands)**

**Book Value**

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|   | <u>Sales Price</u> | <u>and Sales<br/>Cost</u> | <u>Gain/Loss</u> |
|---|--------------------|---------------------------|------------------|
| <b>Multi-Family Residential</b>                 |                    |                           |                  |
| 204-unit Ivy Club Apartments Vancouver, WA      | \$12,250           | \$ 12,070                 | \$ 180           |
| 26-unit Beulah Condominiums Beulah, ND          | 96                 | 96                        | 0                |
| 36-unit Parkway Apartments Beulah, ND           | 159                | 159                       | 0                |
| 18-Unit Dakota Arms Apartments Minot, ND        | 825                | 566                       | 259              |
| <b>Commercial Retail</b>                        |                    |                           |                  |
| 30,000 sq. ft. Barnes & Noble Store Fargo, ND   | 4,590              | 2,916                     | 1,674            |
| 8,040 sq. ft. Petco Store Fargo, ND             | 2,160              | 1,209                     | 951              |
| <b>Vacant Land</b>                              |                    |                           |                  |
| 205,347 sq. ft. parcel of vacant land Libby, MT | 151                | 151                       | 0                |
| <b>Total Property Dispositions</b>              | <u>\$20,231</u>    | <u>\$ 17,167</u>          | <u>\$ 3,064</u>  |

**Table of Contents**

**FUNDS FROM OPERATIONS FOR THE THREE MONTHS ENDED JULY 31, 2004 AND 2003**

IRET considers Funds from Operations ( FFO ) a useful measure of performance for an equity REIT. IRET uses the definition of FFO adopted by the National Association of Real Estate Investment Trusts, Inc. ( NAREIT ) in 1991, as clarified in 1995, 1999 and 2002. NAREIT defines FFO to mean net income (computed in accordance with generally accepted accounting principles), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures will be calculated to reflect funds from operations on the same basis.

While IRET uses the NAREIT definition of FFO, the components of that definition in many cases require interpretation, and IRET accordingly has made certain interpretations in applying the definition. In particular, in calculating FFO per share, IRET adds back to net income computed in accordance with GAAP the allocations made to limited partners, and divides this amount by the total number of IRET common shares of beneficial interest and UPREIT Units outstanding.

Under the partnership agreement pursuant to which IRET's UPREIT Units are issued, UPREIT Unitholders effectively have the same claim on the earnings and assets of IRET as do IRET's common shares of beneficial interest shareholders, and therefore IRET considers that the UPREIT Units also should be included with the common shares of beneficial interest in calculating FFO per share. IRET believes that, while this particular adjustment made by IRET in calculating FFO is not specifically provided for in the NAREIT definition, it is consistent with the definition.

While FFO is widely used by REITs as a primary performance metric, not all real estate companies use the same definition of FFO or calculate FFO in the same way. Accordingly, FFO presented here is not necessarily comparable to FFO presented by other real estate companies.

FFO should not be considered as an alternative to net income as determined in accordance with GAAP as a measure of IRET's performance, but rather should be considered as an additional, supplemental measure, and should be viewed in conjunction with net income as presented in the consolidated financial statements included in this report. Management believes that FFO is helpful to investors as a measure of IRET's performance because it excludes various items included in net income that do not relate to or are not indicative of our performance, such as gains and losses on sales of real estate and real estate-related depreciation and amortization, which can make periodic analyses of operating performance more difficult to compare. FFO does not represent cash generated from operating activities in accordance with GAAP, and is not necessarily indicative of sufficient cash flow to fund all of IRET's needs or its ability to service indebtedness or make distributions.

FFO applicable to common shares and Units for the first quarter of fiscal year 2005 ended July 31, 2004 increased to \$11.4 million, compared to \$9.3 million for the first quarter of fiscal year 2004 ended July 31, 2003, an increase of 22.3%.

**Table of Contents****RECONCILIATION OF NET INCOME AVAILABLE TO COMMON SHAREHOLDERS TO FUNDS FROM OPERATIONS**

(in thousands, except per share amounts)

| Three Months Ended July 31,                                 | 2004      |                                  | 2003                  |          |                                  |                       |
|---|-----------|----------------------------------|-----------------------|----------|----------------------------------|-----------------------|
|   | Amount    | Weighted Avg Shares and Units(2) | Per Share and Unit(3) | Amount   | Weighted Avg Shares and Units(2) | Per Share and Unit(3) |
| Net income available to common shareholders                 | \$ 4,877  | 41,981                           | \$ .12                | \$ 2,920 | 36,358                           | \$ .08                |
| Adjustments:  |           |                                  |                       |          |                                  |                       |
| Minority interest in earnings of Unitholders                | 1,474     | 11,987                           |                       | 842      | 10,149                           |                       |
| Depreciation and Amortization(1)                            | 8,139     |                                  |                       | 5,578    |                                  |                       |
| Gains on depreciable property sales                         | (3,064)   |                                  |                       | 0        |                                  |                       |
| Funds from operations applicable to common shares and Units | \$ 11,426 | 53,968                           | \$ .21                | \$ 9,340 | 46,507                           | \$ .20                |

(1) Depreciation on office equipment and other assets used by us is excluded. Amortization of leasing commissions and property-related intangible assets is included, however, the amortization of financing and other expenses is excluded.

(2) UPREIT Units of the Operating Partnership are exchangeable for common shares of beneficial interest on a one-for-one basis.

(3) Net income is calculated on a per share basis. Funds from Operations is calculated on a per share and unit basis.

**DISTRIBUTIONS**

The following distributions per common share and unit were paid during the three months ended July 31 of fiscal year 2005 and 2004:

| Three months ended | July 31, 2004 | July 31, 2003 |
|--------------------|---------------|---------------|
|                    | \$ .1605      | \$ .1585      |



**Table of Contents**

**LIQUIDITY AND CAPITAL RESOURCES**

**OVERVIEW**

The Company's principal liquidity demands are distributions to the holders of the Company's common and preferred shares of beneficial interest and UPREIT Units, capital improvements and repairs and maintenance for the properties, redemption of outstanding investment certificates, acquisition of additional properties, property development, tenant improvements and debt repayments.

The Company expects to meet its short-term liquidity requirements through net cash flows provided by its operating activities, and through draws from time to time on its unsecured lines of credit. Management considers the Company's ability to generate cash to be adequate to meet all operating requirements and to make distributions to its shareholders in accordance with the REIT provisions of the Internal Revenue Code. Budgeted expenditures for ongoing maintenance and capital improvements and renovations to our real estate portfolio are expected to be funded from cash flow generated from operations of current properties.

To the extent the Company does not satisfy its long-term liquidity requirements, which consist primarily of maturities under the Company's long-term debt, maturing investment certificates, construction and development activities and potential acquisition opportunities, through net cash flows provided by operating activities and its credit facilities, the Company intends to satisfy such requirements through a combination of funding sources which the Company believes will be available to it, including the issuance of UPREIT Units, additional common or preferred equity, proceeds from the sale of properties, and additional long-term secured or unsecured indebtedness.

**SOURCES AND USES OF CASH**

As of July 31, 2004, the Company had three unsecured lines of credit in the amounts of \$10 million dollars, \$10 million dollars, and \$4.4 million dollars from (1) Bremer Bank, (2) First Western Bank and Trust, and (3) First International Bank and Trust, respectively. The Company had no outstanding balances under these lines of credit as of July 31, 2004. Borrowings under the lines of credit bear interest based on the following for each of the line of credit described above (1) Bremer Financial Corporation Reference Rate, (2) highest New York Prime as published in the Wall Street Journal, and (3) highest New York Prime as published in the Wall Street Journal. Accordingly, increases in interest rates will increase the Company's interest expense on its lines of credit and as a result will affect the Company's results of operations and cash flows. The Company renewed its line of credit with First Western Bank and Trust prior to its scheduled expiration on September 1, 2004, and this line now expires October 15, 2004. The other two lines of credit, with Bremer Bank and First International Bank and Trust, expire on September 15, 2004, and December 12, 2004, respectively. The Company expects to renew both of these lines prior to their expiration.

In addition to the above-described three unsecured lines of credit, in April 2004 the Company's operating partnership, IRET Properties, entered into a \$25 million unsecured bridge



**Table of Contents**

loan with Wells Fargo Bank, National Association, in connection with the Company's acquisition of 15 commercial and medical properties located primarily in Duluth, Minnesota and the surrounding area. This bridge loan was repaid in July 2004 with the proceeds of mortgage loans placed against these properties.

In May 2004, the Company completed the sale of .5 million of its common shares of beneficial interest, at a price of \$10.10 per share, resulting in net proceeds to the Company of approximately \$5.2 million.

The issuance of UPREIT Units for property acquisitions continues to be a source of capital for the Company. In the first quarter of fiscal year 2005, 681,189 Units were issued in connection with property acquisitions compared to 1,334,040 Units issued in connection with property acquisitions during the first quarter of fiscal year 2004.

The Company has a Distribution Reinvestment Plan ( DRIP ). The DRIP provides common shareholders of the Company an opportunity to invest their cash distributions in common shares of the Company at a discount of 5% from the market price. The Company issued 258,661 common shares during the first quarter of fiscal year 2005.

Cash and cash equivalents on July 31, 2004 totaled \$35.6 million, compared to \$31.7 million on the same date in 2003. Net cash provided from operating activities increased to \$11.9 million in the first quarter of fiscal year 2005 from \$6.2 million in the first quarter of fiscal year 2004, due primarily to cash provided from the operations of new and existing properties.

Cash used for acquisitions increased by \$16.0 million in the first quarter of fiscal year 2005, to \$38.3 million from \$22.2 million in the first quarter of fiscal year 2004. Cash and other proceeds received from other investing activities (including proceeds from the sale of property and principal payments on mortgage loans receivable) increased by \$24.3 million in the first quarter of fiscal year 2004, to \$23.8 million from (\$527,000) in the first quarter of fiscal year 2004, resulting in a decrease in net cash used in investing activities, to \$14.5 million in the first quarter of fiscal year 2005 from \$22.8 million in the first quarter of fiscal year 2004.

Net cash provided from financing activities also decreased to \$6.4 million during the first quarter of fiscal year 2005 from \$19.8 million during the first quarter of fiscal year 2004, primarily due to the repayment of the Wells Fargo bridge loan in July 2004.

**FINANCIAL CONDITION**

*Mortgage Loan Indebtedness.* Mortgage loan indebtedness increased to \$690 million on July 31, 2004, due to new debt placed on new and existing properties, from \$633 million on April 30, 2004. Ninety-four per cent of such mortgage debt is at fixed rates of interest, with staggered maturities. This limits the Company's exposure to changes in interest rates, which minimizes the effect of interest rate fluctuations on the Company's results of operations and cash flows. As of July 31, 2004, the weighted average rate of interest on the Company's mortgage debt was 6.71%, compared to 7.17% on April 30, 2004.

**Table of Contents**

*Mortgage Loans Receivable.* Mortgage loans receivable decreased to \$638,000 at July 31, 2004 from \$4.9 million at April 30, 2004. This decrease resulted from repayment of the Nebraska Orthopedic mortgage loan receivable.

*Real Estate Owned.* Real estate owned increased to \$1,044.9 million at July 31, 2004 from \$1,008.0 million at April 30, 2004. The increase resulted primarily from the acquisition of the additional investment properties net of dispositions as described above in the Property Acquisitions and Dispositions subsections of this Management Discussion and Analysis of Financial Condition and Results of Operations.

*Investment Certificates.* The Company discontinued the issuance of investment certificates in April 2002. As of July 31, 2004, investment certificates outstanding totaled \$6.6 million, compared to \$7.1 million of such certificates outstanding on April 30, 2004. This decrease resulted from the redemption of maturing investment certificates during the three months ended July 31, 2004.

*Cash and Cash Equivalents.* Cash and cash equivalents on hand on July 31, 2004 was \$35.6 million, compared to \$31.7 million on April 30, 2004. The increase in cash on hand on July 31, 2004, as compared to April 30, 2004, was due primarily to proceeds from mortgage debt placed on the Duluth, Minnesota portfolio.

*Marketable Securities.* The Company investment in marketable securities classified as available-for-sale was \$2.3 million on July 31, 2004, and April 30, 2004. Marketable securities are held available for sale and, from time to time, the Company invests excess funds in such securities or uses the funds so invested for operational purposes.

*Operating Partnership Units.* Outstanding units in the Operating Partnership increased to 12.4 million Units on July 31, 2004, compared to 11.8 million Units outstanding on April 30, 2004. This increase resulted primarily from the issuance of additional limited partnership units to acquire interests in real estate, net of Units converted to common shares.

*Common and Preferred Shares of Beneficial Interest.* Common shares of beneficial interest outstanding on July 31, 2004 totaled 42.3 million compared to 41.7 million outstanding on April 30, 2004. This increase in common shares outstanding was primarily due to the public offering of common shares completed in May 2004, and to the issuance of common shares pursuant to our Distribution Reinvestment Plan. Preferred shares of beneficial interest outstanding on July 31, 2004 and April 30, 2004 totaled 1.15 million.

**PENDING ACQUISITIONS AND DISPOSITIONS**

As of July 31, 2004, the Company had signed an agreement for the purchase of an approximately 185,000 sq. ft. office building in the Minneapolis, Minnesota area, for a purchase price of approximately \$22.0 million. In connection with this transaction, the seller of this office property would purchase from the Company an approximately 62,000 sq. ft. office building in Eden Prairie, Minnesota, for a price of approximately \$5.8 million. These pending acquisitions

**Table of Contents**

and dispositions are subject to customary closing conditions, and no assurance can be given that any of these pending transactions will be consummated.

**RECENT DEVELOPMENTS**

*Common and Preferred Share Distributions.* On August 18, 2004, the Company's Board of Trustees declared a regular quarterly distribution of 16.10 cents per share on the Company's common shares and Units, payable October 1, 2004 to common shareholders and Unitholders of record on September 17, 2004. The Company's Board of Trustees also declared a distribution of 51.56 cents per share on the Company's preferred shares of beneficial interest, payable September 30, 2004 to preferred shareholders of record on September 15, 2004.

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

Our exposure to market risk is limited primarily to fluctuations in the general level of interest rates on our current and future fixed and variable rate debt obligations.

*Variable interest rates.* Even though our goal is to maintain a fairly low exposure to interest rate fluctuation risk, we are still vulnerable to significant fluctuations in interest rates on variable rate debt, on any future repricing or refinancing of our fixed rate debt and on future debt. We primarily use long-term (more than nine years) and medium term (five to seven years) debt as a source of capital. We do not currently use derivative securities, interest-rate swaps or any other type of hedging activity to manage our interest rate risk. As of July 31, 2004, we had the following amounts of future principal payments due on mortgages secured by our real estate:

|                           | (in thousands) |          |          |          |          |            |                          |
|---------------------------|----------------|----------|----------|----------|----------|------------|--------------------------|
| Long Term Debt            | 2005           | 2006     | 2007     | 2008     | 2009     | Thereafter | Total                    |
| Fixed Rate                | \$12,153       | \$17,198 | \$18,576 | \$45,032 | \$42,760 | \$513,548  | \$649,267                |
| Variable Rate             | 1,184          | 1,670    | 2,487    | 1,767    | 2,077    | 31,992     | 41,177                   |
|                           |                |          |          |          |          |            | \$690,444 <sup>(1)</sup> |
| Average Interest Rate (%) | (1)            | (1)      | (1)      | (1)      | (1)      | (1)        | (1)                      |

(1) The weighted average interest rate on our debt as of July 31, 2004, was 6.71%. Any fluctuations in variable interest rates could increase or decrease our interest expenses. For example, an increase of one percent per annum on our \$41.2 million of variable rate indebtedness would increase our annual interest expense by \$412,000.

**ITEM 4. CONTROLS AND PROCEDURES**

IRET carried out an evaluation, under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of IRET's disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation,

the Chief Executive Officer and Chief Financial Officer concluded that IRET's disclosure controls and procedures

**Table of Contents**

are effective in timely alerting them to material information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission.

There were no changes in IRET's internal control over financial reporting that occurred during IRET's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

In the course of our operations, we become involved in litigation. At this time, we know of no pending or threatened proceedings that would have a material impact upon us.

**Item 2. Changes in Securities and Use of Proceeds; Unregistered Sales of Equity Securities**

During the first quarter of fiscal year 2005, the Company issued an aggregate of 64,227.33 common shares to holders of limited partnership units of IRET Properties, on a one-for-one basis upon redemption and conversion of an equal number of limited partnership units. All such issuances of common shares were exempt from registration as private placements under Section 4(2) of the Securities Act, including Regulation D promulgated thereunder. The Company has registered the re-sale of such common shares under the Securities Act.

**Items 3, 4, and 5 are not applicable and have been omitted.**

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits:

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 31.1               | Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2               | Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32                 | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports on Form 8-K during the quarter ended July 31, 2004: On July 1, 2004, the Company filed a report on Form 8-K to furnish, under Items 7 and 12 of such form, the press release announcing the Company's results of operations and financial condition for the three and 12 months ended April 30, 2004.



**Table of Contents**

**Signatures**

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

**INVESTORS REAL ESTATE TRUST**

(Registrant)

By: /s/  
Thomas  
A. Wentz,  
Sr.  
Thomas  
A. Wentz,  
Sr.,  
President  
& Chief  
Executive  
Officer

By: /s/  
Diane K.  
Bryantt  
Diane K.  
Bryantt,  
Senior  
Vice  
President  
&  
Chief  
Financial  
Officer

Date: September 10, 2004

**Table of Contents**

EXHIBIT INDEX

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